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### Notice and Notification Under the Revised Uniform Partnership Act: Some Suggested Changes

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# ARTICLES

## NOTICE AND NOTIFICATION UNDER THE REVISED UNIFORM PARTNERSHIP ACT: SOME SUGGESTED CHANGES

by  
J. Dennis Hynes\*

*This Article addresses the decision by the drafters of the revised Uniform Partnership Act (1996) (RUPA) to reduce the traditional defenses available to partnerships in apparent authority cases. RUPA eliminated the requirement that apparent authority claims against a partnership be based on the claimant's reasonable expectations. Under RUPA a partnership is liable for a partner's unauthorized act even when the claimant had reason to know the act was unauthorized. A defense based on the claimant's knowledge is effective only when the claimant actually knows—is cognitively aware—that the act was unauthorized. This Article argues that this places an unfair burden on innocent partners. It notes that the doctrine of apparent authority rests on the objective theory of contracts and that the approach taken in RUPA is inconsistent with that theory. On a separate but related matter, the Article suggests several technical amendments to the sections of RUPA dealing with constructive notice; the changes would simplify and clarify the language of RUPA.*

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## I. INTRODUCTION

In 1996 the National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated its final version of the revised Uniform Partnership Act (RUPA).<sup>1</sup> RUPA contains many changes to the original Uniform Partnership Act (UPA)<sup>2</sup> and considerably expands the treatment of topics covered in UPA.<sup>3</sup> Among other revisions, a number of changes were made to UPA's notice and notification provisions.<sup>4</sup> In part this involved nothing more than the elaboration of concepts.<sup>5</sup> But some

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<sup>1</sup> Unif. Partnership Act (RUPA) (1996), 6 U.L.A. 1-127 (Supp. 1998). The word "revised" is not in the official title of the Act. Nevertheless, references to the Act as RUPA are widespread in the literature on the Act, in part because RUPA is a convenient and easily pronounced acronym and in part because RUPA is indeed a substantial revision of the Uniform Partnership Act (1914) (UPA).

There are four versions of RUPA. It was promulgated as a uniform act by NCCUSL in 1992, 1993, and 1994, an event unprecedented in NCCUSL history. In 1996 NCCUSL amended RUPA to add limited liability partnership provisions of the full shield variety: if a proper filing is made, partners are shielded from vicarious liability—whether tortious or contractual in nature—for all debts and obligations of their partnership, like shareholders in a corporation are shielded. 6 U.L.A. 6 (Supp. 1998). Its title was changed to "Uniform Partnership Act (1996)" from "Uniform Limited Liability Partnership Act," the title initially given it after adoption of the limited liability provisions. See 6 U.L.A. 1 (Supp. 1998). RUPA has been adopted in 19 jurisdictions to date. 6 U.L.A. 1 (Supp. 1998). Oregon adopted RUPA effective January 1, 1998, see OR. REV. STAT. §§ 67.005-810 (1997), and will repeal UPA effective January 1, 2003, OR. REV. STAT. §§ 68.101-650 (1997). All citations to RUPA are to the amended 1996 version. Page numbers in RUPA citations to 6 U.L.A. refer to pages of the 1998 Cumulative Annual Pocket Part, which contains all of RUPA as amended.

<sup>2</sup> Unif. Partnership Act (UPA) (1914), 6 U.L.A. 238-1011 (1995). At one time UPA was adopted in all states except Louisiana. UPA is now gradually being displaced by RUPA. See *supra* note 1.

<sup>3</sup> RUPA already has generated substantial commentary. The Reporters for RUPA have written several articles discussing the changes made by RUPA. See Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1 (1993) (summarizing the changes made to partnership law by RUPA); Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427 (1991) (discussing policy decisions behind RUPA changes); Donald J. Weidner, *The Revised Uniform Partnership Act Midstream: Major Policy Decisions*, 21 U. TOL. L. REV. 825 (1990) (discussing areas of policy concern with respect to RUPA changes). In addition, there exist a substantial number of articles discussing RUPA's innovative and controversial provisions devoted to the fiduciary duties of partners. See J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 439 n.1 (1997) (citing articles).

<sup>4</sup> See *infra* Part III (discussing RUPA section 102).

<sup>5</sup> The elaboration consisted largely of borrowing heavily from the notification provisions of the Uniform Commercial Code (U.C.C.), thus substantially expanding the text of UPA, but effecting very little change in the underlying concepts. See RUPA § 102 cmt., 6 U.L.A. 32 ("The concepts and definitions of 'knowledge,' 'notice,' and 'notification' draw heavily on Section 1-201(25) to (27) of the Uniform Commercial Code . . .").

changes in terminology were made that, as applied in RUPA section 301,<sup>6</sup> depart from the traditional understanding of the law of apparent authority and result in potentially unfair exposure of partners to liability for fellow partners' unauthorized acts.<sup>7</sup> Also, the sections of RUPA addressing notice to the public contain awkward terminology, seeming to invite fictional reasoning, and could profit from an expansion of the definition of "notice" to include the concept of constructive notice.<sup>8</sup> These changes are the subject of this Article, which proposes several amendments to RUPA's notice provisions.

## II. NOTICE AND NOTIFICATION PROVISIONS IN UPA

The notice and notification provisions in UPA are concise. They read as follows:

### § 3. Interpretation of Knowledge and Notice.

- (1) A person has "knowledge" of a fact within the meaning of this act not only when he has actual knowledge thereof, but also when he has knowledge of such other facts as in the circumstances shows bad faith.
- (2) A person has "notice" of a fact within the meaning of this act when the person who claims the benefit of the notice:
  - (a) States the fact to such person, or
  - (b) Delivers through the mail, or by other means of communication, a written statement of the fact to such person or to a proper person at his place of business or residence.<sup>9</sup>

The above provisions are applied throughout UPA. For the purposes of this Article, the most important section is UPA section 9.<sup>10</sup> UPA's notice provisions have worked effectively during the eighty years that it has served as the foundation of partnership law in this country.

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<sup>6</sup> Section 301 is the key provision in RUPA addressing partners' agency status, including their authority to bind the partnership. *See* RUPA § 301, 6 U.L.A. 46 (Supp. 1998).

<sup>7</sup> *See infra* text accompanying notes 30-39 (discussing the third party's burden to make inquiry when it is relying on apparent authority and the circumstances give it reason to know that the transaction proposed by the partner with whom it is dealing may not be authorized by the firm).

<sup>8</sup> *See infra* text accompanying notes 49-65 (discussing RUPA section 303(e), dealing with recorded statements of authority relating to real property, and sections 704 and 805, providing for statements of dissociation and dissolution).

<sup>9</sup> UPA § 3, 6 U.L.A. 248.

<sup>10</sup> *See infra* Part IV (discussing apparent authority).

### III. NOTICE AND NOTIFICATION PROVISIONS IN RUPA

RUPA considerably expanded the notice and notification provisions of UPA, drawing heavily on similar provisions in the Uniform Commercial Code.<sup>11</sup> The RUPA provisions are set forth immediately below:

#### § 102. Knowledge and Notice.

- (a) A person knows a fact if the person has actual knowledge of it.
- (b) A person has notice of a fact if the person:
  - (1) knows of it;
  - (2) has received a notification of it; or
  - (3) has reason to know it exists from all of the facts known to the person at the time in question.
- (c) A person notifies or gives a notification to another by taking steps reasonably required to inform the other person in ordinary course, whether or not the other person learns of it.
- (d) A person receives a notification when the notification:
  - (1) comes to the person's attention; or
  - (2) is duly delivered at the person's place of business or at any other place held out by the person as a place for receiving communications.
- (e) Except as otherwise provided in subsection (f), a person other than an individual knows, has notice, or receives a notification of a fact for purposes of a particular transaction when the individual conducting the transaction knows, has notice, or receives a notification of the fact, or in any event when the fact would have been brought to the individual's attention if the person had exercised reasonable diligence. The person exercises reasonable diligence if it maintains reasonable routines for communicating significant information to the individual conducting the transaction and there is reasonable compliance with the routines. Reasonable diligence does not require an individual acting for the person to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.
- (f) A partner's knowledge, notice, or receipt of a notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of a notification by the partnership, except in the case of a fraud on

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<sup>11</sup> See *supra* note 5. The comment to RUPA section 102 also states, "The UCC text has been altered somewhat to improve clarity and style, but in general no substantive changes are intended from the UCC concepts. 'A notification' replaces the UCC's redundant phrase, 'a notice or notification,' throughout the Act." RUPA § 102 cmt., 6 U.L.A. 21 (Supp. 1998).

the partnership committed by or with the consent of that partner.<sup>12</sup>

Although the RUPA provisions are far more elaborate than the UPA provisions, the only significant change for purposes of this Article is the definition of the word "knowledge." In RUPA it means a person's actual knowledge.<sup>13</sup> The definition in UPA section 3(1) is more expansive and includes the concept of bad faith knowledge arising from other known facts. This distinction plays a significant role in the treatment of apparent authority under the two acts.<sup>14</sup>

With regard to notice, it is curious that the drafters of RUPA did not include the concept of constructive notice in the section 102(b) definition of notice, in light of the innovative changes made in RUPA relating to the filing of statements of authority,<sup>15</sup> dissociation,<sup>16</sup> and dissolution.<sup>17</sup> UPA did not provide for the filing of any statements, and thus it naturally did not include constructive notice within its definition. As developed below, the failure to include constructive notice within the definition of notice in RUPA results in the awkward use of language, seeming to invite the use of fiction.<sup>18</sup>

#### IV. APPARENT AUTHORITY UNDER UPA AND RUPA

The important doctrine of apparent authority receives different treatment under UPA and RUPA. Apparent authority is covered in UPA section 9(1), which reads as follows:

§ 9. Partner Agent of Partnership as to Partnership Business.

- (1) Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particu-

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<sup>12</sup> RUPA § 102, 6 U.L.A. 31 (Supp. 1998).

<sup>13</sup> "A person 'knows' a fact only if that person has actual knowledge of it. Knowledge is cognitive awareness. That is solely an issue of fact. This is a change from the UPA Section 3(1) definition of 'knowledge' which included the concept of 'bad faith' knowledge arising from other known facts." RUPA § 102 cmt., 6 U.L.A. 21 (Supp. 1998).

<sup>14</sup> See *infra* Part IV.

<sup>15</sup> See RUPA §§ 303, 304, 6 U.L.A. 49-53 (Supp. 1998) (providing for filing statements of partnership authority and of denial).

<sup>16</sup> See RUPA § 704, 6 U.L.A. 90 (Supp. 1998) (providing for filing a statement of dissociation). Dissociation is an innovative concept in RUPA. It provides for the dissociation of a partner from the partnership without causing dissolution of the partnership. See RUPA §§ 601, 801, 6 U.L.A. 74, 87 (Supp. 1998).

<sup>17</sup> See RUPA § 805, 6 U.L.A. 93 (Supp. 1998) (providing for notice by the filing of a statement of dissolution).

<sup>18</sup> See *infra* text accompanying notes 57-62.

lar matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.<sup>19</sup>

The counterpart provision in RUPA is section 301(1), reading as follows:

§ 301. Partner Agent of Partnership.

Subject to the effect of a statement of partnership authority under Section 303:

- (1) Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.<sup>20</sup>

The key difference between the two acts turns on their respective definitions of "knowledge." Under both acts if a partner acts without authorization but within the ordinary course of business, the partnership can be bound to the transaction unless the third party knew the partner lacked authorization. Knowledge under UPA includes "knowledge of such other facts as in the circumstances shows bad faith."<sup>21</sup> Under RUPA the limitation on the third party's power to bind the partnership is also defined in terms of knowledge, but RUPA's definition of knowledge is limited to "cognitive awareness"<sup>22</sup> of the fact at issue—the lack of authority.

It is true that RUPA section 301(1) also includes the phrase "or had received a notification that the partner lacked authority." However, that phrase operates only in a narrow set of circumstances because a notification involves one person (the partnership) taking deliberate steps to inform another person (the third party) of a fact.<sup>23</sup> Notification will not always, or even usually, occur in many transactions involving third parties; the partnership often will not be aware that the transaction between the unauthorized partner and the third party is taking place.

The issue posed by the different meanings of the word "knowledge" in the two acts is this: Does a partnership deserve protection from a partner's unauthorized acts when the third party lacked conscious awareness that the acting partner was unauthorized, but because of suspicious circumstances, had reason to know that the partner was unauthorized? UPA

<sup>19</sup> UPA § 9, 6 U.L.A. 400. Section 9 has three other subsections, but they do not play a significant role for purposes of this Article. *Id.*

<sup>20</sup> RUPA § 301(1), 6 U.L.A. 46 (Supp. 1998).

<sup>21</sup> See UPA § 3(1), 6 U.L.A. 248; see also *supra* Part II.

<sup>22</sup> See RUPA § 102 cmt., 6 U.L.A. 32 (Supp. 1998); see also *supra* note 13.

<sup>23</sup> See RUPA § 102(c), 6 U.L.A. 32 (Supp. 1998); see also *supra* Part II.



appears to answer yes, a partnership should be protected from liability under such circumstances. RUPA seems to call for a negative response because RUPA does not consider what a third party has "reason to know," but instead limits the partnership's defense to a "cognitive awareness" of the lack of authority.

Which act is more consistent with the law of apparent authority and which is more fair to innocent partners? The law of agency can provide guidance on this issue. It plays a significant role in the uniform partnership acts,<sup>24</sup> in large part because partners are regarded as general agents of their partnership.<sup>25</sup> The traditional law of apparent authority, as reflected in the Restatement of Agency, requires that the third party's belief be reasonable.<sup>26</sup> Apparent authority is based on the objective theory of contracts,<sup>27</sup> which is designed to realize the reasonable expectations of a contracting party.<sup>28</sup> Warren Seavey, the principal architect of modern agency law,<sup>29</sup> expresses this limitation in the following way: "A person can not bind a principal to a contract or conveyance because of apparent authority or inherent agency power, if he should know, has reason to know, or has been notified that the agent is not authorized to

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<sup>24</sup> See UPA § 4(3), 6 U.L.A. 250 ("The law of agency shall apply under this act."); RUPA § 104(a), 6 U.L.A. 36 (Supp. 1998) ("Unless displaced by particular provisions of this [Act], the principles of law and equity supplement this [Act]."); RUPA § 104 cmt., 6 U.L.A. 36 (Supp. 1998) ("These supplementary principles encompass . . . the law of agency . . ."); see also RESTATEMENT (SECOND) OF AGENCY § 14A cmt. a (1958) ("[T]he rights and liabilities of partners with respect to each other and to third persons are largely determined by agency principles.").

<sup>25</sup> See RUPA § 301, 6 U.L.A. 46 (Supp. 1998) (stating that "[e]ach partner is an agent of the partnership for the purpose of its business").

<sup>26</sup> See RESTATEMENT (SECOND) OF AGENCY § 8 cmt. c (1958) ("*Belief by third person.* Apparent authority exists only to the extent that it is reasonable for the third person dealing with the agent to believe that the agent is authorized.").

<sup>27</sup> See *id.* § 8 cmt. d. Comment d states:

Apparent authority is based upon the principle which has led to the objective theory of contracts, namely, that in contractual relations one should ordinarily be bound by what he says rather than by what he intends, so that the contract which results from the acceptance of an offer is that which the offeree reasonably understands, rather than what the offeror means. It follows, therefore, that when one tells a third person that another is authorized to make a contract of a certain sort, and the other, on behalf of the principal, enters into such a contract with the third person, the principal becomes immediately a contracting party, with both rights and liabilities to the third person, irrespective of the fact that he did not intend to contract or that he had directed the "agent" not to contract, and without reference to any change of position by the third party.

*Id.*

<sup>28</sup> See 1 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1 at 2 (1963) ("That portion of the field of law that is classified and described as the law of contracts attempts the realization of reasonable expectations that have been induced by the making of a promise.").

<sup>29</sup> Seavey was the Reporter for both editions of the Restatement of Agency.

make it.”<sup>30</sup> Seavey describes “reason to know” and “should know” as follows:

A person has reason to know or should know that an agent is not authorized, if a reasonable person in his position, knowing what he knows or should have learned, would believe or suspect that the agent is not authorized. Thus, where an agent, authorized to execute checks, uses one to pay a personal debt, the creditor has reason to know that the agent is acting improperly. So where one charges to the principal something which the seller should know is for the agent’s personal use, or borrows money which the lender knows will be used for the agent’s own purposes or where previous dealings with the agent should have made him aware of the limits of the agent’s authority.<sup>31</sup>

#### A. *Apparent Authority Under UPA*

It seems safe to conclude that the drafters of UPA were addressing the above limitation of reasonable belief when they added the qualifying phrase “knowledge of such facts as in the circumstances shows bad faith” to the definition of knowledge in section 3(1). The language is a little awkward, but courts have been reading it broadly as expressing the reasonable belief requirement of the objective theory and not as establishing a narrow defense limited to knowledge of or participation in fraud. Thus, when claimants have had “reason to know” from suspicious circumstances of a partner’s lack of authority, they have failed in their claims against a partnership based on apparent authority.

For example, in *Anchor Centre Partners v. Mercantile Bank*,<sup>32</sup> limited partners made eight capital contribution notes to their partnerships evidencing their obligation to contribute capital to the partnerships. KBDC, the corporate general partner, transferred the notes to Mercantile Bank as security for loans to KBDC. The loans were made without a full explanation of the planned disposition of the proceeds and apparently with some suggestion that part of the proceeds were to be a personal loan to KBDC.<sup>33</sup> The bank also was aware that the principal owners of KBDC “were becoming financially unsound in their various operations . . . .”<sup>34</sup>

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<sup>30</sup> WARREN A. SEAVEY, *HANDBOOK OF THE LAW OF AGENCY* § 76 (1964).

<sup>31</sup> *Id.* § 76(E) (citations omitted); *see also* RESTATEMENT (SECOND) OF AGENCY § 9 cmt. d (“A person has reason to know of a fact if he has information from which a person of ordinary intelligence . . . would infer that the fact in question exists or that there is such a substantial chance of its existence that, if exercising reasonable care with reference to the matter in question, his action would be predicated upon the assumption of its possible existence.”).

<sup>32</sup> 803 S.W.2d 23 (Mo. 1991) (en banc).

<sup>33</sup> *Id.* at 31. The court stated, “In disbursing the proceeds of the 1986 loans made to KBDC, Mercantile first paid its loan fees of \$22,000. It next paid off the 1984 loans [to one of the limited partnerships] of \$4,450,000. Finally, the balance of \$2,178,000 was wire transferred to the account of KBDC at another bank.” *Id.* at 29.

<sup>34</sup> *Id.* at 32.

The court concluded that the bank did not have actual knowledge of the unauthorized nature of the loans because the partnership agreements were ambiguous.<sup>35</sup> After stating that a bank is presumed to know that a partner, without the agreement of other partners, has no power to assign specific partnership assets as security for personal debts, the court denied the bank's claim for enforcement of the notes. The court explained:

Taken together, these circumstances were sufficient to . . . put Mercantile on notice that the endorsement and assignment of the eight capital notes amounted to a breach of a fiduciary duty. Given those facts and circumstances, it would take an intentional "closing of the eyes and stopping of the ears" to not recognize what was afoot. The trial court did not err in concluding that the endorsement and assignment of the capital notes was a breach of KBDC's fiduciary duty of which the bank reasonably should have known.<sup>36</sup>

*Hobbs v. Virginia National Bank of Petersburg*<sup>37</sup> involved the enforceability of a bank's loan of a large sum to a small partnership business.<sup>38</sup> After quoting section 9(1) of UPA, the court sent to the finder of fact the issue of the bank's reasonableness in relying on the apparent authority of the

<sup>35</sup> *Id.* at 31. The court explained:

The evidence of actual knowledge of a breach of fiduciary duty to which the Court is referred is the partnership agreements. . . . The partnership agreements are not models of clarity. The most that can be said of [them] is that they are ambiguous in describing what loans may or may not be obtained and what security may or may not be given by the general partner. . . . Third parties dealing with partnerships should not be held to have actual knowledge of limitations on the authority of a partner when such limitations may only be deduced by applying canons of construction. The agreements do not impart actual knowledge to the reader of those documents that the . . . 1986 loans were unauthorized.

<sup>36</sup> *Id.* at 32 (citation omitted). *See also* *Boyd v. Leasing Assocs.*, 516 S.W.2d 485, 490-91 (Tex. App. 1974) (holding a lease against a partnership unenforceable). The court stated:

[The credit manager] knew that Nasa Grill [defendant partnership] was a small restaurant and seated no more than twenty-five or thirty people. He never questioned why a small business of that nature would need a 2-ton truck. . . .

. . . .  
 . . . [W]e find no evidence that [plaintiff] used diligence and discretion in ascertaining the extent of [the apparent partner's] authority [to bind the partnership to a lease of the truck].

*Id.*

<sup>37</sup> 133 S.E. 595, 603 (Va. Ct. App. 1926).

<sup>38</sup> *Id.* at 604. The sum borrowed was \$19,300, evidenced by 18 negotiable notes executed by J.W. Thomas in the name of the partnership. The partnership was in the crockery and chinaware business and was known as the "China Palace." *Id.* It was a small business and the value of its fixtures and stock was about \$4,500. *Id.* at 611. "[T]he total invested capital of the firm amounted to about \$4,500, with debts for merchandise of \$500 . . . ." *Id.* The dissenting opinion noted that the total sum of money borrowed was "entirely out of proportion to the line of credit the firm was entitled . . . ." *Id.* (Christian, J. dissenting). The dissent related to a separate issue, involving partner liability by estoppel.

borrowing partner, Thomas. The court concluded that Thomas clearly had the authority to bind the partnership by executing a note and borrowing money if he had exercised that authority in the usual course of business. Therefore, the court asked: "Were the notes in question here so executed, or do the large sums borrowed, apparently unnecessary for the small business, indicate to a prudent money lender otherwise, or that there was something amiss about the transaction?"<sup>39</sup>

### B. *Apparent Authority Under RUPA*

As noted above, the language of RUPA section 301 appears to limit innocent partners' defenses based on the third party's knowledge to cases in which the third party either had actual knowledge that the transaction was unauthorized or had received a formal notification to the same effect. It would have been a simple matter to use the words "had notice" instead of "knew" in section 301. As defined in RUPA section 102(b)(3), "notice" includes having "reason to know [a fact] exists from all of the facts known to the person at the time in question."<sup>40</sup> It also encompasses a notification, which would have covered the other limiting clause in section 301.<sup>41</sup>

What reasoning lies behind the drafters' decision not to use "notice"? Apparently the drafters of RUPA made a policy decision based on their interpretation of the principle "know your partner."<sup>42</sup> The theory behind this principle, as the drafters viewed it, is that the risk of loss from partner misconduct more appropriately belongs on the partnership than on third parties who do not knowingly participate in or take advantage of the misconduct, whether or not they had reason to know that misconduct was taking place. This philosophy is articulated in the comment to section 301, which states:

[A]s used in the UPA, the term "knowledge" embodies the concept of "bad faith" knowledge arising from other known facts. As used in RUPA, however, "knowledge" is limited to actual knowledge. Thus, RUPA does not expose persons dealing with a partner to the greater risk of being bound by a restriction based on their purported reason to know of the partner's lack of authority from all the facts they did know.<sup>43</sup>

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<sup>39</sup> *Id.* at 603. The court inquired earlier, "Was there anything in the amounts of money borrowed under all the circumstances shown in evidence to arouse suspicion on the part of the bank that Thomas was exceeding the authority which was conferred upon him as a partner to bind the partnership?" *Id.* at 602.

<sup>40</sup> See RUPA § 102(b)(3), 6 U.L.A. 31 (Supp. 1998); see also *supra* Part III.

<sup>41</sup> See RUPA § 102(b)(2), 6 U.L.A. 31 (Supp. 1998).

<sup>42</sup> Robert R. Keatinge, a member of the Colorado Bar Association Partnership Laws Committee that reviewed RUPA for adoption in Colorado, explained this policy decision in a March 8, 1995 meeting of the Committee attended by the author. Keatinge was a key figure in the deliberations of NCCUSL on RUPA.

<sup>43</sup> RUPA § 301 cmt. 2, 6 U.L.A. 46 (Supp. 1998) (citation omitted).

Thus, by removing the defense that the third party's expectation was unreasonable, the drafters of RUPA made a deliberate choice to reduce the customary defenses available in an apparent authority case. This carries the principle "know your partner" too far. The doctrine of apparent authority is based on the objective theory of contracts and should remain consistent with that theory. Granted, the innocent partners send a signal to third parties through their act of appointing the unauthorized partner to the position of partner. By force of statute, this makes the partner a general agent of the firm.<sup>44</sup> But if the third party has reason to know something is amiss, its expectation that the other partners have authorized the transaction is unreasonable. Under that circumstance the third party is the cheapest cost avoider.<sup>45</sup> Considering that, what is gained by enforcing the contract?

Under a literal reading of RUPA section 301, the *Anchor Centre* and *Hobbs* cases would come out differently. The opinions in both cases strongly suggested that the plaintiffs lacked actual knowledge that the loans were unauthorized.<sup>46</sup> There were no facts indicating that the plaintiffs in either case received notification from the partnership involved. This exhausts the defenses of innocent partners under RUPA. Yet in the eyes of the courts in both cases, the suspicious circumstances in the cases fit the test of "reason to know" put forth by Seavey.<sup>47</sup> It seems unfortunate to set a statutory standard that discourages courts from even addressing that inquiry.<sup>48</sup>

## V. CONSTRUCTIVE NOTICE UNDER RUPA

The drafters of RUPA introduced major innovations in the areas of authority and apparent authority by providing for the filing of statements

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<sup>44</sup> See RUPA § 301(1), 6 U.L.A. 46 (Supp. 1998).

<sup>45</sup> The third party is the cheapest cost avoider because it is aware or reasonably should be aware in the course of the particular transaction at issue that something is amiss and requires confirmation with the other partners. The costs to the partnership are more substantial because they involve the costs of general surveillance of all activities of each partner. The partnership and the other partners have no idea that something is amiss in the particular transaction at issue, and thus they are not in a position to react to it and bring the particular unauthorized transaction to a halt.

<sup>46</sup> See *supra* notes 35, 39 and accompanying text.

<sup>47</sup> See *supra* notes 30-31 and accompanying text.

<sup>48</sup> Realistically, courts may simply ignore the literal language of section 301 and continue to apply the standards that have been applied under UPA. This may be so, but why not redraft the statute to make it clear that the standards under UPA will continue? This argument proved persuasive to the Colorado Bar Association Partnership Laws Committee, which redrafted section 301 to substitute the words "had notice" for the phrase "knew or received a notification." See COLO. REV. STAT. § 7-64-301(a) (1997). See also *infra* text accompanying note 71 (containing a recommended revision of section 301 incorporating the "reason to know" defense under apparent authority by utilizing the word "notice").

with a central repository.<sup>49</sup> RUPA provides for filing statements of authority,<sup>50</sup> dissociation,<sup>51</sup> and dissolution.<sup>52</sup> Statements of dissociation and dissolution both utilize constructive notice:<sup>53</sup> ninety days after filing either statement, a departing partner's lingering apparent authority is terminated, regardless of the good faith expectations of creditors who had either known of or previously dealt with the partner.<sup>54</sup> The doctrine of constructive notice also exists in statements of authority, but it plays a more limited role there.<sup>55</sup> Only with regard to real property do such statements cut off apparent authority, and then only if the statement is recorded in the county where the real property is located.<sup>56</sup>

Paradoxically, RUPA section 102(b) does not include the concept of constructive notice in its definition of notice. This omission results in the use of some awkward terminology when describing the consequences of filing certain statements under RUPA. For example, section 703(b)(3)<sup>57</sup>

<sup>49</sup> See RUPA § 105(a), 6 U.L.A. 36 (Supp. 1998). Section 105(a) designates the Secretary of State as the repository for statements. Statements of authority concerning real property must also be filed with the local clerk and recorder of the county where the real property is located. See also RUPA § 303(d)(2), 6 U.L.A. 49 (Supp. 1998) (allowing recording of a certified copy of a filed statement granting authority to a partner).

<sup>50</sup> RUPA § 303, 6 U.L.A. 49 (Supp. 1998); see also RUPA § 304, 6 U.L.A. 52 (Supp. 1998) (providing for a statement of denial of authority by a partner or a person named as a partner).

<sup>51</sup> RUPA § 704, 6 U.L.A. 86 (Supp. 1998).

<sup>52</sup> RUPA § 805, 6 U.L.A. 93 (Supp. 1998).

<sup>53</sup> The phrase "constructive notice" is defined as "a presumption of law, making it impossible for one to deny the matter concerning which notice is given." BLACK'S LAW DICTIONARY 1211 (4th ed. 1951). It is used in the comments to RUPA. See RUPA § 805 cmt. 3, 6 U.L.A. 94 (Supp. 1998) ("[T]hus, after 90 days the statement of dissolution operates as constructive notice conclusively limiting the apparent authority of partners to transactions that are appropriate for winding up the business.").

<sup>54</sup> See RUPA § 805(c), 6 U.L.A. 93 (Supp. 1998) ("For the purposes of Sections 301 and 804 [addressing partner's power to bind partnership after dissolution], a person not a partner is deemed to have notice of the dissolution and the limitation on the partners' authority as a result of the statement of dissolution 90 days after it is filed.").

<sup>55</sup> With regard to *expansion* of authority, however, the mere filing of a statement with the Secretary of State constitutes a conclusive grant of authority in favor of a person who gives value without knowledge to the contrary. RUPA § 303(d)(1), 6 U.L.A. 49 (Supp. 1998).

<sup>56</sup> RUPA § 303(e), 6 U.L.A. 50 (Supp. 1998).

<sup>57</sup> Section 703, Dissociated Partner's Liability to Other Persons, in relevant part, reads:

- (b) A partner who dissociates without resulting in a dissolution and winding up of the partnership business is liable as a partner to the other party in a transaction . . . [if] the other party:
  - (1) reasonably believed that the dissociated partner was then a partner;
  - (2) did not have notice of the partner's dissociation; and
  - (3) is not deemed to have had knowledge under Section 303(e) or notice under Section 704(c).

states that a partner who dissociates is liable for two years following the dissociation only if the other party "*is not deemed to have had knowledge under Section 303(e) or notice under Section 704(c).*"<sup>58</sup> The terminology "deemed to have had" knowledge or notice is awkward. It sounds archaic and fictional.

It seems strange, furthermore, to use the word "knowledge" when dealing with notification from a valid recording. The Restatement of Agency, reflecting conventional usage, defines notification as "a juristic act which determines the rights of the parties, sometimes irrespective of knowledge by the recipient. It may be given to all persons . . . by filing a writing in a specified place, as the recording of a deed."<sup>59</sup> Also, why is "knowledge" used in the first part of RUPA section 703(b)(3), which refers to section 303(e), and "notice" used in the second part, which refers to section 704(c), when both sections deal with a notification based on a public filing?<sup>60</sup> Finally, section 301(1) cuts off apparent authority for "ordinary" business of the partnership only if the third person "knew or had received a notification" that the partner lacked authority.<sup>61</sup> How does that requirement mesh with sections 303(e) and 704(c), both of which cut off apparent authority but neither of which contemplates "receipt" of notification as that is defined in section 102(d)?<sup>62</sup>

The above awkward language appears in RUPA because RUPA does not include constructive notice in its definition of notice.<sup>63</sup> The com-

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RUPA § 703(b), 6 U.L.A. 84 (Supp. 1998).

<sup>58</sup> RUPA § 703(b)(3), 6 U.L.A. 88 (Supp. 1998) (emphasis added). Section 303(e) reads as follows:

A person not a partner is deemed to know of a limitation on the authority of a partner to transfer real property held in the name of the partnership if a certified copy of the filed statement containing the limitation on authority is of record in the office for recording transfers of that real property.

RUPA § 303(e), 6 U.L.A. 50 (Supp. 1998).

Section 704 reads as follows:

Statement of Dissociation.

- (a) A dissociated partner or the partnership may file a statement of dissociation stating the name of the partnership and that the partner is dissociated from the partnership.
- (b) A statement of dissociation is a limitation on the authority of a dissociated partner for the purposes of Section 303(d) and (e).
- (c) For the purposes of Sections 702(a)(3) and 703(b)(3), a person not a partner is deemed to have notice of the dissociation 90 days after the statement of dissociation is filed.

RUPA § 704, 6 U.L.A. 86 (Supp. 1998).

<sup>59</sup> RESTATEMENT (SECOND) OF AGENCY § 9 cmt. f (1958).

<sup>60</sup> Section 303(e) deals with a recorded statement; section 704(c) deals with a statement filed with the Secretary of State.

<sup>61</sup> RUPA § 301(1), 6 U.L.A. 46 (Supp. 1998).

<sup>62</sup> See RUPA §§ 303(e), 704(c), 6 U.L.A. 40, 86 (Supp. 1998).

<sup>63</sup> As noted earlier, UPA also failed to include constructive notice in its definition of notice, but it did not provide for the filing of statements and thus had no need to address that concept. See also *supra* text following note 17.

ments to RUPA section 102 suggest an explanation for the failure to include constructive notice: "Generally, under RUPA, statements filed pursuant to section 105 do not constitute constructive knowledge or notice, except as expressly provided in the Act."<sup>64</sup> Doubtless the comment is referring to the fact that statements of authority are not constructive notice to others with respect to *limitations* on partners' authority, except with regard to recorded statements dealing with real property. But that qualification could be handled by explicit references to the sections that do provide constructive notice.<sup>65</sup> Under such circumstances the word "notice" could safely be used in the relevant sections. Admittedly, this is a linguistic point. The intent behind the existing language would be clear to most courts. Nevertheless, the text could be improved and given a more modern and understandable tone. The following Part contains an illustration of the increased clarity through use of the full definition of notice.

## VI. SUGGESTED REVISIONS OF RUPA

Contained below are suggested revisions of RUPA, commencing with an expansion of section 102(b) to incorporate the concept of constructive notice, as recommended in the above text. Colorado enacted many of the following revisions into law when RUPA was adopted in 1997.<sup>66</sup> The revisions followed a lengthy study of RUPA by the Partnership Laws Subcommittee of the Colorado Bar Association.<sup>67</sup>

### § 102.<sup>68</sup> Knowledge and Notice.

. . . .

(b) A person has notice of a fact ~~if the person~~:

- (1) If the person knows of it;
- (2) If the person has received a notification of ~~it~~ the fact;
- (3) If the person has reason to know it exists from all of the facts known to the person at the time in question;  
or
- (4) by reason of a filing or recording to the extent provided by and subject to limitations set forth in subsections 303(d), 303(e), 704(c) or 805(c).<sup>69</sup>

<sup>64</sup> RUPA § 102 cmt., 6 U.L.A. 32 (Supp. 1998).

<sup>65</sup> See *infra* Part VI (containing the recommended changes to section 102, identified by underscore and strikeout).

<sup>66</sup> See COLO. REV. STAT. §§ 7-64-101 to -1206 (1997). The amendments became effective January 1, 1998.

<sup>67</sup> The author was corecorder (along with Professor Emeritus Clifford Calhoun) for the Subcommittee.

<sup>68</sup> Citations conform to the numbering of RUPA.

<sup>69</sup> See COLO. REV. STAT. § 7-64-102(2).



It is recommended that the following conforming amendments be made to RUPA. Most of these amendments respond to the expanded definition of notice contained above in section 102(b)(4).<sup>70</sup>

§ 301. Partner Agent of Partnership.

Subject to the effect of a statement of partnership authority under Section 303:

- (1) Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing had notice ~~knew or received a notification~~ that the partner lacked authority.<sup>71</sup>

§ 302. Transfer of Partnership Property.

- ....
- (b) A partnership may recover partnership property from a transferee only if it proves that execution of the instrument of initial transfer did not bind the partnership under Section 301 and:
    - (1) as to a subsequent transferee who gave value for property transferred under subsection (a)(1) or (2), proves that the subsequent transferee had notice ~~knew or received a notification~~ that the person who executed the instrument of initial transfer lacked authority to bind the partnership; or
    - (2) as to a transferee who gave value for property transferred under subsection (a)(3), proves that the transferee had notice ~~knew or received a notification~~ that the property was partnership property and that the

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<sup>70</sup> Interestingly, Colorado has further amended section 102 to expand RUPA's subsection (d) in order to define more clearly the expectation-based standard underlying the giving and receiving of notice. COLO. REV. STAT. § 7-64-102(4). The change reads as follows (citations conform to the numbering of RUPA):

§ 102(d) A person receives a notification when the notification:

- (1) comes to the person's attention; or
- (2) is ~~duly delivered~~ received at the person's place of business or at any other place held out by the person as a place for receiving communications, or is received by a person who is apparently authorized to receive the notification;  
or
- (3) has been given and the circumstances are such that it is fair and reasonable, as against the person to whom such notice has been given, to treat the notice as having been received.

<sup>71</sup> This change responds to the arguments made above recommending that RUPA include the "reason to know" defense under apparent authority. *See supra* text accompanying notes 41-48. It does not directly involve the recommended expanded definition of notice because even the current definition of notice in RUPA would trigger the "reason to know" limitation. *See supra* text accompanying note 40.

person who executed the instrument of initial transfer lacked authority to bind the partnership.<sup>72</sup>

§ 303. Statement of Partnership Authority.

....

(d) Except as otherwise provided in subsection (g), a filed statement of partnership authority supplements the authority of a partner to enter into transactions on behalf of the partnership as follows:

(1) Except for transfers of real property, a grant of authority contained in a filed statement of partnership authority is conclusive in favor of a person who gives value without notice ~~knowledge or receiving notification~~ to the contrary, so long as and to the extent that a limitation on that authority is not then contained in another filed statement. A filed cancellation of a limitation on authority revives the previous grant of authority.

(2) A grant of authority to transfer real property held in the name of the partnership contained in a certified copy of a filed statement of partnership authority recorded in the office for recording transfers of that real property is conclusive in favor of a person who gives value without having notice ~~knowledge~~ to the contrary, so long as and to the extent that a certified copy of a filed statement containing a limitation on that authority is not then of record in the office for recording transfers of that real property.

(e) A person not a partner has notice ~~is deemed to know~~ of a limitation on the authority of a partner to transfer real property held in the name of the partnership if a certified copy of a filed statement containing the limitation on authority is of record in the office for recording transfers of that real property.

(f) Except as otherwise provided in subsections (d) and (e) and in subsections 704 and 805, a person not a partner does not have notice ~~is not deemed to know~~ of a limitation on the authority of a partner merely because the limitation is contained in a filed statement.

§ 702. Dissociated Partner's Power to Bind and Liability to Partnership.

(a) For two years after a partner dissociates without resulting in a dissolution and winding up of the partnership business, the partnership, including a surviving partnership under [Article] 9, is bound by an act of the dissociated partner which would have bound the partnership under Section 301 before dissociation only if at the time of entering into the transaction the other party:

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<sup>72</sup> See COLO. REV. STAT. § 7-64-302.

- (1) reasonably believed that the dissociated partner was then a partner; and
- (2) did not have notice of the partner's dissociation. ~~;~~ and
- ~~(3) is not deemed to have had knowledge under Section 303(c) or notice under Section 704(c).~~<sup>73</sup>

#### § 703. Dissociated Partner's Liability to Other Persons.

....

- (b) A partner who dissociates without resulting in a dissolution and winding up of the partnership business is liable as a partner to the other party in a transaction entered into by the partnership, or a surviving partnership under [Article] 9, within two years after the partner's dissociation, only if the partner is liable for the obligation under Section 306 and at the time of entering into the transaction the other party:
  - (1) reasonably believed that the dissociated partner was then a partner; and
  - (2) did not have notice of the partner's dissociation. ~~;~~ and
  - ~~(3) is not deemed to have had knowledge under Section 303(c) or notice under Section 704(c).~~<sup>74</sup>

#### § 704. Statement of Dissociation.

....

- (c) For the purposes of Sections 702(a)(2) and 703(b)(2), a person not a partner ~~is deemed to have~~ has notice of the dissociation 90 days after the statement of dissociation is filed.<sup>75</sup>

#### § 802. Partnership Continues After Dissolution.

....

- (b) At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners, including any dissociating partner other than a wrongfully dissociating partner, may waive the right to have the partnership's business wound up and the partnership terminated. In that event:
  - (1) the partnership resumes carrying on its business as if dissolution had never occurred, and any liability incurred by the partnership or a partner after the dis-

<sup>73</sup> Subsection 702(a)(3) is deleted because the concept addressed there—constructive notice under sections 303 and 704—is now picked up under subsection 702(a)(2) as a result of the expanded section 102(b) definition of notice.

<sup>74</sup> Subsection 703(b)(3) is deleted because, as explained in note 73, *supra*, concerning section 702(a)(3), constructive notice is now covered by subsection 703(b)(2).

<sup>75</sup> The cross-references in section 704(c) have been changed to conform the language to the changes made in sections 702 and 703; subsection (3) of sections 702 and 703 is deleted on the ground of redundancy; subsection (2) now uses the word "notice" in its expanded sense.

solution and before the waiver is determined as if dissolution had never occurred; and

- (2) the rights of a third party accruing under Section 804(1) or arising out of conduct in reliance on the dissolution before the third party has notice ~~knew or received a notification~~ of the waiver may not be adversely affected.

#### § 805. Statement of Dissolution.

....

- (c) For the purposes of Sections 301 and 804, a person not a partner ~~is deemed to have~~ has notice of the dissolution and the limitation on the partners' authority as a result of the statement of dissolution 90 days after it is filed.

#### § 1006. Applicability.

....

- (c) Before January 1, 199\_, a partnership voluntarily may elect, in the manner provided in its partnership agreement or by law for amending the partnership agreement, to be governed by this [Act]. The provisions of this [Act] relating to the liability of the partnership's partners to third parties apply to limit those partners' liability to a third party who had done business with the partnership within one year preceding the partnership's election to be governed by this [Act], only if the third party has notice ~~knows or has received a notification~~ of the partnership's election to be governed by this [Act].

### VII. CONCLUSION

In summary, although RUPA makes many improvements in the law of partnership, some modest changes to its notice and notification provisions may assist in making its meaning even more clear. Also, a slight change in wording would improve section 301, the basic agency and authority section of RUPA. By utilizing the word "notice," section 301 would incorporate basic principles of the doctrine of apparent authority and place appropriate and measured responsibility onto persons dealing with partners. This Article proposes amendments to RUPA that would bring about these improvements.