
Linda Kelley Ebberson

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Plaintiffs were 6 of 35 limited partners in Auburn West Associates, a Washington limited partnership formed in 1964 by the defendant and sole general partner, Investment Exchange Corporation, for the purpose of acquiring real property from the general partner and others to be improved and held for lease or resale. Neither the prospectus, the articles of limited partnership, nor the partnership certificate provided a profit formula for anticipated sales of real estate from the general partner to the partnership.

Plaintiffs brought an action for an accounting and dissolution of the partnership on the theory that the general partner had breached its fiduciary duty to the limited partnership by acquiring certain real property after the formation of the partnership and selling it to the partnership at a substantial profit without the express consent of the limited partners. On appeal from a directed verdict for the defendants, the Washington Supreme Court reversed. Held: A general partner in a limited partnership is accountable to the partnership as a

1. The Articles of Limited Partnership for Auburn West Associates, Article III, stated the purpose of the partnership:
   To initially acquire, for investment, improve and hold for lease or resale, a tract of real property. The General Partner presently is the owner of interests in said real property. To additionally acquire from the General Partner such other adjacent and contiguous tracts as, in the sole determination of the General Partner, will enhance the partnership properties and objectives.

2. There was no express indication in the prospectus that the general partner would take a profit upon sale of real estate to the limited partnership. Reference in the prospectus to Article VIII of the Articles of Limited Partnership, which represented that the general partner would be reimbursed for costs and expenses incurred in management of the partnership affairs, “in addition to its respective share of the profits of the partnership,” id. at 6–7, could cause one to conclude that the general partner would profit from its participation in Auburn West Associates via returns on the partnership units it held and in that manner alone.

3. Bassan involved the “Murakami” parcel which was acquired subsequent to the formation of the partnership at a cost of $382,500 to the general partner and then sold to the partnership for $550,000, resulting in a profit of $167,500 to the general partner. In addition, a commission of $24,500 was paid by the partnership to the authorized real estate subsidiary of the general partner. 83 Wn. 2d at 924, 524 P.2d at 236; see text accompanying notes 21–28 infra.
fiduciary and may not derive profits from its dealings with the limited partnership unless an express formulation of allowable profits is disclosed in the articles of limited partnership. In dictum, the court intimated that it would analyze the fairness of transactions between general partners and limited partnerships, regardless of disclosed profit formulas. The three-judge dissent argued that the majority ignored basic rules of contract law by rejecting the contention that the partnership agreement was modified by the parties' course of dealings. Bassan v. Investment Exchange Corp., 83 Wn. 2d 922, 524 P.2d 233 (1974).

Bassan is the first case in Washington to be decided under Section 9 of the Washington Uniform Limited Partnership Act (WULPA) since its adoption in this jurisdiction in 1945. The court's decision is unique not only in its statement that the general partner is precluded from retaining undisclosed profits in its dealings with and on behalf of the limited partnership, but also in its implication that the court will look beyond the form of the transaction to examine the substantive fairness of the bar-

4. The court stated that general partner self-dealing is not, ipso facto, impermissible if it is specifically authorized in the partnership agreement. However, the court's language implies that, in some instances, e.g., exorbitant profits, even authorized self-dealing will not be permitted. See text following note 40 infra.

5. Section 9 provides in part: "A general partner shall have all the rights and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners . . . ." WASH. REV. CODE § 25.08.090 (1974); see Homestake Mining Co. v. Mid-Continent Exploration Co., 282 F.2d 787, 799 (10th Cir. 1960) (applying, in dictum, the fiduciary duties of a partner in a non-limited partnership to the general partner of a limited partnership). Washington has basically adopted the Uniform Limited Partnership Act (ULPA) as promulgated by the National Conference of Commissioners on Uniform State Laws. The only major divergence is Washington's addition of Subsections (2) and (3) to § 7. See note 46 infra.

6. In the event the articles of limited partnership have been incorporated into the partnership certificate, which must be signed by each limited partner, it is accurate to say that general partner profits must receive the express consent of all limited partners. WASH. REV. CODE § 25.08.020(1) (1974). There is nothing, however, in the WULPA which requires the articles to be incorporated in the partnership certificate. There is generally a "separate, private limited partnership agreement covering matters [like profit shares of general partners] not required to be stated in the certificate." J. CRANE & A. BREMBERG, LAW OF PARTNERSHIP 145 (1968). Whether or not the articles are incorporated into the certificate, the general partner is well-advised to have each limited partner sign the articles of partnership as well as the partnership certificate to assure it has received each limited partner's consent to the provisions outlined in the articles. This rule is more rigid than the corporate approach which simply requires consent of the holders of 2/3 of the class of shares entitled to vote on profits taken by a corporate officer or director on transactions with the corporation. See WASH. REV. CODE § 23A.24.020 (1974).
gain to the limited partners. This note will discuss the specific problems raised in Bassan and analyze the court's disposition of the issues as presented. Second, the note will examine and evaluate, in the context of the real estate limited partnership, the basis for imposing a fiduciary duty of disclosure upon a general partner, as well as the nature of the duty. The note concludes that, in order to provide greater protection to limited partners than that provided by the general rules of contract law, the court should examine the substantive fairness of post-formation transactions between the general partner and the limited partnership, utilizing recently promulgated administrative guidelines.7

I. THE COURT'S REASONING IN BASSAN

A. Nature of the Auburn West Associates' Offering

The general partner in Bassan, Investment Exchange Corporation, was organized as a Washington corporation for the purpose of forming and managing real estate limited partnerships. Eight persons comprised the shareholders, officers and directors of the corporation. In 1964, Investment Exchange drafted Articles of Limited Partnership and prepared and circulated a prospectus for the promotion and sale of Auburn West Associates' limited partnership units.8 The limited partnership offering was aimed at a relatively unsophisticated investor9 and was originally exempt from Washington's securities reg-

8. Brief for Appellants at 4, Bassan.
9. The Auburn West Associates prospectus provided potential investors very little information with which to assess the offering. The information pertained primarily to site location for a proposed shopping center, appraisals of property held by the partner, offering of limited partnership units and capitalization. Advantages to limited partners were phrased in appealing but extremely general terms, e.g., “4. You have no management problems and you have no personal liability”; and “6. An early profit may be realized by the Partners by the anticipated sale of a portion of Auburn West Associates' parcels of land to users.” Prospectus for Auburn West Associates at 4 (on file at Washington Law Review) [hereinafter cited as Prospectus]. Compare the more sophisticated prospectuses collected in 1 NOTABLE SYNDICATIONS (S. Roulac ed. 1972), which generally provide a detailed statement of investment objectives and policies, description of the property, management agreement, assumptions used in preparation of financial forecasts, projected income and expenses, cash flow projection, profit (loss) projection, risk factors, interest of the parties and federal tax consequences, among other features.
istration requirements. It was a combined specific property and "blind pool," or nonspecified properties, offering. Investors in Auburn West Associates were not subject to any suitability standards, as in the case of large public offerings; they were, however, required to contribute a minimum of $10,000 per limited partnership unit.

The investors were never provided an accurate representation of Investment Exchange's anticipated withdrawal from partnership funds. At the outset, Investment Exchange held five parcels of land and agreed to acquire a sixth, but neither the articles of limited partnership nor the prospectus specifically described any other parcels to be acquired subsequently by Investment Exchange. Yet, Investment Exchange was granted discretion in its management of the partnership interests by the articles of limited partnership. This broad discretion, combined with the statutory prohibition of a limited partner's exercise of "control," left Investment Exchange free to appropriate substantial profits for itself on sales of real estate to the limited partnership.

10. Wash. Rev. Code § 21.20.320(9) (1974). The offering maintained an exempt status (20 persons or less) even though there were ultimately 35 limited partners; the statute provides the offering shall be exempt if offered to not more than 20 persons in this state during any period of twelve consecutive months. Id. Limited partners joined Auburn West Associates from 1964 to 1969. See note 1 infra. A "blind pool" offering is one wherein the general partner solicits investor money for post-formation acquisition of properties pursuant to stated investment objectives. See Part IV-E infra.

11. Investor suitability standards should include a minimum annual gross income and minimum net worth, access to advice from qualified sources and general capacity to bear the lack of liquidity of the investment. See Part IV-A infra.

12. Brief for Appellants at 4, Bassan.

13. Id. at 8-10.


15. While Auburn West Associates was actively engaged in the real estate business. Investment Exchange netted $431,750 on sales to the limited partnership of real estate costing the Investment Exchange $866,500. 83 Wn. 2d at 924-27, 524 P.2d at 236-37. In addition, Investment Exchange and its wholly-owned subsidiary, Investment Exchange Realty, received over $110,000 from the partnership in commissions for selling partnership units and in real estate commissions on transactions of the partnership. Of the latter amount, $32,500 represented a 5% commission to the general partner on sales of partnership units, despite the affirmative representation in the prospectus that "no commission or other remunerations will be paid or given directly or indirectly for soliciting any prospective buyer [of partnership units]." Brief for Appellants at 15, Bassan. One limited partner, Milton Grout, who attended the general partner's meetings, was in a position, and perhaps under a duty, to report Investment Exchange's anticipated profits to the other limited partners before the transaction closed. The point was not raised in Bassan, probably because of the speed with which legal action was initiated: Investment Exchange's decision as to the amount of profit to be taken on the Murakami transaction. see text accompanying notes 21-22 infra.
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B. Profit Skimming—The Abuse of Auburn West Associates

The six limited partners in Bassan originally sought recovery of all profits which Investment Exchange had taken by reason of its sales of real estate to the partnership. With respect to the five parcels originally held by Investment Exchange, the highest profit taken was 58 percent and the lowest 33 percent of its cost. Of the properties acquired subsequent to formation of the partnership, the highest profit taken was 280 percent and the lowest 92 percent of its cost. An indication of the profits taken by Investment Exchange was found in a prospectus prepared for the SEC which revealed that from May 1964 through December 1965, the partnership acquired eight parcels of property from Investment Exchange upon which Investment Exchange realized an average 53 percent profit over cost. The limited partners' action for recovery of the above profits was barred by the statute of limitations.

The final transaction, however, and the one on which Investment Exchange reaped its greatest profit in dollar amount, was not barred by the statute of limitations. On October 13, 1969, the Murakami brothers had sold a parcel to Investment Exchange for $382,500. Just 33 days later, on November 15, 1969, Investment Exchange's shareholders formally ratified the resale of the Murakami parcel to Auburn West Associates for $550,000, thereby securing a profit of $167,500 or approximately 44 percent of its cost.

Investment Exchange sought to legitimize its profit margin by an independent appraisal made at the time of sale to the partnership, which set the fair market value of the Murakami parcel at $688,000. This was in contrast to another independent appraisal, made at the same time, of $325,000. The most important factor, however, was that the Murakamis were willing to sell, and Investment Exchange

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was made on November 15, 1969 and the action was commenced but a few days later on November 26, 1969. 83 Wn. 2d at 927, 524 P.2d at 237.

18. 83 Wn. 2d at 926–27, 524 P.2d at 237.

19. Id. at 926, 524 P.2d at 237.

20. The three-year statute of limitations for fraud, WASH. REV. CODE § 4.16.080(4) (1974), was applied despite the fact the partnership agreement was a written contract.


22. 83 Wn. 2d at 927, 524 P.2d at 237.

23. See notes 102–03 and accompanying text infra.
willing to buy, for $382,500 just 33 days earlier. The most condemning feature of the transaction was that Investment Exchange realized its profit merely by assignment of the earnest money agreement to the partnership. The profit created by the fictitious spread was not expressly authorized in the partnership documents; nor had the limited partners, at any time before or after the Murakami transaction, expressly consented to the profits to Investment Exchange. This undisclosed self-dealing clearly violated Investment Exchange’s fiduciary duty to the limited partnership.

Upon exposure of the fiduciary’s self-dealing, the Bassan court properly recognized that the general partner, Investment Exchange, should be denied all personal profit or advantage gained from the transaction. To effectuate that rule, the court required the establishment of a common fund for the benefit of the limited partnership. This is in accord with the statutory framework of a general partner’s fiduciary obligations in a limited partnership.

C. Statutory Framework

By specifying that a “general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners,” Section 9 of the WULPA extends the basic fiduciary relationship of partners in a nonlimited, voluntary partnership to limited partnerships.
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general partnership\textsuperscript{33} to the members of a limited partnership.\textsuperscript{34} In \textit{Bassan}, the court properly recognized the above language as effectively applying to limited partnerships Section 21(1) of the Uniform Partnership Act,\textsuperscript{35} which provides in part:

> Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

A literal construction of Section 21(1) implies the fiduciary relationship arises during negotiations for the formation of the partnership,\textsuperscript{36} necessitating full and complete disclosure of all features of the purpose rather than using them to acquire a shopping center as contemplated in the partnership agreement, the court held:

O.B.A. [general partner], its officers and directors owed N.C.A. [limited partnership] a fiduciary duty in dealing with the partnership funds remitted to O.B.A. by First Jersey, without knowledge on the part of the public investors in N.C.A. . . . . The evidence sustains the conclusion that O.B.A. was the promoter of N.C.A. and as a consequence thereof assumed a fiduciary duty in its dealings with the partnership to the extent at least of assuring the application of N.C.A. funds for their intended purpose.


In the event of wrongful conduct by the general partner such as conspiring to defraud the partnership in operation and sale of partnership real estate, a representative action will lie on behalf of the limited partnership. Alpert v. Haimes, 64 Misc. 2d 608, 315 N.Y.S.2d 332 (1970). \textit{But see} Millard v. Newmark & Co., 24 App. Div. 2d 333, 266 N.Y.S.2d 254 (1966).

\textsuperscript{33} See notes 59–60 and accompanying text infra.

\textsuperscript{34} See Cummings v. Nordmark, 73 Wn. 2d 322, 438 P.2d 605 (1968); 2 S. ROWLEY, \textit{MODERN LAW OF PARTNERSHIP} § 53.9, at 570 (2d ed. 1960).


\textsuperscript{36} 1 S. ROWLEY, \textit{MODERN LAW OF PARTNERSHIP} § 21.1, at 523–24 (2d ed. 1960). In Allen v. Steinberg, 244 Md. 119, 223 A.2d 240, 246 (1966), the court applied the same analysis in a limited partnership situation, stating: “[T]he principle of utmost good faith covers not only dealings and transactions occurring during the partnership but also those taking place during the negotiations leading to the formation of the partnership.” Promoters have long been held liable to their corporations as fiduciaries in cases where the corporation was formed for the purpose of acquiring properties from the promoters but the promoters neglected to disclose their profits from the transactions to their associates. In Victor Oil Co. v. Drum, 184 Cal. 226, 193 P. 243, 246 (1920), the court held the promoters to a duty to either disclose anticipated profits or to sell the property at their cost, stating:

\[T]he essence of the business was that the defendants, through the medium of a corporation, induced a number of persons to associate with them for the purchase of certain properties for prices greater than the properties could be ob-
proposed partnership so that a potential investor may reach an informed decision. This may be accomplished by incorporating the general partner’s profit formula into the articles of limited partnership along with each limited partner’s signature on the certificate of limited partnership.\textsuperscript{37} Without these safeguards, a subsequent transaction may well be invalidated. The \textit{Bassan} court’s refusal to find implied consent by the limited partners to profits on the Murakami transaction based on acquiescence in profits taken on earlier transactions,\textsuperscript{38} coupled with the requirement of full and complete disclosure, indicates the court has properly read a requirement of “express” consent into Section 21(1).\textsuperscript{39}

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\textsuperscript{37} WULPA § 2. WASH. REV. CODE § 25.08.020 (1974); see note 6 supra.

\textsuperscript{38} 83 Wn. 2d at 927, 524 P.2d at 237:

The limited partners . . . could only consent after the fact to whatever profit the general partner determined it should have as to a particular transaction. Because of this, although the limited partners may have consented after the fact to specific profits taken on previous transactions, this could not imply consent to the Murakami transaction because the limited partners could not know what the profit to Investment Exchange Corporation was until after the sale closed.

This simply means that the consent of the limited partners may be implied only if no action is taken after the transaction is closed and the general partner’s profits are revealed. In no event could consent on the present transaction be implied from consent to profits on earlier transactions as the net result would be an unlimited license by the general partner to set its future profits at whatever rate it chose, in complete disregard of its obligations to the limited partnership.

\textsuperscript{39} The position of the \textit{Bassan} dissent that consent to additional compensation could be implied after formation of the partnership is ill-founded for at least three reasons. First, the relationship of the partners is expressly defined by the written agreements between the parties such that “it is presumed that they delegated all the powers they wished to confer upon each other and withheld all powers or authority not affirmatively delegated.” Frankfort Oil Co. v. Snakard, 279 F.2d 436, 443 (10th Cir.), cert. denied, 364 U.S. 920 (1960). See also Weizer v. Commissioner, 165 F.2d 772 (6th Cir. 1948). Thus, the general partner’s compensation for services is specified in the express provisions for management fees, commissions and fees paid to the general partner’s subsidiaries, and a share of the ultimate partnership profits. See note 49 and accompanying text infra. Second, the WULPA expressly requires that partnership rights be specified in writing, WULPA § 9, WASH. REV. CODE § 25.08.090 (1974), and the rule that statutes in derogation of the common law are to be strictly construed is not applicable to limited partnership statutes. \textit{Id.} § 28(1), WASH. REV. CODE § 25.08.280(1) (1974). Third, as a practical matter, the limited partners lack direct
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D. Effect of the Articles of Limited Partnership

The Bassan court recognized that self-dealing by a general partner in a limited partnership may be sanctioned, however, if it is expressly provided for in the articles of limited partnership:40

Partners may include in the partnership articles practically any agreement they wish and if the asserted self-dealing was actually contemplated and specifically authorized with a method for determining, in advance, the amount of the profit it would not, ipso facto, be impermissible and deemed wrongful.

Thus, the general partner may be entitled to skim profit from transactions with the partnership, but only to the extent expressly authorized in the articles of partnership.41

II. THE GENERAL PARTNER’S FIDUCIARY DUTY OF DISCLOSURE

A. Nature of Limited Partnership and Potential Abuses

Problems with conflicts-of-interest and self-dealing are most difficult to avoid where, as in most limited partnerships, the general partner has virtually unchecked managerial powers.42 This is especially true where, as in Bassan, the limited partnership deals in real estate, the general partner is a corporate entity incorporated solely to promote, manage and participate in the real estate business through limited partnerships, and the limited partners tend to be inexperienced investors.43 In exchange for limited liability,44 together with antici-
pated benefits of cash flow, tax shelter and ultimate capital appreciation, the limited partners in a real estate limited partnership must entrust the general partner with the day-to-day management of their investments. Thus, the limited partners do not have a voice in determining which parcels of real property will be purchased at what prices, since such determinations are part of the general partner's "control" of the partnership business. Section 1 of the WULPA demands in turn that the managing general partner be subject to unlimited personal liability.

Observation of the limitations placed upon the limited partner's participation in partnership affairs exempts the limited partner from general liability and risks only the amount of his or her original subscription in the limited partnership. See WULPA §§ 7 & 17. WASH. REV. CODE §§ 25.08.070, .170 (1974); Lichtyger v. Franchar Corp., 18 N.Y.2d 528, 536, 223 N.E.2d 869, 873, 277 N.Y.S.2d 377, 383 (1966).

45. In a real estate limited partnership, cash flow is generated by the excess of rental income over expenses. Tax shelter may be achieved via deductions for depreciation, interest and losses. Capital appreciation may result upon the ultimate disposal of the partnership's real estate. Comment, supra note 32, at 140. The primary reason for organizing a real estate venture as a limited partnership rather than as a corporation is to obtain partnership treatment for federal income tax purposes. The form of organization appeals to an investor interested in the "pass-through" of partnership losses deductible from other ordinary income as well as the potential income reportable as long term capital gains. Hrusoff & Cazares, Formation of the Public Limited Partnership, 22 HAST. L.J. 87, 96 (1970). For a sample prospectus of a real estate limited partnership promising these features, see Prospectus for American Housing Partners, August 31, 1971, in I NOTABLE SYNDICATIONS 5, 15-17 (S. Roulac ed. 1972).


(1) 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.

(2) A limited partner shall not be deemed to take part in the control of the business by virtue of his possessing or exercising a power, specified in the certificate, to vote upon matters affecting the basic structure of the partnership, including the following matters or others of a similar nature:

(a) Election, removal, or substitution of general partners, including, but not limited to, transfer of a majority of the voting stock of a corporate general partner.

(b) Termination of the partnership.

(c) Amendment of the partnership agreement.

(d) Sale of all or substantially all of the assets of the partnership.

(3) The statement of powers set forth in subsection (2) of this section shall not be construed as exclusive or as indicating that any other powers possessed or exercised by a limited partner shall be sufficient to cause such limited partner to be deemed to take part in the control of the business within the meaning of subsection (1) of this section.

(UULPA § 7 (1969) includes only subsection (1).)


48. WASH. REV. CODE § 25.08.010 (1974). There is dispute whether a corporation may become a partner in a limited partnership. Although § 2 of the WULPA pro-
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Entrusted with full managerial control of the partnership's business interests, the general partner in a real estate limited partnership generally receives compensation for various promotional and management activities in the form of: 49 (1) brokerage commissions or fees on the sale of property to the partnership; (2) property management fees and further commissions or fees from the lease or sale of partnership properties to third parties; and (3) portfolio investment fees or promotional interests in the partnership, i.e., a share of the ultimate profits of the partnership. Manipulation of these profit features by the general partner, without disclosing the actual amounts withdrawn from the partnership or providing a formula by which the general partner's withdrawals are to be calculated, creates a high potential for abuse by the general partner.

An even more egregious example is suggested by the fact that the general partner may realize "gain" on the sale of property to the partnership, as though it were an arm's length transaction. The general partner may obtain an unduly high appraisal upon sale to the limited partnership, and thus realize undeserved profits based upon the fictitious spread between its cost and an artificial fair market value. 50 Such potential for abuse clearly indicates a need to impose a fiduciary duty on the general partner of a real estate limited partnership, as the

vides that a limited partnership may be formed by two or more persons, it does not define "person." There is some authority for the view that the basis for the rule excluding corporations from becoming partners in a "venture" also applies with respect to a corporation becoming a general partner in a limited partnership. 2 S. ROWLEY, MODERN LAW OF PARTNERSHIP § 53.2, at 555 (2d ed. 1960). There is a noticeable trend, however, to permit corporations to serve as general partners. Id. at 555–56 n.30.

Although the issue has never been formally adjudicated in Washington, it is apparently a long-standing practice to form a corporation for the purpose of serving as a general partner in a limited partnership. (Investment Exchange Corporation was formed for that purpose in 1956. Prospectus, supra note 9, at 6.) The fact that a corporation may be formed for any lawful purpose implies that a corporation may be a general partner. See WASH. REV. CODE §§ 23A.08.010–.020 (1974); Comment, Public Limited Partnerships in Northwest Real Estate Syndication, 7 WILLAMETTE L.J. 74, 75–76 (1971).

49. See Augustine, The Public Real Estate Limited Partnership—An Introduction, in D. AUGUSTINE & R. LOWELL, REAL ESTATE SYNDICATIONS 1, 17 (1972). See also Lichtyger v. Franchard Corp., 18 N.Y.2d 528, 223 N.E.2d 869, 277 N.Y.S.2d 377 (1966) (limited partners entitled to bring derivative action for breach of fiduciary duty against a general partner who impaired the limited partners' investment return by reducing the rental rates on partnership property; the general partner received a fixed management fee which was unaffected by the rental reduction).

50. See Part I–B supra.
Washington court did in *Bassan*. The court, however, left the content and scope of the duty undefined.

B. *The Duty of Disclosure in Related Areas*

Due to the paucity of case law in the limited partnership area, the precedential value of *Bassan* would have been enhanced had the court attempted to delineate the parameters of the general partner's fiduciary duty. The court could have explored the nature of the fiduciary duty of the general partner, both as to disclosure and limitation of compensation, by considering analogous areas of law such as the corporate director-shareholder relationship and the managing partner-partner relationship.

As with the corporate shareholder who relies on the corporate directors and officers for information regarding the organization's business transactions, the limited partner is wholly dependent upon the representations of the general partner. Both forms of enterprise involve a separation between investor and management. The limited partner has no control over the partnership's day-to-day business, except through right of refusal to concur in certain acts for which his or her consent is required by law. The limited partner is much like the holder of participating preferred stock: liability of both is limited to their original investment; both are ordinarily treated for accounting and credit purposes as holding equity rather than debt; and both are often privileged only to inspect the organization's books, to be kept

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51. WULPA § 9, WASH. REV. CODE § 25.08.090 (1974) provides in part: [W]ithout the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to:

1. Do any act in contravention of the certificate;
2. Do any act which would make it impossible to carry on the ordinary business of the partnership;
3. Confess a judgment against the partnership;
4. Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose;
5. Admit a person as a general partner;
6. Admit a person as a limited partner, unless the right to do so is given in the certificate;
7. Continue the business with partnership property on the death, retirement, or insanity of a general partner, unless the right to do so is given in the certificate.


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informed, and to seek an accounting or dissolution in appropriate circumstances.\textsuperscript{54}

In view of the substantial degree of similarity between the status of limited partners and that of corporate shareholders, it is instructive to consider the degree of loyalty demanded of a corporate fiduciary. In \textit{State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.},\textsuperscript{55} the Washington Supreme Court held that a corporate officer occupies a relationship to the private corporation and its shareholders “akin to that of a trustee, and owe[s] undivided loyalty, and a standard of behavior above that of the workaday world.”\textsuperscript{56} The result is that neither directors nor officers may directly or indirectly acquire secret personal profit or advantage through business transactions allegedly on behalf of the corporation.\textsuperscript{57} The \textit{Hayes} court specified that “nondisclosure by

\begin{itemize}
\item \textsuperscript{54} Compare \textit{Wash. Rev. Code} §§ 23A.08.460 & 25.08.100 with § 25.08.070 (1974). As indicated in note 46 \textit{supra}, Washington law grants the limited partner relatively more managerial influence than the preferred shareholder by permitting the limited partner to vote on certain matters affecting the basic structure of the partnership. These powers however, do not constitute an exercise of “control” so as to subject the limited partners to unlimited liability. More importantly, these powers are not of a nature which would enable the limited partners to check the general partner’s day-to-day withdrawals of partnership funds in order to thwart possible general partner self-dealing. Also, it is important to note that Subsection (2)(d) of Washington’s 1972 amendments, now \textit{Wash. Rev. Code} § 25.08.070(2) (d) (1974), does not reach sales from the general partner to the limited partnership.


\item \textsuperscript{55} 64 Wn. 2d 375, 391 P.2d 979 (1964). Hayes, an officer of Coast Oyster Corporation, negotiated the sale of Coast to Keypoint Oyster Company and secretly agreed that in exchange for his cosignature on Keypoint’s loan, he would receive stock in Keypoint. Thus, Hayes obtained secret profit and personal advantage at the expense of Coast Oyster Corporation. See Williams v. Queen Fisheries, Inc., 2 Wn. App. 691, 469 P.2d 583 (1970) (corporate officer’s use of corporation’s equipment, employees, credit and funds to establish a personal business constituted a breach of the officer’s fiduciary duty of loyalty and warranted an accounting as well as discharge of the officer).

\item \textsuperscript{56} 64 Wn. 2d at 381, 391 P.2d at 983.

\item \textsuperscript{57} See Leppaluoto v. Eggleston, 57 Wn. 2d 393, 357 P.2d 725 (1960) (profits gained by a corporate officer in an unauthorized transaction on behalf of the corporation belong to the corporation); Sanders v. E-Z Park, Inc., 57 Wn. 2d 474, 358 P.2d 138 (1960) (action taken by board of directors, for which director with personal financial interest voted, is voidable by the stockholders); Larson v. A. W. Larson Co., 56 Wn. 2d 271, 217 P.2d 789 (1950) (officers of a corporation are bound to exercise the utmost good faith in conserving corporate property and furthering corporate interests). See also Kane v. Klos, 50 Wn. 2d 778, 314 P.2d 672 (1957); Arneman v. Arneman, 43 Wn. 2d 787, 264 P.2d 256 (1953); Shermer v. Baker, 2 Wn. App. 845, 472 P.2d 589 (1970).

\end{itemize}
an interested director or officer is, in itself, unfair. This wholesome rule can be applied automatically without any of the unsatisfactory results which flowed from a rigid bar against self-dealing.  

Further explanation of the type of disclosure required in a Bassan-type relationship may be derived from the nonlimited general partnership principles which have long required full disclosure of facts material to a transaction with the partnership. Thus, a sale of property by one partner to the partnership will be "sustained only when it is made in good faith, for a fair consideration and on a full and complete disclosure of all important information as to value."  

C. The Duty of Disclosure in the Limited Partnership Context

It is arguable that the obligation running from the general partner to the limited partners is even greater in the limited partnership situation than in that of the nonlimited, general partnership because of the limited partners' restricted voice in the partnership business.

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58. 64 Wn. 2d at 382, 391 P.2d at 984. Similarly, the Bassan court concluded that nondisclosure of the general partner’s profit interest in a transaction is ipso facto unfair, irrespective of whether the profits might be reasonable. At that point, the limited partners had an option of granting the general partner its profits or denying them in total while still taking the opportunity. Although the court found it unnecessary to decide, it implied the limited partners may consent to exorbitant profits to the general partner upon full and complete disclosure. Such disclosure creates a rebuttable presumption of fairness. Note, however, that WASH. AD. CODE § 460-32A-045(c) (1975) specifies that a price to the partnership in excess of the general partner's original cost is now presumptively unfair unless some material change has occurred to the property since it was acquired by the general partner. See notes 106–07 infra.

59. See Karle v. Seder, 35 Wn. 2d 542, 550, 214 P.2d 684, 688 (1950) (in the sale and purchase of general partnership interests, each partner is "required to make a full disclosure of all material facts within his knowledge in any way relating to partnership affairs"); Simich v. Culjak, 27 Wn. 2d 403, 178 P.2d 336 (1947) (the managing partner acts as a trustee for the partnership); Kittilsby v. Vevelstad, 103 Wash. 126, 129, 173 P. 744, 745 (1918) ("[T]here is no stronger fiduciary relation known to the law than that of copartnership, where one man's property and property rights are subject to a large extent to the control and administration of another."). See also Morrison v. Ultican, 35 Wn. 2d 504, 517, 213 P.2d 617 (1950); Danich v. Culjak, 190 Wash. 79, 66 P.2d 860 (1937).

60. Karle v. Seder, 35 Wn. 2d 542, 550, 214 P.2d 684, 688 (1950). In Finn v. Young, 46 Wash. 74, 77, 89 P. 400, 401 (1907), the court stated: A sale by one partner to another of his partnership interest will not be sustained unless made for a fair consideration and upon full disclosure by the vendee to the vendor of whatever information he has as to the value of such property; and concealment of a material fact by the party whose duty it is to disclose it is sufficient to annul the compact. See also cases cited in note 59 supra. The rule is the same for promoters. See note 36 supra.

61. See Part II–A and note 51 and accompanying text supra.
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classical concept of an agency relationship between partners applied to general partnerships cannot be properly applied to the limited partnership situation: "The principal-agent relationship which exists between the partners of an ordinary partnership is not present between the limited and general partners of a limited partnership," 62

One authority has broadly characterized the fiduciary duty of a general partner in a real estate limited partnership as consisting of two aspects: 63

First, the general partner owes the limited partners a duty of good faith, loyalty and due care. The general partner must act in the best interests of the partnership and in a manner reasonably calculated to benefit the partnership financially.

Second, the general partner must comply with the provisions of the partnership agreement and whatever other representations (e.g. the prospectus or offering circular) were made to the limited partners at the time the limited partners committed capital to the partnership.

In short, the general partner must disclose all material facts bearing on the investment decision and subsequent management of the limited partnership, and must limit its compensation so as both to comply with the express agreement of the parties and to promote the financial interests of the limited partnership. Although the Bassan court made it clear that nondisclosure of a material fact constitutes, per se, a breach of the general partner's fiduciary duty, 64 its recognition of the highest degree of loyalty owing from the general partner to the limited partnership implies that, in future cases, the court may go beyond disclosure to analyze the ultimate fairness of the transaction to the limited partners.

III. FAIRNESS OF THE TRANSACTION

That in Bassan the general partner took substantial profits on the Murakami transaction, and that there was an obvious absence of an

arm's length bargain, permit the inference that the court's disposition was in some measure a reaction to the lack of substantive fairness of the transaction. Developments in this area may have greater impact on limited partnerships than the basic proposition of full disclosure of the general partner's anticipated profits. The following sections outline means by which the court may judge future challenges to transactions whereby general partners have engaged in self-dealing.

A. The Arm's Length Bargain Test

The long-standing rule governing fiduciaries requires that where any portion of their transactions with the organization is challenged, it will be rigorously scrutinized. The burden is on the fiduciary to prove its good faith and to show the inherent fairness of the transaction. The test is “whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain.” The value of the test in the limited partnership context lies in assessing the original formation to determine whether the agreement bears the appearance of a duly-negotiated bargain and whether provision was made in the agreement for ongoing transactions between the general partner and the partnership. Had the Bassan court expressly applied

845. 472 P.2d 589 (1970) (duty of majority stockholder purchasing stock of minority stockholder to disclose all material facts affecting the value of the stock known to the majority stockholder but not the minority stockholder).

65. See Ong Hing v. Arizona Harness Raceway, Inc., 10 Ariz. App. 380. 459 P.2d 107 (1969) (where director deals with his or her corporation, and his or her interest is adverse to that of the corporation, the transaction will be closely scrutinized); Tovrea Land & Cattle Co. v. Linsenmeyer, 100 Ariz. 412 P.2d 47 (1966) (same); Central Building Co. v. Keystone Shares Corp., 185 Wash. 645. 56 P.2d 697 (1936) (courts will always closely scrutinize any transaction between officers or trustees and the corporation); Tefft v. Schaefer, 148 Wash. 602. 269 P. 1048 (1928) (court will closely scrutinize acts of corporate officers in directing expenditures which result in personal profit or advantage to majority stockholders).

66. Pepper v. Litton, 308 U.S. 295 (1939) (bankruptcy court may require controlling shareholder to establish fairness of claims for salary); Merger Mines Corp. v. Grismer, 137 F.2d 335 (9th Cir.), cert. denied, 320 U.S. 794 (1943) (promoter must show good faith and inherent fairness of stock and loan transactions with corporation).

this test, it could only have concluded that the Murakami "bargain" was "negotiated" by the general partner with itself, and that there was not one earmark of an arm's length bargain. Instead, the court based its opinion solely upon the general partner's failure to disclose a profit formula. Disclosure alone, however, does not guarantee that the features of an arm's length bargain will be present. Moreover, not all arm's length bargains will satisfy the fiduciary duty of the general partner in a limited partnership.

B. The Business Opportunity Doctrine

If an officer or director, for personal profit, takes advantage of an opportunity in which the corporation has a legitimate interest, the opportunity will be deemed held in trust for the benefit of the corporation. This doctrine of "corporate opportunity" is equally applicable in the general partnership context.

Whether the business opportunity properly belongs to the organization depends upon the facts and circumstances of each case. If they

68. In Bassan, there was disclosure that the general partner was profiting on sales to the partnership in the form of an accounting footnote in the partnership financial statement. The statement was issued after the limited partners had committed their investments and indicated property acquired by Auburn West Associates for $642,343 had cost Investment Exchange $459,000. 83 Wn. 2d at 922, 524 P.2d at 233. In addition, a prospectus prepared in 1969 for the SEC indicated that from May 1964 through December 1965 Auburn West had acquired eight parcels from Investment Exchange, whose basis in those parcels was $488,221, for $749,250. Id. This is not, however, the type of disclosure which is conducive to informed investment decision-making. For a discussion of minimum disclosure requirements, see Part II-C supra.

69. See Part IV-C infra.


71. In re Wilson's Estate, 50 Wn. 2d 840, 315 P.2d 287 (1957) (purchase of Caterpillar by partner from partner who had died several years previously held a purchase for the benefit of the partnership as the transaction was clearly connected with the logging partnership business); Stewart v. Ullrich, 117 Wash. 109, 201 P. 16 (1921); Shrader v. Downing, 79 Wash. 476, 140 P. 558 (1914); Elle v. Babbitt, 259 Ore. 590, 488 P.2d 440 (1971) (partner may not use for personal benefit information or opportunities which properly belong to partnership). In Foucek v. Janicek, 90 Ore. 251, 225 P.2d 783 (1950), defendant-partner allegedly accepted for himself an offer made to the partnership which amounted to $50,000 or more from a joint venture arrangement for purchase and resale of war surplus materials. After finding the corporate opportunity doctrine applicable to partnership law, the court held that a partner may not use information acquired in the course of the partnership's business for private gain and will be required to share the profits therefrom even though they accrue after termination of the partnership. See also Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928) (joint venture).

indicate the opportunity was within the realm of the organization's business and the organization had the capacity to acquire it, the officer, director or managing partner will be held to a duty to acquire the opportunity for the organization.\(^7\)

The business opportunity doctrine should be found generally applicable in the real estate limited partnership context, at least with respect to post-formation transactions. Upon formation of the partnership, it is expected that the general partner will locate property at a relatively low price which, due to the nature of its location, is likely to show a substantial appreciation in the near future. The general partner will in turn sell the property to the limited partnership, receiving a fixed finder's fee or other similar compensation for acquisition services as set forth in the partnership agreement.\(^7\) No profit spread is contemplated. Therefore, in Bassan, the court could have found that the profit margin taken by the general partner, Investment Exchange, on the spread between its cost and the alleged fair market value of the Murakami parcel was an appropriation of a limited partnership business opportunity such that a constructive trust would be imposed in favor of the limited partnership in the amount of Investment Exchange's net profit on the sale.

IV. DISCLOSURE, FAIRNESS AND SUBSTANTIVE ADMINISTRATIVE REGULATION: THE NEW WASHINGTON RULES


73. Paulman v. Kritzer, 139 Ill. App. 282, 219 N.E.2d 541 (1966), aff'd, 38 Ill. 2d 101, 230 N.E.2d 262 (1967) (Where defendant corporate director purchased property with corporate funds and on resale retained profits personally, corporation had right to claim the benefits of the transaction); Hubbard v. Pape, 2 Ohio App. 326, 203 N.E.2d 365 (1964) (Where evidence established that corporate officer, in violation of duly-enacted regulations of the corporation, had purchased capital stock without first offering the stock to the company at book value, officer was required to transfer the opportunity to the corporation). See also Kaufman v. Wolfson, 153 F. Supp. 253 (S.D.N.Y. 1957).

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Rules)\textsuperscript{75} and thus were not subject to them. These regulations recently underwent major revision, incorporating and adapting much of the substance of the Guidelines of the Midwest Securities Commissioners Association (Midwest Guidelines).\textsuperscript{76} This recent revision was apparently in response to the substantial number of limited partnership offerings\textsuperscript{77} and their increased availability to the less sophisticated investor.\textsuperscript{78} The new Washington Rules combine the disclosure and fairness tests for transactions involving the general partner and the limited partnership: disclosure provides the marrow of the new rules, a presumption of unfairness to the partnership provides the sinew.

Although a substantial number of ongoing limited partnerships may be exempt, the new rules should serve as guidelines for judicial scrut-
tiny of challenged limited partnership abuses similar to those in Bassan. This section of the note provides an overview and analysis of the capacity of the Washington Rules to insure reasonable real estate limited partnership offerings. In particular, the following problems are discussed: adequacy of investor protection where there are minimal general partner and no investor suitability standards; the value of detailed disclosure documents; the methods utilized to curb general partner self-dealing in transactions with the partnership; the value of a limited form of "control" exercisable by limited partners; and the approach of the new rules to the special problems raised by nonspecified properties or "blind pool" offerings.

A. The Members: Sponsor and Investor Suitability Standards

In order to protect creditor reliance upon the solvency of the general partner, the Washington Rules now impose a net worth requirement on the sponsor79 of a real estate program.80 However, where the Washington Rules regulate with one hand, they salve with the other by excepting the net worth requirement if the sponsor can show that it is not "necessary to the viability of the program."81 This exception is as unfortunate as it is confusing. The term "viability of the program" is undefined and begs the questions of investor protection and general partner solvency, the very questions to which the net worth requirement attempts to respond.82 Another weakness of the net worth re-

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79. A "sponsor" is defined as:
any person directly or indirectly instrumental in organizing, wholly or in part, a [partnership] program or any person who will manage or participate in the management of a program, including the general partner(s) and any affiliate of any such person, but does not include a person whose only relation with the program is as that of an independent property manager, whose only compensation is as such. "Sponsor" does not include wholly independent third parties such as attorneys, accountants, and underwriters whose only compensation is for professional services rendered in connection with the offering of syndicate interests. WASH. AD. CODE § 460-10A-155 (1975).
80. The sponsor's minimum financial net worth must equal at least 5% of the gross amount of all offerings in the past 12 months plus 5% of the gross amount of the current offering to a maximum net worth of $1,000,000. Id. § 460-32A-015.
81. Id.
82. Compare Midwest Guidelines, supra note 76, at Part II-B. By leaving the minimum net worth requirement for general partners unqualified, the Midwest Guidelines set a floor above which a general partner is presumed solvent which in turn provides a minimum assurance to creditors that their accounts will be satisfied. This aids the partnership in establishing its investment program while limiting at least one of the risks, i.e., general partner viability, to potential investors.
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quirement section is that it stops short of effectively guaranteeing continued general partner reliability by requiring evidence of an ability to maintain net worth for a significant period after the offering is completed.\textsuperscript{83} The section also provides no assurance of general partner competence as would an additional requirement of minimum relevant business experience.\textsuperscript{84}

While attempting to assure the reliability and capacity of a potential general partner, there should also be some effort to insure investor suitability. This the Washington Rules do not attempt. By comparison, due to the "limited transferability, the relative lack of liquidity, and the specific tax orientation of many real estate Programs,"\textsuperscript{85} the Midwest Guidelines require sponsors to establish and apply suitability standards to potential investors.\textsuperscript{86} The standards are to be formulated in view of the program's investment policies to determine the type of person who could benefit from, as well as afford, the long-term risks of the investment. If a program's investment policies are aimed at creating tax deductions and long-term appreciation through real estate acquisitions and development, the offering should be limited to those in higher income tax brackets who can bear the relative illiquidity of this type of real estate investment.\textsuperscript{87}

\textsuperscript{83} Id. "The general partners shall present evidence of ability to maintain this net worth for a period of three years after completion of the offering."

\textsuperscript{84} Compare id. at Part II--A, which requires the sponsor and the general partner or their chief operating officers to have at least two years relevant real estate experience and the person providing services to the partnership to have no less than four years relevant experience in the type of service being rendered or demonstrate sufficient knowledge and experience to perform the proposed services. The lack of general partner management experience is among the chief factors which studies indicate lead to the failure of some real estate syndicates. Van Camp, supra note 78, at 404.

\textsuperscript{85} Midwest Guidelines, supra note 76, at Part III--A.

\textsuperscript{86} The Midwest Guidelines, id. at Parts III--A, C & D, require that the sponsor maintain records of information indicating its investors meet the suitability standards formulated for a particular program. Initially, the suitability standards proposed by the sponsor must be submitted to the securities administrator for review for fairness. Substantive standards set forth in the Midwest Guidelines include a minimum investment of $2,500 per investor for low risk offerings and a minimum initial cash purchase of $5,000 per investor in the high risk or primarily tax oriented offerings. It is unclear that such quantitative requirements insure investor sophistication but they could provide some assurance that those who cannot afford an illiquid investment will be deterred from investing their life savings.

\textsuperscript{87} Specifically, where the primary benefit will be the application of partnership deductions against the investor's own taxable income from other sources, only those with significant taxable incomes should purchase the units. Second, in many cases there will be little cash flow, particularly if unimproved land is held for appreciation or, as for example, in the case of investment in federally-assisted housing projects where the FHA limits project owners to a minimal cash return. In addition, manage-
B. The Disclosure Documents

The new Washington Rules require that at least 25 specific factors be described in the limited partnership prospectus, among which are included: risk factors; business experience over the last 10 years of the general partners or of the principal officers of a corporate general partner; all direct and indirect compensation to be paid to the general partner; investment objectives and policies; "track records" of the general partner; a summary of the terms of the proposed limited partnership including any self-dealing contemplated by the general partner; a summary of the federal tax consequences; financial statements and projections; and provisions governing transactions with affiliates of the sponsor. Such detailed disclosure documents should provide even the unsophisticated investor with the materials necessary to make an informed investment decision, and should substantially

ment fees on improved properties tend to absorb a substantial portion of the cash return. Third, high leverage (mortgage financing) increases the risks, for in the event net cash flow is insufficient to service the debt, the partnership's equity may be reduced or eliminated through foreclosure. This would result in a taxable gain without surplus cash where the liquidated mortgage balance exceeds the tax basis. The average taxpayer is generally ill-prepared to pay taxes on gain which is not coexistent with cash flow. Finally, the risks which point to a need to assure investor suitability also include the fact that real estate is not readily marketable and is subject to adverse economic changes. See Prospectus for American Housing Partners (Aug. 31, 1971), in I Notable Syndications 5 (S. Roulac ed. 1972).

88. Wash. AD. CODE § 460-32A-195 (1975). This section closely parallels provisions of the Midwest Guidelines, supra note 76, at Part VIII-C.

89. Risk factors may include an outline and warning of: initial financing, partnership dependency upon management and upon unpredictable factors, factors beyond the partnership's control, present and potential conflicts of interest, the high degree of competition, leverage investments and the increased risk of loss, limited transferability of units, compensation of management, conditional tax status and minimal reserves for operating expenses. Prospectus for Atlanta Area Apartment Program (Oct. 8, 1971), in I Notable Syndications 43 (S. Roulac ed. 1972).

90. It would appear that a statement of investment objectives and policies is particularly important to the investor in nonspecified, "blind pool" programs. For a definition of such programs, see note 11 supra. Wash. AD. Code § 460-32A-235 (1975) makes express provisions for nonspecified property programs requiring a statement of the types of properties in which it proposes to invest, "such as first-user apartment projects, subsequent-user apartment projects, shopping centers, office buildings, unimproved land, etc." Such requirements have been the subject of some criticism. The question arises whether the information regarding the properties the partnership intends to purchase is essential to the individual's decision whether to invest in a particular partnership. In comparison, newly formed mutual funds do not disclose that they intend to invest a given percentage of their portfolio in a particular stock. The criticism is that it is arbitrary to single out partnerships for such treatment. See Augustine, Public Real Estate Limited Partnership—An Introduction, in D. Augustine & R. Lowell, Real Estate Syndications 11 (1972).

91. Practically, even the unsophisticated investor should be able to draw the appropriate conclusions from disclosure that general partner has never managed the
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decrease the likelihood that oral or "course of dealings" modifications will be found to alter the scheme from that which was originally contemplated.

C. Transactions Between the Members: Curbing Self-dealing

In an effort to stem general partner self-dealing, particularly with regard to general partner compensation and indirect profit or advantage from transactions with its affiliates or subsidiaries, the Washington Rules adopt much of the detailed regulation of the Midwest Guidelines.\(^9\) They provide that the total consideration of all kinds paid directly or indirectly to the general partner or its affiliates shall be reasonable.\(^9\) The handling by the general partner of any funds and assets of the partnership subjects the general partner to a fiduciary duty, regardless of whether the funds are in its immediate possession.\(^9\)

1. General partner compensation

The Washington Rules approve and limit three basic types of compensation: acquisition fees, management fees and promotional interests. An acquisition fee\(^9\) is payable only for services actually rendered to the partnership and general partners shall not receive real estate

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\(^9\) Midwest Guidelines, supra note 76, at Part IV.

\(^9\) WASH. AD. CODE § 460–32–020 (1972), as revised § 460–32A–020 (1975). Unhelpfully, what constitutes "reasonable" fees, compensation and expenses is to be determined by considering all aspects of the program, including: organization and offering expenses, compensation for acquisition services, compensation for development and/or construction services, compensation for program management, and additional compensation to the sponsor in the form of subordinated interest and promotional interests. This section has very little informational or regulatory value beyond requiring that all such compensation to be paid by the partnership be disclosed in the prospectus in tabular form, specifying how and when it will be paid. The actual regulatory feature is found in the 18%-of-gross-proceeds limit on all compensation paid to everyone involved in the program. See id. § 460–32A–025.

\(^9\) Id. § 460–32A–205.

\(^9\) Id. § 460–10A–055 provides:

ACQUISITION FEE. The total of all fees and commissions paid by any party in connection with the purchase, construction, or development of property by a program. Included in the computation of such fees or commissions shall be any real estate commission, acquisition fee, selection fee, development fee, construction fee, non-recurring management fee, or any fee of a similar nature, however designated.
commissions, finder's fees or similar fees from anyone other than the partnership. All such fees are subject to an upper limit of 18 percent of the gross proceeds of the offering. A ceiling of one percent of the cost of real property is placed upon the general partner's program management fee. The promotional interest (partnership share) of the general partner is now subordinated to the return of the limited partners' capital contribution.

2. Spread between general partner cost and price to the partnership

A crucial aspect of general partner compensation, previously subject to substantial abuse as illustrated by the facts of Bassan, is that of general partner profits on sales of real estate to the limited partnership. Under the former Washington Rules, the general partner was permitted to sell real estate to the limited partnership at its fair market value based on "independent appraisals." Of course, the inexactitude of most real estate appraisals left the way open for abuse. For

96. Id. § 460–32A–025. This section appears directed at amounts paid by owners of real estate to the general partner to induce the general partner to acquire the real property for resale to the partnership.

97. Id. § 460–32A–025(2). As the definition quoted in note 95 supra indicates, the 18% limit applies to fees (or profits) for both pre- and post-formation acquisitions of property by the general partner. Compare WASH. AD. CODE § 460–32A–045 (1975), prohibiting post-formation sale of property to the partnership at a price "greater than the cost of such property to the sponsor," and allowing sale at formation for a price greater than cost only where "some material change has occurred to the property which would increase the value since the [general partner] acquired the property." See notes 106–07 and accompanying text infra.

98. WASH. AD. CODE § 460–32A–030 (1975). The "cost of property" is defined in § 460–1A–100 as:

The sum of the price paid by the buyer for property plus all costs, payments, and expenses and costs of improvements, if any, reasonably and properly allocable to the property in accordance with generally accepted accounting principles (cost may include acquisition fees, loan "points," prepaid interest, and debts). Section 460–32A–030 should be read in conjunction with § 460–32A–045 such that the "cost" referred to in the former is the cost to the partnership. If, in fact, this is the manner in which a general partner's program management fee is to be set, the limitations on cost in transactions between the general partner and limited partnership set forth in § 460–32A–045 (see notes 106–07 infra) should be rigidly applied. This is necessary to prevent abuse in setting the cost basis for general partner management fees.

99. Id. § 460–32A–035. The objective is to insure a return of the limited partner's investment before the general partner begins to profit, thereby avoiding potential self-dealing whereby the general partner "milks" the partnership of its profits.

100. WASH. AD. CODE § 460–32–100 (1972).

101. See Comment, supra note 32, at 143 n.28, in which the author notes: "People unfamiliar with real estate appraisal often make the fallacious assumption that the determination of value by an appraiser is precise and accurate and is determined..."
example, in the Murakami transaction in Bassan, one report indicated that the fair market value of the property was $688,000 on the date it was acquired by the partnership, based upon an estimated value of the future retail value of its component parts. Another report valued the property at $325,000 on the same date, based upon the present value of the parcels on a bulk basis.

The new Washington Rules deemphasize the use of appraisals and the concept of fair market value with respect to sales of real estate to the partnership. They now proscribe the sale or lease to the partnership of:

property in which a [general partner] has an interest unless: (a) The transaction occurs at the formation of the [partnership], and is fully disclosed in its prospectus or offering circular, and (b) The property is sold upon terms fair to the [partnership] and at a price not in excess of its appraised value . . . .

Most importantly, the Washington Rules call for an examination of the fairness and reasonableness of the property valuation: If the general partner's cost is less than the price offered to the limited partners, there will be a presumption of unfairness, rebuttable by a showing that "some material change has occurred to the property which would increase the value since the [general partner] acquired the property."

As for post-formation transactions, the rule is absolute:

by 'scientific' methods. This is simply not so." The author cites the evaluation of numerous factors involved in the appraisal process discussed in S. KAHN, F. CASE & A. SCHIMMEL, REAL ESTATE APPRAISAL AND INVESTMENT 12 (1963), including economic, sociological, political and geographic variables. The inequities often involved in an appraisal are illustrated in a taxation case, Northwest Chemurgy Sec. Co. v. Chelan County, 38 Wn. 2d 87, 228 P.2d 129 (1951), where appraisals of the same real estate by expert witnesses as well as the tax assessor ranged from $30,000 to $110,800 over a two year period, despite the fact that there were no substantial changes in the improvements or the surroundings during that period. See also text accompanying notes 102–03 infra.

102. Brief for Appellants at 13, Bassan.
103. Id. at 14.
104. Appraisals have been retained to a limited extent by specifying that the general partner may be required to keep an appraisal on file for five years (presumably from the date of acquisition by the general partner although this is unstated in the statute). WASH. AD. CODE § 460–32A–105 (1975).
105. Id. § 460–32A–045.
106. Id. § 460–32A–045(1)(c). The section states further: Material factors may include the passage of a significant amount of time (but in no event less than 2 years), the assumption by the promoter of the risk of ob-
The property may be purchased by the limited partnership at “a price no greater than the cost of such property to the [general partner].”

3. Miscellaneous transactions

Expenses of the partnership are to be billed directly to the partnership and in no event will reimbursement be paid to an affiliate or the promoter. This avoids the problems raised when, as in Bassan, a general partner’s profits are challenged and the general partner responds that it was merely attempting to cover its operating expenses. Expenses of the partnership paid to a nonaffiliated third party are presumptively bona fide.

The Washington Rules expressly forbid reciprocal business arrangements which would violate any of the other provisions. They forbid both commingling of funds with any other “person” and investments in other programs. These provisions are aimed at the potential for abuse of “interlocking directorates,” often authorized by articles of limited partnership, in which an individual or corporation is the general partner of numerous limited partnerships and proceeds to transact business among the limited partnerships.
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D. Rights of Limited Partners: A Limited Form of "Control"

In conjunction with the 1972 amendments to Section 7 of the WULPA, the new Washington Rules identify the rights of the limited partners to: call meetings of the limited partnership; remove a general partner for cause; dissolve the partnership; and approve or reject outsider replacement of the general partner. In addition, the general partner must prepare and submit periodic reports as well as provide the limited partners with reasonable access to the partnership's records. None of these rights evidence "control" of the partnership, since they are specifically excepted by statute from the definition of control, and since no creditor would be induced by this organizational scheme to rely upon the limited partner's personal assets.

E. Nonspecified Property Offerings: "Blind Pools"

Due to the higher risks to the investor generally involved in a proposal to acquire certain types of property in the future, "blind pool" offerings require special regulations. The new Washington Rules

114. See note 46 supra.
116. Id. § 460-32A-150.
117. Id.
118. Id. § 460-32A-155.
119. Id. § 460-32A-160.
120. Id. § 460-32A-165.
122. See Feld, The "Control" Test for Limited Partnerships, 82 HARV. L. REV. 1471, 1478 (1969) ("[t]he limited partner would not be generally liable so long as he does not do anything which would affect the partnership's relations to third parties . . . ."). See generally Comment, "Control" in the Limited Partnership, 7 JOHN MARSHALL J. PRAC. & PROC. 416, 422 (1974).

The Commissioner normally will not authorize the offer and sale of limited partnership interests in a "blind pool" where there is no specific property to be acquired by the real estate syndicate and the formulation of the syndicate is solely for the purpose of raising funds to acquire unspecified property at some time in the future. New York has specifically prohibited such offerings. N.Y. GEN. BUS. LAW § 352-e (McKinney Supp. 1974). The disfavor of "blind pool" offerings stems from the risks inherent in investing in a program without being able to evaluate the profit potential of underlying assets. See Comment, supra note 32, at 142-44.
make some progress toward regulating such offerings by requiring a statement of investment objectives, limiting the types of property which may be acquired, limiting the offering period, and requiring a special report to the investors on at least a quarterly basis. However, the Washington Rules stop far short of fully compensating for the higher risk involved in blind pool offerings and of providing the additional measure of investor protection required. By contrast, the Midwest Guidelines suggest that: "blind pool" enterprises be subject to a minimum capitalization of $1,000,000; the sponsor must have had at least five years experience in the real estate business in an executive capacity and two years in the management and acquisition of property of the types to be acquired; and the minimum investment for higher-risk offerings would be applied. While the Washington Rules now differentiate between specified and nonspecified property offerings, the revisers apparently did not fully anticipate the potential for abuse in the context of accumulating investors' funds for discretionary investment purposes.

V. CONCLUSION

It is not enough to label the general partner in a real estate limited partnership a "fiduciary" and presume its responsibilities are thereby clearly defined. There are three primary elements of the general partner's fiduciary duties: First, that the general partner's obligation to

124. See note 90 and accompanying text supra.
125. Id.
126. WASH. AD. CODE § 460–32A–240 (1975) (one year from date of effectiveness of the offering).
127. Id. § 460–32A–245.
128. Midwest Guidelines, supra note 76, at Part VI–A.
129. Id. Part VI–B. See also id. at Part III–B–1.
130. Id. Part III–D sets a minimum investment for high and low risk offerings, and it is presumed, by inference from the anticipated higher risks of nonspecified property offerings expressly provided for in Part VI, that the higher risk figure of $5,000 should be applied. There is, however, no definite correlation between a higher price and investor sophistication. See note 86 supra. For example, in Bassan investors paid $10,000 per limited partnership unit despite the unsophisticated nature of the offering. See note 9 supra.
132. But see id. § 460–32A–045(d). Although this section is not within the provisions pertaining strictly to nonspecified property offerings, because it limits the general partner to a price equal to its original acquisition cost on post-formation acquisitions and sales to the partnership, it must be applicable in the "blind pool" context. This section may, depending upon its application, provide the protection necessary in a "blind pool" offering.
the limited partnership commences well before its formation, at the prospective stage; second, as *Bassan* establishes, that the general partner is bound by its representations made to the limited partners in its prospectus and all partnership agreements such that a right or interest not expressly given to the general partner in the agreement will be denied upon formation; third, that the general partner's profits are subordinate to the interest of the limited partnership, and if the specific profit is not disclosed and coexistent with advancing the partnership enterprise it will be disallowed.

These three elements are present in the new Washington Rules for Real Estate Limited Partnerships. The Rules also encompass the Washington court's suggestion in *Bassan* that full and complete disclosure of all elements of general partner profits may be inadequate. Disclosure is the hallmark of the new Washington Rules, with the added dimension of limits beyond which general partner profits and transactions will be presumed unfair to the partnership. It is suggested that the courts may find it useful to examine challenged general partner abuses under the fairness inquiry of the common law arm's length bargain and business opportunity doctrines as well as the presumptions provided by the new Washington Rules. These tools recognize the appeal real estate limited partnership investments have to the unsophisticated investor who requires substantially greater protection than is provided by basic contract rules or full and complete disclosure principles.

*Linda Kelley Ebberson*