STARTUP PARTNERSHIPS

CHRISTINE HURT

INTRODUCTION 2488
I. FROM HERE TO PROFITABILITY 2493
A. Facebook, Inc. 2494
B. Snap Inc. 2496
C. Urban Decay, LLC 2497
II. STARTUP PARTNERSHIPS 2499
A. Forming a General Partnership 2500
1. The "De Facto" Partnership Doctrine 2501
2. State Law Tests 2505
B. The Consequences of General Partnership 2507
1. Partner v. Partner 2508
2. Partner v. Third Party 2513
III. IN DEFENSE OF THE "DE FACTO" PARTNERSHIP 2516
A. Default Categorization as Necessary Backstop 2516
1. Intentional, Informal General Partnership 2517
2. Intentional, Pre-formal General Partnership 2518
3. Default Partnership Doctrine Is Limited by Definition 2518
B. Viable Alternatives to UPA/RUPA Default Partnership Status Are Lacking 2520
1. The De Facto Corporation Doctrine 2520
2. Why Not Contract Law? 2524
3. Why Not Property Law? 2527
4. Why Not Copyright Law? 2528
C. The General Partnership Form Is Not Obsolete 2530
1. Limited Liability Preference 2531
2. Elimination of Fiduciary Duties Preference 2531
D. Partnership Law and Theory of the Firm 2532
E. Partnership Law and the Covenant Not to Compete 2533
IV. AVOIDING IMPLIED PARTNERSHIP STATUS 2536
A. Agreeing Not to Agree 2536
B. The Pre-organization Danger Zone 2537
CONCLUSION 2538

STARTUP PARTNERSHIPS

CHRISTINE HURT*

Abstract: Every business firm that is created must be categorized as some type of entity from the moment it begins to have value, either positive value or negative value. For many firms, the entity is simply a sole proprietorship. But if there is not a "sole" owner, then the entity must be something else, and if the owners have not incorporated as a corporation, limited liability company, or limited partnership, then that "something else" is a general partnership. In this way, the most important law that governs startup companies may in fact be partnership law. Through the application of state partnership law to a nascent venture, parties will have the right to an equal share of profits if not specified, have the right to co-manage the venture, and owe fiduciary duties to one another, including the duty of confidentiality and the duty not to compete with the venture. Most disputes that arise in which one party alleges an informal partnership involve relatives, former romantic partners, or acquaintances in small businesses. Some of these informal partnership cases, however, involve joint ventures between business giants and even billion-dollar technology startups. Though parties may find it surprising that the business idea they have been working on with acquaintances, friends, or even competitors is a general partnership, the legal doctrine that compels this result preserves expectations, protects the vulnerable from opportunistic venturers, and encourages entrepreneurship and information sharing.

INTRODUCTION

Business entity law may not seem as existential as other areas of legal inquiry, but at its core is a compelling mystery: when does a business begin?

The law can pinpoint the beginning of an incorporated entity by its incorporation date, whether the entity is a corporation,[1] a limited partnership,[2]

© 2020, Christine Hurt. All rights reserved.

* George Sutherland Chair, Professor of Law, Brigham Young University Law School. The author would like to thank Clark Asay, Deborah DeMott, Jessica Erickson, Joseph K. Leahy, Thomas E. Rutledge, D. Gordon Smith, Jeff Schwartz, Andrew Tuch, and Verity Winship for their helpful insights. In addition, this paper was greatly improved by discussions at the Corporate and Securities Litigation Conference, the Fiduciary Law Workshop, and the 2019 Law and Society Conference.

[1] *See, e.g.*, ME. REV. STAT. ANN. tit. 13-B, § 405(2) (2019) ("The existence of the corporation shall begin as of the filing date of the articles of incorporation, endorsed by the Secretary of State upon the articles filed as provided by section 106."); OHIO REV. CODE ANN. § 1701.04(D) (West

or a limited liability company.[3] These entities do not begin from a legal standpoint until the filing of particular documents and the processing of that filing by a state governmental office. In reality though, the incorporation of an entity may come at the end of, or at least in the middle of, discussions, negotiations, agreements, and other activities among and between future founders of corporations (or limited liability companies or limited partnerships). When the ultimate entity is formed, then it subsumes the activities and agreements that preceded it, perhaps in a formal ratification process.[4] Participants determine the ownership structure, management roles, and governance rules, or take the "off-the-rack" structure provided by the applicable state statute. The informal business becomes the formal entity.

The business "firm," however, began as a business "idea," and the informal business operates for at least some period of time before the creation of a formal business firm. Sometimes the informal business at the beginning does not mirror the ultimate entity, or at least not with the same parties that were involved in the beginning. Something happens on the way to the incorporation altar, with some parties participating in the formal venture, and others not.[5] Expectations were formed; positions may have changed; and money or other property may have been contributed to the venture, in addition to time, labor, and ideas. Post-incorporation profits may be generated, but the original founders of the business may not be allowed to share in the profits of that business with the founding incorporators.

The new corporation seeks to create a new origin story, one that begins much later than the actual founding of the business. The new origin story not only denies credit to the original founders on a website's "About Us" page, but also the ability to share in the profits, the seeds of which may have been planted by them.[6] Corporate law has various doctrines that pro-

---

2019) ("The legal existence of the corporation begins upon the filing of the articles or on a later date specified in the articles that is not more than ninety days after filing . . . .").

[2] *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-201(b) (West 2019) ("A limited partnership is formed at the time of the filing of the initial certificate of limited partnership in the Office of the Secretary of State or at any later date or time specified in the certificate of limited partnership if, in either case, there has been substantial compliance with the requirements of this section.").

[3] *See, e.g.*, KY. REV. STAT. ANN. § 275.020(2) (West 2019) ("Unless a delayed effective date is specified, the existence of the limited liability company shall begin when the articles of organization are filed by the Secretary of State."); UNIF. LTD. LIAB. CO. ACT § 201(d) (UNIF. LAW COMM'N 2006, amended 2013) ("A limited liability company is formed when the certificate of organization becomes effective and at least one person has become a member.").

[4] *See* MODEL BUS. CORP. ACT § 1.46 (AM. BAR ASS'N 2016).

[5] *See* Paul R. Tremblay, *The Ethics of Representing Founders*, 8 WM. & MARY BUS. L. REV. 267, 300 (2017) (describing startup "drift," which includes "some participants drifting away to other projects and new helpers showing up").

[6] *Compare About Us*, URBAN DECAY, https://www.urbandecay.com/about-us.html [https://perma.cc/84dj-gbac] (declaring Wende Zomnir a "founding partner" who, with "her co-conspira-

tect shareholders of incorporated entities from certain pre-incorporation activities and also allow shareholders to benefit from those activities.[7] These doctrines only protect official shareholders, however, not jilted, would-be shareholders.

Perhaps surprisingly, a partnership doctrine may help these parties, even though the parties never considered themselves a partnership. Under general partnership law embodied in state statutes, parties form a general partnership (GP) if they agree to co-own a business for profit, and this agreement does not need to be written or formalized in any way.[8] In fact, parties even may disclaim that they are creating a partnership, but the law will treat the entity as such if the arrangement has the requisite incidents of partnership.[9] These statutory provisions give rise to partnerships known by different names: de facto partnerships;[10] implied partnerships;[11] default partnerships;[12] oral partnerships;[13] and informal partnerships.[14] This Article generally refers to these

---

tors[,] unleashed a line of lipsticks and nail enamels inspired by seedier facets of the urban landscape"), *with* Holmes v. Lerner, 88 Cal. Rptr. 2d 130, 135 (Ct. App. 1999) ("An early press release stated: 'The idea for Urban Decay was born after [Sandy] Lerner and her horse trainer, Pat Holmes, were sitting around in the English countryside.'").

[7] For a discussion of the de facto corporation doctrine, see *infra* Part III.B.1.

[8] REVISED UNIF. P'SHIP ACT § 202(a) (UNIF. LAW COMM'N 1997, amended 2013) ("Except as otherwise provided in subsection (b), the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership."); UNIF. P'SHIP ACT § 6(1) (UNIF. LAW COMM'N 1914) ("A partnership is an association of two or more persons to carry on as co-owners a business for profit.").

[9] *See* REVISED UNIF. P'SHIP ACT § 202 cmt. (explaining that "[t]he addition of the phrase 'whether or not the persons intend to form a partnership'" in section 202(a) of the Revised Uniform Partnership Act (RUPA) codifies the judicial interpretation of subsection 6(1) of the Uniform Partnership Act (UPA): that parties "may inadvertently create a partnership despite their expressed subjective intention not to do so").

[10] *See, e.g.*, Parker v. N. Mixing Co., 756 P.2d 881, 884 (Alaska 1988); Persson v. Smart Inventions, Inc., 23 Cal. Rptr. 3d 335, 347 (Ct. App. 2005); Fournie v. Fournie Contracting Co., Inc., No. 5-15-0283, 2016 WL 4399801, at *3 (Ill. App. Ct. Aug. 17, 2016); Butler v. Sudderth, 784 So. 2d 125, 127–28 (La. Ct. App. 2001); Best Cartage, Inc. v. Stonewall Packaging, LLC, 727 S.E.2d 291, 299 (N.C. Ct. App. 2012) (holding that the trial court erred in dismissing the plaintiff's claims of "de facto partnership"); Pertuis v. Front Roe Rests., Inc., 817 S.E.2d 273, 281 (S.C. 2018) (reversing the lower court's finding that three S corporations operated as a "de facto partnership").

[11] *See, e.g.*, Schauf v. Schauf, 107 P.3d 1237, 1239 (Kan. Ct. App. 2005); Montgomery v. Montgomery, 181 S.W.3d 720, 727 (Tenn. Ct. App. 2005); Big Easy Cajun Corp. v. Dallas Galleria Ltd., 293 S.W.3d 345, 349 (Tex. App. 2009); Vasquez v. Hawthorne, 33 P.3d 735, 737 (Wash. 2001).

[12] Courts have not used the term "default" to describe these partnerships, but scholars have done so. *See, e.g.*, Jeanne M. Rickert, *Ohio's New Partnership Law*, 57 CLEV. ST. L. REV. 783, 808 (2009) ("Partnership law is most important for 'default' partnerships. These are informal relationships, often formed without the benefit of legal advice.").

[13] *See, e.g.*, Mabry v. Pelton, 432 S.E.2d 588, 589 (Ga. Ct. App. 1993); Finkel v. Firestone, 958 N.Y.S.2d 435, 435 (App. Div. 2013).

types of nonregistered general partnerships as default partnerships, informal partnerships, or implied partnerships. Though catchy, the "de facto partnership" label is misleading because these partnerships are "de jure" in that they are formed according to the provisions of the statute.[15]

Once the law recognizes the parties as partners in a general partnership, then all the rights and obligations of partnership govern their relations to one another. Partners owe fiduciary duties to one another,[16] have the right to co-manage the business, have the right to an equal share of profits,[17] and have the obligation to contribute toward partnership losses.[18] Under this doctrine, would-be owners in potential, but unformed, entities may have an avenue of redress after being forced out of the business prior to incorporation. Though corporations may fire officers, vote out directors, and terminate employment relationships largely with impunity,[19] partners do not have the same latitude to expel partners.[20] Partners who shut out partner cofounders may be liable for breaching fiduciary duties and forced to give ousted partners the value of their liquidated share.

The default partnership is not just a theory or an occasional rarity in everyday life; it continues to rear its head in cases involving both inexperienced contract parties and the most sophisticated business players.[21] The doctrine protects all types of individuals and organizations that do business

---

[14] *See, e.g.*, Balt. St. Builders v. Stewart, 975 A.2d 271, 276–77 (Md. Ct. Spec. App. 2009); Krause v. Becker, No. 48051, 2008 WL 6102036, at *1 (Nev. July 21, 2008); McCord v. Goode, 308 S.W.3d 409, 412 (Tex. App. 2010); *see also* Val Ricks, *Self-help in the Break-up of Informal Partnerships*, 12 DEPAUL BUS. & COMM. L.J. 259, 285–86 (2014) (discussing informal partnerships in the context of the Texas General Partnership Law).

[15] *See Persson*, 23 Cal. Rptr. 3d at 347 ("Preliminarily, the term 'de facto partnership' is not one found in any California case."). The court in *Persson v. Smart Inventions, Inc.* reasoned that because a partnership is defined by statute and in the common law, any partnership that meets the factors of the statute or common law is a partnership under law, and "any partnership without a written agreement is a 'de facto' partnership." *See id.*

[16] REVISED UNIF. P'SHIP ACT § 409(a) ("A partner owes to the partnership and the other partners the duties of loyalty and care . . . .").

[17] *Id.* § 401(a) ("Each partner is entitled to an equal share of the partnership distributions and, except in the case of a limited liability partnership, is chargeable with a share of the partnership losses in proportion to the partner's share of the distributions.").

[18] *See id.*

[19] For a discussion regarding shareholder oppression, see *infra* note 124 and accompanying text.

[20] *See* REVISED UNIF. P'SHIP ACT § 601(3), (4) (providing that a partner may be expelled only pursuant to a partnership agreement or upon a unanimous vote under a specific set of circumstances).

[21] *See, e.g.*, Joseph K. Leahy, *An LLC Is the Key: The False Dichotomy Between Inadvertent Partnerships and the Freedom of Contract*, 52 TEX. TECH L. REV. 243, 245–47 (2020) (discussing a default partnership case recently before the Texas Supreme Court involving two large energy companies).

with each other on a handshake basis: spouses,[22] parents and children,[23] siblings,[24] unmarried romantic partners,[25] friends,[26] and business acquaintances.[27] Occasionally, it can help even sophisticated market participants

[22] *See, e.g.*, Kautzman v. Kautzman, 585 N.W.2d 561, 565–66 (N.D. 1998) (upholding the district court's finding of the existence of a financial partnership regarding a property distribution in a divorce proceeding where the wife's pre-marital savings were used to start a business, and she did most of the bookwork and shared the profits).

[23] *See, e.g.*, *Schauf*, 107 P.3d at 1242; *In re* Moon Estate, No. 294176, 2011 WL 254934, at *5–6 (Mich. Ct. App. Jan. 27, 2011) (affirming the probate court's finding of the existence of a father-son farming partnership and reasoning that stricter proof is unnecessary to find partnerships among family members, despite the argument that the father was merely helping out his son without expectation of an ownership stake).

[24] *See, e.g.*, Villanueva v. Villanueva, No. FSTCV186037228S, 2019 WL 6327396, at *3 (Conn. Super. Ct. Oct. 30, 2019) (finding a partnership between two brothers despite the long-running business being run through a limited liability company (LLC) owned by one brother alone because the other brother did not have a tax identification number); Vargo v. Clark, 716 N.E.2d 238, 242–43 (Ohio Ct. App. 1998) (upholding the lower court's findings that a wife's sister was a co-venturer in a husband-wife grocery store and reasoning that although performance of services by a family member does not alone justify an implied contract for payment, the contract was supported by other evidence of a joint venture); Nguyen v. Hoang, 507 S.W.3d 360, 372–75 (Tex. App. 2016) (affirming the trial court's finding that a partnership existed where siblings and their spouses co-owned a chicken farm).

[25] *See, e.g.*, Bass v. Bass, 814 S.W.2d 38, 44 (Tenn. 1991); Story v. Lanier, 166 S.W.3d 167, 170, 175, 178–79 (Tenn. Ct. App. 2004); *Vasquez*, 33 P.3d at 738; *see also* Wayne v. Byrens, B227575, 2012 WL 1925410, at *1 (Cal. Ct. App. May 29, 2012) (upholding the trial court's determination that no implied partnership existed, but granting the plaintiff-boyfriend $1.5 million under the theory that the girlfriend fraudulently induced him into believing there was a partnership and quantum meruit).

[26] *See, e.g.*, Rothenberger v. Green, No. SACV 13-174-JST (JPRx), 2013 WL 12130035, at *1–2 (C.D. Cal. May 13, 2013) (alleging that writing partner Rothenberger breached his partnership duties by selling the script for the movie *Olympus Has Fallen*, which he co-wrote and revised over several years with his long-time friend, Green, who had worked with him on multiple projects). To date, the movie has spawned two sequels: *London Has Fallen* (2016) and *Angel Has Fallen* (2019). *See* Ben Kenigsberg, *Summer Movies 2019: Here's What's Coming Soon to Theaters*, N.Y. TIMES (May 23, 2019), https://www.nytimes.com/2019/05/23/movies/summer-movies.html [https://perma.cc/N4P7-L2Y8]. Green alleged both violation of copyright law and breach of partnership duties, and the parties eventually settled for $175,000 and future economic rights in the film. *See Rothenberger*, 2013 WL 12130035, at *2; Bausch v. Green, No. 1835 EDA 2017, 2018 WL 1475693, at *1–2 (Pa. Super. Ct. Mar. 27, 2018). Perhaps ironically, Green then had to split his share with his former wife during their divorce proceedings. *See Bausch*, 2018 WL 1475693, at *2, *4.

[27] *See, e.g.*, Kahn Creative Partners, Inc. v. Nth Degree, Inc., No. CV 10-932 JST (FFMx), 2011 WL 1195680, at *1–2 (C.D. Cal. Mar. 29, 2011) (denying the defendant's motion for summary judgment as to the implied partnership cause of action). Prior to trial, the parties settled the implied partnership claim. *See* Stipulation to Dismissal with Prejudice of Plaintiff's Complaint at 1, *Kahn Creative Partners, Inc.*, 2011 WL 1195680 (No. CV 10-932 JST (FFMx)), 2011 WL 8066539.

who have not quite "defined the relationship"[28] with other participants.[29] Though the doctrine may be seen as a last-ditch weapon of embittered malcontents, it is actually a useful legal backstop, one that is necessary to create a climate of entrepreneurship and encourage collaboration and innovation.[30] This Article examines the uses of partnership doctrine and analyzes how parties can and cannot contract around the doctrine to create the pre-incorporation rights and obligations they intend. Part I provides recent and notable examples of litigation in the shadow of the default partnership doctrine: Facebook, Inc.; Snap Inc.; and Urban Decay.[31] Part II provides necessary background on the partnership statutory provisions that outline the default partnership doctrine and its judicial interpretations.[32] Part III provides a defense of the doctrine as necessary to innovation, collaboration, and entrepreneurship while exploring alternative legal theories that could arguably replace the doctrine.[33] Finally, Part IV gives practical suggestions on how contracting parties can avoid any undesired result the default partnership doctrine may cause.[34]

I. FROM HERE TO PROFITABILITY

When hopeful entrepreneurs devise a formal or informal plan to start a business, they may not be focusing on creating a business entity but instead

---

[28] *See generally DTR*, Urban Dictionary, https://www.urbandictionary.com/define.php?term=DTR [https://perma.cc/WU3H-MGJ8] ("Define The Relationship. When two people discuss their mutual understanding of a romantic relationship (casual dating, serious boyfriend, etc).").

[29] *But see* Grunstein v. Silva, No. 3932-VCN, 2014 WL 4473641, at *17 (Del. Ch. Sept. 5, 2014), *aff'd sub nom.* Dwyer v. Silva, 113 A.3d 1080 (Del. 2015). The Delaware Chancery Court explained:

> For better or worse, Delaware's oral partnership law does not differentiate among the dollar amount involved, the number of terms, or the complexity of the agreement. Thus, an oral partnership agreement could be formed even if the partnership were worth billions of dollars and had dozens of material and complex terms. But as a practical matter, this type of oral agreement is unlikely for obvious reasons. Indeed, a reasonable negotiator could rationally assume that a complex partnership agreement involving an acquisition worth more than a billion dollars would necessarily have to be reduced to writing for all of the essential terms to be fully agreed upon. Of course, that does not mean that an oral partnership could not be formed, especially where the essential terms are capable of being reduced to a few simple terms or to an objective controlling standard.

Id. at *12–13.

[30] *See* Leahy, *supra* note 21, at 294 (remarking on the exaggeration that default partnerships are "partnership[s] by ambush").

[31] *See infra* Part I.

[32] *See infra* Part II.

[33] *See infra* Part III.

[34] *See infra* Part IV.

on creating a product or service. They may brainstorm names for these businesses but not names or forms for a business entity to organize that business activity. Eventually, after founders have invested time, labor, know-how, capital, and possibly valuable intellectual or other property, they may move to formalize the business inside an entity, such as a corporation, a limited liability company (LLC), or a limited partnership (LP). Various factors may prompt or necessitate formal organization: monetization, outside investment from professional investors, legal advice, or the hiring of non-founder employees. Prior to the first step toward incorporation as a legal entity, however, participants may make significant firm-specific investments without written or formal categorizations of roles. During this pre-organizational period, opportunities exist in the pre-incorporated form to act opportunistically and deprive some founders of the returns on their investments.

A. Facebook, Inc.

One does not have to look hard to find examples of founders acting opportunistically to shut co-participants out of future profits. The most well-known example is the birth of the media giant Facebook, Inc.[35] This origin story has been depicted in books and on film,[36] and at least as told by Cameron and Tyler Winklevoss, twin brothers and Harvard University classmates of Mark Zuckerberg, proceeds as follows: The Winklevoss brothers and Divya Narendra envisioned creating a website that "would allow students and alumni of a college or university to create a network specific to that institution, and give the students and alumni a place to meet, exchange information, discuss employment prospects, and serve as an on-line dating service."[37] This website, eventually called "ConnectU" by the Winklevoss brothers and Narendra, was to initially serve the Harvard community and then expand to serve other universities and institutions.[38] According to the original three founders, they engaged Zuckerberg to help them get ConnectU to completion, and Zuckerberg was "involved with website development" and business planning, entrusted with the basic idea for the Harvard Connection website, project, and enterprise, and had access to proprietary

[35] *See* ConnectU LLC v. Zuckerburg, 482 F. Supp. 2d 3 (D. Mass. 2007), *rev'd*, 522 F.3d 82 (1st Cir. 2008), *dismissed on remand*, Order of Dismissal, No. 2004-cv-11923-DPW (D. Mass. July 22, 2011).

[36] *See, e.g.*, BEN MEZRICH, THE ACCIDENTAL BILLIONAIRES: THE FOUNDING OF FACEBOOK: A TALE OF SEX, MONEY, GENIUS AND BETRAYAL (2009); THE SOCIAL NETWORK (Columbia Pictures 2010).

[37] First Amended Complaint ¶ 12, *ConnectU LLC*, 482 F. Supp. 2d 3 (No. 2004-cv-11923-DPW), 2004 WL 2778374.

[38] *Id.*

and confidential ideas and information.[39] In exchange, Zuckerberg received a "monetary interest [in the website]."[40] Three days after promising to complete the ConnectU website, however, Zuckerberg registered a domain name for his own website, TheFaceBook, and launched his competitor to ConnectU less than a month later.[41] Zuckerberg never mentioned to the Winklevoss brothers nor to Narendra that he was working on a competing website while committed to finishing ConnectU, which he never did.[42] Zuckerberg incorporated the business owning thefacebook.com as TheFaceBook LLC two months later with Eduardo Saverin[43] and Dustin Moskovitz.[44]

Zuckerberg's depiction of the facts are more mundane: He "did work related to the [Harvard Connection] website" but was not "engaged to do so."[45] In his version of the events, he was a mere unpaid contractor.

The consequences that would have followed from a court upholding the Winklevoss story over the Zuckerberg story cannot be overstated. If the Winklevoss plaintiffs prevailed at trial, then they would have sufficiently alleged a partnership between the four Harvard classmates. If Zuckerberg were a partner, then he owed fiduciary duties to the others not to usurp business opportunities, to keep information about the business and the website confidential while a partner, and not to use partnership property, i.e., the code, for his (or TheFaceBook's) purposes. Also, if a partnership existed, then the code belonged to the partnership and TheFaceBook infringed on

---

[39] *Id.* ¶ 16.

[40] *Id.* ¶ 17.

[41] *Id.* ¶ 19.

[42] *See id.* ¶¶ 19–20.

[43] *See id.* ¶ 21. Zuckerberg's maneuvering against Saverin constituted part of this litigation as well. Saverin, a defendant in the ConnectU litigation, counterclaimed against Zuckerberg and Facebook, Inc., alleging breach of duty by Zuckerberg. First Amended Cross-Complaint ¶ 1, TheFacebook, Inc. v. Saverin, No. 105 CV 039867 (Cal. Super. Ct. Oct. 5, 2006), 2006 WL 6627814. Saverin's cross-complaint alleged that he and Zuckerberg created a two-third to one-third implied partnership, and then formalized that agreement in an LLC formed in April 2004 with Moskovitz, in which both Saverin and Zuckerberg were managers and members (Zuckerberg 65%, Saverin 30%, and Moskovitz 5%). *See id.* ¶¶ 11, 17. In October 2004, Zuckerberg convinced Saverin to agree to convert Facebook to a corporation, promising that Saverin would own 34% of Facebook, Inc. *Id.* ¶¶ 26–30. In April 2005, however, Zuckerberg and the two other shareholders signed a written consent issuing them each millions of shares, severely diluting Saverin. *Id.* ¶ 29. At the time of the Facebook IPO, Saverin's claim of 2% (he had sold half his stock earlier) was valued at $2.18 billion, compared to $34 billion had he retained his original stake. *See* Brian Solomon, *Eduardo Saverin's Net Worth Publicly Revealed: More Than $2 Billion in Facebook Alone*, FORBES (May 18, 2012), https://www.forbes.com/sites/briansolomon/2012/05/18/eduardo-saverins-net-worth-publicly-revealed-more-than-2-billion-in-facebook-alone/#2c11190f32ac [https://perma.cc/N4QA-DX28].

[44] *See* First Amended Complaint, *supra* note 37, ¶ 21.

[45] *See* Answer of All Defendants to First Amended Complaint ¶ 14, *ConnectU, Inc.*, 482 F. Supp. 2d 3 (No. 2004-cv-11923-DPW), 2004 WL 5371846.

the partnership's copyright. Currently, the market capitalization of Facebook, Inc. is over $750 billion.[46]

The litigation between the Winklevoss brothers and Zuckerberg ended rather quickly in mediation after a few procedural skirmishes over diversity jurisdiction.[47] Zuckerberg paid the plaintiffs $65 million, which they presciently negotiated to be paid $20 million in cash and $45 million in stock.[48] The stock is now worth more than $500 million.[49]

Because the parties did not proceed to trial, no written opinion exists to confirm or deny whether the four founders formed a partnership. The defendants may have settled for strategic reasons or because other claims were potentially damaging, such as the copyright claims. The facts as alleged by the plaintiffs, however, align with the elements of a default partnership.

B. Snap Inc.

Though starting a billion-dollar company in college may seem like a pipedream, recently it has happened more than once. Like Facebook, the social media platform Snapchat was created by three college students (at Stanford, not Harvard), but the similarities do not end there. According to Frank Reginald "Reggie" Brown IV, his co-founders, Evan Spiegel and Robert Murphy, conspired to exclude him from the project, eventually incorporating without him. Brown filed a lawsuit against his former classmates, alleging an implied partnership.[50] In 2011, Brown approached Spiegel with an idea to create a mobile platform that would allow users to send pictures that then disappeared.[51] They recruited Murphy to help them, even moving in together over the summer at Spiegel's father's home.[52] Brown completed many tasks for the project, including applying for a patent listing

---

[46] *Facebook, Inc. (FB)*, YAHOO! FINANCE, https://finance.yahoo.com/quote/FB [https://perma.cc/7E2X-MYF2] (showing that Facebook's market capitalization exceeded $750 billion as of August 21, 2020).

[47] *See* ConnectU LLC v. Zuckerberg, 522 F.3d 82, 85 (1st Cir. 2008).

[48] Ben Mezrich, *"He Thinks We're Going to Take a Swing at Him?": Inside the Decades-Long Cage Match Between Mark Zuckerberg and the Winklevoss Twins*, VANITY FAIR: HIVE (Apr. 30, 2019), https://www.vanityfair.com/news/2019/04/inside-the-mark-zuckerberg-winklevoss-twins-cage-match [https://perma.cc/UJ3W-6GQZ]. This conclusion is vastly (over)simplified. Shortly after agreeing to the settlement, the Winklevoss brothers moved to vacate it given new discovery evidence, but were unsuccessful. *See* Christopher D. Newkirk & Ashley L. Viehauser, *The ConnectU and Facebook Dispute: Has the Final Chapter Been Written?*, 20 INTELL. PROP. & TECH. L.J. 1, 4 (2008).

[49] Mezrich, *supra* note 48.

[50] Complaint ¶ 1, Brown v. Snapchat, Inc., No. BC501483 (Cal. Super. Ct. dismissed Sept. 12, 2014) ("This is a case of partners betraying a fellow partner.").

[51] *Id.* ¶¶ 15–17.

[52] *Id.* ¶¶ 18, 23.

the three as "co-inventors."[53] After the product launched on iTunes as "Picaboo," however, Spiegel locked Brown out of the platform in August 2011 and eventually incorporated with Murphy first as Toyopa Group, LLC, and then Snapchat Inc.[54]

The defendants removed the California state case to federal court, asserting that the case was, in essence, a federal copyright case surrounding who owned the Snapchat code and therefore should be heard by a federal court.[55] The district court for the Central District of California disagreed, stating that the copyright defense did not preempt the partnership and breach of partnership agreement claims in the complaint and remanded the case to state court.[56] The case settled the same year, with Brown receiving $158 million.[57] The settlement in this case seems related to the strength of the default partnership claims, given the strong evidence of the parties' intent to co-own a business together.

C. Urban Decay, LLC

A less recent but more fully litigated case involving a successful claim of implied partnership arose out of the creation of the now-successful cosmetics brand known as Urban Decay. In that case, both the trial and appellate courts found that Patricia Holmes and Sandra Lerner entered into an oral partnership agreement when they agreed one evening to start a company based on unusual nail polish colors with creative names, such as "Plague," "Bruise," "Mildew," "Smog," "Uzi," and "Oil Slick."[58] That same evening, Lerner called her business consultant to secure a trademark for the name, "Urban Decay." Though the two women did not delineate their roles or how they would split eventual profits, if any, they spoke in general terms

---

[53] *Id.* ¶ 29.

[54] Brown v. Snapchat, Inc., No. CV 13-08569 RGK (AGRx), 2014 WL 12573368, at *1 (C.D. Cal. Feb. 3, 2014); Complaint, *supra* note 50, ¶ 27. The company changed its official name to Snap Inc. in 2016. *See* Biz Carson, *Snapchat Is Now Called Snap Inc. and Will Sell Its Spectacles for $129*, BUS. INSIDER (Sept. 24, 2016), https://www.businessinsider.com/snapchat-rebrands-as-snap-inc-spectacles-will-cost-129-2016-9 [https://perma.cc/UG2X-9ATV].

[55] *Brown*, 2014 WL 12573368, at *1–2.

[56] *Id.* at *3 (holding that copyright law did not preempt the partnership claim).

[57] Notice of Ruling re: Dismissal of Action at 1, *id.* (No. CV 13-08569 RGK (AGRx)) (dismissing the claim with prejudice after parties stipulated to confidential settlement); *see* Samantha Masunaga, *The Guy Who Came Up with the Idea for Snapchat Got $158 Million and Vanished from Public Life*, L.A. TIMES (Mar. 1, 2017), https://www.latimes.com/business/la-fi-tn-reggie-brown-20170301-story.html [https://web.archive.org/web/20200809093653/https://www.latimes.com/business/la-fi-tn-reggie-brown-20170301-story.html] (noting that at the time of settlement, Snapchat released a statement that the company "acknowledge[s] Reggie's contribution to the creation of Snapchat and appreciate his work in getting the application off the ground").

[58] *Holmes*, 88 Cal. Rptr. 2d at 133.

about starting a business, hiring employees, and doing the creative work. Lerner told her housekeeper that the business "was all Pat's idea," but they would use Lerner's money.[59]

Urban Decay was quickly incorporated as a limited liability company, but Holmes could not get Lerner to explain to her the nature of Lerner's business title or ownership percentage.[60] At the same time, Lerner was issuing press releases and giving interviews retelling the story of how Holmes came up with the idea of Urban Decay.[61] Finally, approximately six months after agreeing to start the business together and working daily in various aspects of the business, Holmes was given a document offering her a one percent ownership interest in Urban Decay, LLC.[62] Holmes filed suit another six months later, in August 1996.[63] Lerner, who herself had been ousted from Cisco Systems, Inc., a corporation she had founded,[64] disputed that Holmes was a co-founder, admitting only that a "group interested in the project would gather at Lerner's patio," and that Holmes attended these "extremely informal get-togethers" as "a friend."[65] In addition, Lerner offered Holmes one percent of Urban Decay because Lerner wanted to keep "a friend and [her] horse partner," not because she thought Holmes was a co-founder.[66]

The jury found that an agreement to co-own a business had been made and that the parties' post-agreement actions, such as attending board meetings, devoting attention full-time to the business, and not receiving employee compensation, confirmed the existence of a partnership agreement that was breached by Lerner and her new management.[67] Holmes was granted $480,000 in damages plus $630,000 in punitive damages, and that award

---

[59] *Id.*

[60] *See id.* at 134–35.

[61] *See id.* at 135.

[62] *See id.* at 133–36.

[63] *Id.* at 136.

[64] *See* Julie Bort, *Cisco Just Turned 30: This Is the Dramatic Story of How the Founders Were Ousted*, BUS. INSIDER (Dec. 12, 2014), https://ca.finance.yahoo.com/news/cisco-just-turned-30-dramatic-195538426.html [https://perma.cc/N6LC-ED2K] (detailing the story of how Lerner and her husband, Len Bosack, created the "multi-protocol router" and attracted Sequoia Capital as an early investor for Cisco, only to be fired by the CEO Sequoia installed).

[65] Opening Brief of Appellants Sandra Lerner and David Soward at 8, *Holmes*, 88 Cal. Rptr. 2d 130 (No. A081440). Lerner attempted to discount Holmes's account by questioning why "wealthy" "entrepreneur" Lerner, with "the fashion interest, all the business experience and connections, and the money," would ask Holmes, "an experienced horse trainer," to start a company with her. *See id.* at 1, 3, 4, 12–13.

[66] *See id.* at 11.

[67] *See Holmes*, 88 Cal. Rptr. 2d at 137.

was upheld on appeal in 1999.[68] One year later, Urban Decay was acquired by LVMH Moët Hennessy Louis Vuitton SE.[69]

The appellate court specifically addressed the implied partnership doctrine as it was worded in the former version of the California Uniform Partnership Act and determined that dividing profits was evidence of a partnership, but not a required element, as the defendants had argued.[70] The most important element, or "crucial factor," was "the intent of the parties revealed in the terms of their agreement, conduct, and the surrounding circumstances."[71] The court held that the surrounding circumstances supported the trial verdict.[72]

II. STARTUP PARTNERSHIPS

The legal rationale for Patricia Holmes winning a million-dollar verdict and for Reggie Brown and the Winklevoss brothers receiving multi-million-dollar settlements is that the respective founders formed a general partnership at the outset, prior to the subset of founders forming alternative entities. This powerful doctrine stands between a spurned founder receiving nothing and an equal share of the pre-organizational business. Some defendants argue, however, that the doctrine is not fair and that it allows business actors to claim a "partnership by ambush" or at least "surprise or accidental partnerships."[73] This Part argues that the doctrine provides a very important backstop to opportunism and may actually reflect the result of a hypothetical bargain better than any other alternative.[74] Section A of this Part discusses the formation of a general partnership under the Revised Uniform Partnership Act and the Uniform Partnship Act, as well as variations

---

[68] *Id.* at 132, 137.

[69] *See* Scheherazade Daneshku, *L'Oréal Buys Urban Decay Cosmetics Brand*, FIN. TIMES (Nov. 26, 2012), https://www.ft.com/content/5427f052-37b2-11e2-8edf-00144feabdc0 [https://perma.cc/LL5P-SALN]. Urban Decay was sold twice more to private equity firms but purchased by L'Oreal in 2012, reportedly for $300 million. *Id.*

[70] *Holmes*, 88 Cal. Rptr. 2d at 132 ("We affirm the judgment against Lerner, primarily because we determine that an express agreement to divide profits is not a prerequisite to prove the existence of a partnership.").

[71] *Id.* at 138 ("[T]he rules to establish the existence of a partnership . . . should be viewed in the light of the crucial factor of the intent of the parties revealed in the terms of their agreement, conduct, and the surrounding circumstances when determining whether a partnership exists.").

[72] *See id.* at 137–43.

[73] *See* Mike Lynn, *Letters of Intent—Stories from the Courthouse*, 4 ROCKY MOUNTAIN MIN. L. FOUND. *A-25, *A-39 (2016).

[74] *See infra* notes 77–165 and accompanying text.

under state law.[75] Section B explores the relationship among parties once courts deem that a general partnership had been formed.[76]

A. Forming a General Partnership

The general partnership is the only business entity between or among participants[77] that does not require a formal filing with a state agency, generally the Secretary of State.[78] Because of the lack of a filing requirement, the general partnership is the default entity for two or more persons who form a business, much like a sole proprietorship is the default structure for individuals who conduct a business without creating a business entity to hold that business.[79] In other words, if two or more individuals or entities begin conducting business without organizing as another entity, then the law treats that joint enterprise as a general partnership, whether the parties consciously chose to create a general partnership with or without a written partnership agreement, or merely if the parties had not organized as a different entity yet out of ignorance, neglect, or deliberate choice.[80]

---

[75] *See infra* Part II.A.

[76] *See infra* Part II.B.

[77] A sole proprietorship, with one owner, also does not require a formal filing to create a business; however, an owner may choose to register an assumed name in addition to necessary business licenses. *See* Roy Clemons & Dennis R. Lassila, *Choice of Entity Issues: Single-Member LLCs vs. 'Regular' Sole Proprietorships*, 117 J. TAX'N 259, 260 (2012) ("There is generally no specific process for forming a regular sole proprietorship. No application needs to be filed with the state in which the business is located or the owner resides, and no formal papers have to be drawn to form the business.").

[78] Some states allow for an optional registration of general partnerships. *See, e.g.*, CAL. CORP. CODE § 16105 (West 2019).

[79] *See* Catherine A. Hardee, *Who's Causing the Harm?*, 106 KY. L.J. 751, 763 (2017) ("A sole proprietorship is the default business form for an individual running a business, while a general partnership is the default rule for two or more individuals operating a business." (footnote omitted)).

[80] When a group of business participants eventually does organize as a different entity, then whether that group was a partnership prior to incorporation can depend on the length of time, whether the purported partners always intended to organize, and whether basic elements of an agreement were disputed. *See, e.g.*, Eng v. Brown, 230 Cal. Rptr. 3d 771, 790 (Ct. App. 2018) (stating that "[c]ourts have shown considerable skepticism towards alleged preincorporation agreements" to form a partnership); Persson v. Smart Inventions, Inc., 23 Cal. Rptr. 3d 335, 339–40, 349 (Ct. App. 2005) (concluding that the parties could not sue under partnership law even though the business was not incorporated for three years); Mindenberg v. Carmel Film Prods., Inc., 282 P.2d 1024, 1026–27 (Cal. Ct. App. 1955) (holding that there was no partnership where "the original plan was formation of a corporation"); *see also* Ramone v. Lang, No. Civ.A. 1592-N, 2006 WL 905347, at *13 (Del. Ch. Apr. 3, 2006) ("Had Lang and Ramone agreed to all the material terms of the business relationship, including how they would share profits and losses as partners, and Lang later balked on signing the final documents, it *might* have been possible to conclude they had formed a general partnership even though their stated intent was to form an LLC.").

Some parties may agree to "do business together" but not understand the legal implications of being "business partners" or jointly running a business. Others may intend ultimately to form an incorporated entity but do not take concrete steps toward choosing an incorporated form or filing necessary paperwork.[81] Still others may be merely exploring whether the proposed business is viable prior to organizing a formal entity. These default partnerships and early-stage entities may not have a written partnership agreement, though they may have other types of contracts among them that provide evidence of a joint business.[82]

1. The "De Facto" Partnership Doctrine

Whether parties have formed a partnership is governed by the general partnership statute of the relevant state.[83] Most states follow some version of the Revised Uniform Partnership Act (RUPA), though a few large states still follow the Uniform Partnership Act (UPA).[84] When parties choose to form a corporation, LLC, or LP through filing the necessary documents, they have chosen a jurisdiction and accompanying business organization act to govern their relationship. Parties who form an informal general partnership without a filing, however, will be governed by the partnership act in the most appropriate jurisdiction. Though the UPA is silent as to choice of

[81] Courts may view discussions to form an incorporated entity either as evidence of intent to co-own a business and therefore to form a partnership, or negative evidence of intent to form a partnership. *Compare* Iacono v. Estate of Capano, C.A. No. 11841-VCL, 2020 WL 3495328, at *9–10 (Del. Ch. June 29, 2020) (holding that negotiations over a draft LLC operating agreement were sufficiently detailed to find a 50/50 partnership between two sophisticated real estate developers prior to the death of one of the parties), *with* MAS Assocs., LLC v. Korotki, 214 A.3d 1076, 1079 (Md. 2019) (holding that the parties could not simultaneously intend to form an LLC and intend to form a partnership). The court in *MAS Associates, LLC v. Korotki* seems to have ignored the doctrinal requirement that parties intend to co-own a business, not co-own a partnership.

[82] *See, e.g.*, Brown v. 1401 N.Y. Ave., Inc., 25 A.3d 912, 916–17 (D.C. 2011) (holding that tax returns and a lease signed as partners constituted evidence of a partnership).

[83] For most unincorporated entities, courts apply the statute of the state in which the business dealings arose or were situated. *See, e.g.*, *In re* S & D Foods, Inc., 144 B.R. 121, 158 (Bankr. D. Colo. 1992) (applying Colorado partnership law to determine whether a prepetition partnership or joint venture had been formed in Colorado).

[84] Forty-five U.S. jurisdictions (including the District of Columbia) have adopted some version of RUPA, and South Carolina is currently considering legislation to adopt RUPA. *See* REVISED UNIF. P'SHIP ACT (UNIF. LAW COMM'N 1997, amended 2013); UNIF. P'SHIP ACT (UNIF. LAW COMM'N 1914); *Partnership Act*, UNIF. LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=52456941-7883-47a5-91b6-d2f086d0bb44 (last visited Aug. 21, 2020). The states that follow the UPA are Georgia, Indiana, Massachusetts, Michigan, New Hampshire, New York, and North Carolina. *See Partnership Act*, *supra.* Only Louisiana has adopted neither the UPA or RUPA. *See id.*

law,[85] RUPA provides that the general partnership law of the state in which the "principal office" is located will control.[86]

Both the UPA and RUPA define a partnership as an "association of two or more persons to carry on as co-owners a business for profit"[87] that has not been organized under any other statute, such as a corporation act, limited partnership act, or limited liability company act.[88] The question then becomes whether two or more parties intended to "co-own" a business enterprise. Often, parties participate in business ventures as nonowners: consultants, employees, and lenders. Relatedly, some individuals may gratuitously help with the business ventures of spouses, family members, and friends. Both uniform acts provide tests to determine which sorts of relationships are not partnerships, listing the sharing of profits, but not revenues, as prima facie evidence of a partnership.[89]

For example, both the UPA and RUPA exclude common ownership in real and personal property as sufficient for creating a partnership without additional evidence.[90] Though many parties co-own property with the intent

---

[85] The governing law of a disputed partnership in a UPA state would be determined by common-law choice of law principles. *See* CHRISTINE HURT & D. GORDON SMITH, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 1.04[A] (3d ed. Supp. 2020).

[86] *See* REVISED UNIF. P'SHIP ACT § 104 (amending former section 106, which provided for the location of the "chief executive office" to control choice of law). RUPA defines "principal office" as "the principal executive office of a partnership or a foreign limited liability partnership, whether or not the office is located in this state." *Id.* § 102(15); *see also* Rowell v. Shell Chem. LP, No. 14-2392, 2015 WL 3505118, at *5 (E.D. La. June 3, 2015) (applying the federal test for "principal place of business" to a general partnership organized in Delaware).

[87] REVISED UNIF. P'SHIP ACT § 202(a); UNIF. P'SHIP ACT § 6(1). Note that if parties choose to be governed by the relevant statute as a general partnership, whether the venture is a "business for profit" may be irrelevant. *See* Fisher v. Wilkoski, No. 2017AP732, 2018 WL 727065, at *9–10 (Wis. Ct. App. Feb. 6, 2018) (holding that a firm organized to own and operate an aircraft and hangar for personal use, with the partners splitting expenses, may not have been a partnership because it was not co-owned as a business for profit; however, the partners made the firm a partnership by virtue of signing a partnership agreement that adopted the Wisconsin UPA as controlling law).

[88] REVISED UNIF. P'SHIP ACT § 202(b); UNIF. P'SHIP ACT § 6(2). Many incorporated businesses would meet the test for de facto partnership, but by incorporating, the parties opt out of partnership classification. *See Eng*, 230 Cal. Rptr. 3d at 789 (holding that partnership is ordinarily superseded by incorporation, but that a plaintiff could claim, in rare circumstances, that the parties intended to retain partnership status after incorporation); *Persson*, 23 Cal. Rptr. 3d at 347 (reversing the trial court's erroneous finding that two shareholders in a corporation were contemporaneously partners in the same de facto partnership "solely for the purpose of imposing a fiduciary duty on the de facto partners"); McCormick v. Dunn & Black, P.S., 167 P.3d 610, 615 (Wash. Ct. App. 2007) (rejecting the claim made by a shareholder in an incorporated law firm that other shareholders breached fiduciary duties toward him because the law firm was a de facto partnership, given that the shareholders had agreed to split profits).

[89] REVISED UNIF. P'SHIP ACT § 202(c)(3); UNIF. P'SHIP ACT § 7(4).

[90] REVISED UNIF. P'SHIP ACT § 202(c)(1) ("Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not of itself establish a part-

to engage in joint activities to improve, develop, or use the property in business, mere joint ownership is not sufficient.[91] The acts also distinguish between the sharing of "gross returns" as not being evidence of a partnership with the sharing of "profits" as "prima facie" evidence of a partnership.[92] Some state courts require evidence of an intent to share profits or the actual sharing of profits before finding evidence of a partnership;[93] however, the uniform acts treat this criterion as prima facie evidence of a partnership but not as a necessary element.[94] Particularly in startup partnerships, the existence of profits may be months or years in the future, even though the partnership has already been created. Even in these cases, though, the intent or agreement to share in business profits in the future seems to be at least somewhat essential in proving that the parties "co-owned" a venture.[95] The concept of co-ownership seems to include the right to future income streams in what is owned.

The acts further consider employees, creditors, and landlords[96] as parties who may receive a share of profits in payment but do not deem them

---

nership, even if the owners share profits made by use of the property."); UNIF. P'SHIP ACT § 7(2) ("Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not of itself establish a partnership, whether such co-owners do or do not share any profits made by the use of the property.").

[91] Hillman v. Cannon, 2011 WL 6670657, at *1, *6 (Iowa Ct. App. Dec. 21, 2011) (concluding that although the parties jointly operated a dairy farm and co-owned cows and equipment, one party alone owned the land, barn, certain large equipment, and feed crops).

[92] REVISED UNIF. P'SHIP ACT § 202(c)(2)–(3); UNIF. P'SHIP ACT § 7(3)–(4). When one party is paid out of revenues, not profits, then that party has not agreed to share losses or otherwise take a risk of loss, which is essential to co-owning a business. *See* La Familia Cosmovision, Inc. v. Inspiration Networks, No. 13 CVS 1079, 2014 WL 5342583, at *8 (N.C. Super. Ct. Oct. 20, 2014) (holding that sharing a risk of loss was indicative of a legal partnership).

[93] *See, e.g.*, Best Cartage, Inc. v. Stonewall Packaging, LLC, 727 S.E.2d 291, 299 (N.C. Ct. App. 2012) (holding that in North Carolina, sharing of any actual profits and co-ownership of business are "indispensable" elements of a partnership (quoting Wilder v. Hobson, 398 S.E.2d 625, 627 (N.C. Ct. App. 1990))); Flanary v. Wilkerson, No. COA10-1401, 2011 WL 5540195, at *7 (N.C. Ct. App. Nov. 15, 2011) (concluding that the trial court erred in failing to instruct the jury that evidence of an agreement to share profits and losses was necessary to form a partnership); Wilder v. Hobson, 398 S.E.2d 625, 627 (N.C. Ct. App. 1990) ("[C]o-ownership and sharing of any actual profits are indispensable requisites for a partnership."); Messer Griesheim Indus., Inc. v. Cryotech of Kingsport, Inc., 131 S.W.3d 457, 470 (Tenn. Ct. App. 2003); Ellsworth Paulsen Constr. Co. v. 51-SPR-L.L.C., 183 P.3d 248, 252 (Utah 2008) (holding that five elements, including an agreement to share losses, were necessary to find the existence of a default partnership).

[94] *See In re* KeyTronics, 744 N.W.2d 425, 437, 441 (Neb. 2008) (citing the nonnecessity of all indicia of co-ownership to establish partnership).

[95] *See, e.g.*, Malone v. Patel, 397 S.W.3d 658, 675 (Tex. Ct. App. 2012) (holding that although the defendant had not received profits yet, he had a right to share in the profits).

[96] *See, e.g.*, *In re* Estate of Nuss, 646 N.E.2d 504, 507–08 (Ohio Ct. App. 1994) (holding that a mother and her son were not partners, though the son farmed the mother's land with her equipment and kept all proceeds but paid taxes on the land).

partners,[97] unless additional facts are present.[98] Periodic payments regardless of profits suggest that the recipient is not a partner but a lender, employee, or other contract party.[99] Disputes sometimes arise before purported lenders have been repaid at all, causing confusion in the absence of a written agreement as to whether the parties intended the money in question to be a loan or a capital contribution.[100] In disputed cases, courts will look to how much control the purported lender has over the venture and whether it constitutes more daily control than a normal lending relationship.[101]

Though these tests may be helpful in illuminating relationships that are not partnerships, the relationships that are considered to be partnerships will then be subject to a fact-specific test[102] focused on the intent of the partners.[103] Courts will analyze, however, whether the parties intended to co-own a business for profit, not whether the parties specifically intended to create an entity known as a partnership.[104] Though the test is both subjective (did the parties intend a relationship with the indicia of partnership?) and objective (did the parties act as if they were in a relationship that resembles a partnership?), the court will necessarily look at objective evidence beyond the parties' testimony to determine whether a partnership exists. For example,

---

[97] REVISED UNIF. P'SHIP ACT § 202(c)(3); UNIF. P'SHIP ACT § 7(4).

[98] *See, e.g.*, *Malone*, 397 S.W.3d at 679 ("[Appellant] has cited us no authority for the proposition that an at-will employee, as a matter of law, cannot ever own a partnership interest in his or her employer. An at-will employee can be, and often is, also an equity owner in his or her employer company.").

[99] *See, e.g.*, Batterman v. Wells Fargo AG Credit Corp., 802 P.2d 1112, 1117 (Colo. App. 1990) (concluding that a lender who received fixed interest income, which continued to accrue despite the firm's losses, was not a partner); Barnes v. Perry, No. 18 CVS 177, 2018 WL 3649987, at *7 (N.C. Super. Ct. July 30, 2018) (denying a motion to dismiss because the parties could have a property broker relationship or a partnership relationship).

[100] *See, e.g.*, Peoples Bank v. Bryan Bros. Cattle Co., 504 F.3d 549, 558 (5th Cir. 2007) (holding that there was insufficient evidence to conclude whether the sporadic payments the plaintiffs received were a share of the profits or repayment).

[101] *See, e.g.*, Spier v. Lang, 53 P.2d 138, 140 (Cal. 1935) (concluding that creditors who advanced money to an oil driller in return for a share of proceeds from the well "did not participate in the conduct or management of the business of drilling the wells, and concerted action in the management, control, or carrying on the business was not contemplated by the contract").

[102] *See* Leahy, *supra* note 21, at 250 ("Rather, partnership formation always poses a *factual* question . . . .").

[103] *See, e.g.*, *Hillman*, 2011 WL 6670657, at *3 (holding that an intent to associate is the crucial test of partnership).

[104] REVISED UNIF. P'SHIP ACT § 202(a) ("[T]he association of two or more persons to carry on as co-owners a business for profit forms a partnership, *whether or not the persons intend to form a partnership*." (emphasis added)). This conditional language does not appear in section 6(1) of the UPA. *See* UNIF. P'SHIP ACT § 6(1); *see also* TEX. BUS. ORGS. CODE ANN. § 152.051(b) (West 2019) ("[A]n association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a 'partnership,' 'joint venture,' or other name.").

courts examine how the parties interact with one another, refer to one another,[105] collaborate in the business,[106] and share in the profits of the business.[107]

2. State Law Tests

The state in which the purported partnership's principal office resides, not a chosen state or organization, will most likely govern whether parties have created a partnership; therefore, these disputed partnership cases occur in all U.S. jurisdictions.[108] Regardless of which state's statute controls, the tests are fairly similar; however, because the facts are different in each case, the resulting court holdings are quite varied. Of the most populous states, New York and Michigan are notable as UPA jurisdictions that have not enacted RUPA.[109] Other states with significant business activity, such as California and Illinois, have enacted RUPA § 202 verbatim, which is identical to UPA §§ 6–7, with the added phrase "whether or not the parties intend to form a partnership."[110]

On the other hand, Texas, which generally follows RUPA, prior to the 2013 amendments, has enacted its own statutory provision governing the formation of a general partnership. The Texas statute lists five factors that courts should consider in characterizing any arrangement as a partnership: "(1) receipt or right to receive a share of profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing business losses; or liability for claims by third parties; and (5) agreement to

---

[105] Whether the parties refer to one another as "partner," internally or externally, can be evidence of a partnership but is not sufficient to prove a partnership because of the colloquial use of the word in many contexts. *See, e.g.*, Dombek v. Adler, No. 2:18-cv-391-RMG, 2019 WL 459019, at *4 (D.S.C. Feb. 5, 2019); Neuger v. Salke, No. 2:14-CV-08040AB (JCx), 2018 WL 3064299, at *10, *12 (C.D. Cal. June 20, 2018) (holding that, under California law, the mere use of the word "partner" to refer to one another is not sufficient to show an intent to form a partnership); T.G. Plastics Trading Co. Inc. v. Toray Plastics (Am.), Inc., 958 F. Supp. 2d 315, 327–28 (D.R.I. 2013) ("[T]he use of the word 'partner' . . . colloquially . . . does little to establish that a legal partnership existed.").

[106] *See, e.g.*, Buette Derousse Commercial Real Estate Props., LLC v. TRP Twin Peaks, LLC, No. 2 CA-CV 2018-0033, 2018 WL 6735182, at *4–5 (Ariz. Ct. App. Dec. 24, 2018).

[107] *See, e.g.*, Mellino v. Kampinski Co., L.P.A., 837 N.E.2d 385, 390–91 (Ohio Ct. App. 2005) (holding that there was sufficient evidence that a partnership existed where a lawyer received a percentage of fees collected by the firm, less overhead expenses such as rent and utilities).

[108] REVISED UNIF. P'SHIP ACT § 104.

[109] *See* MICH. COMP. LAWS ANN. § 449.2108 (West 2019); N.Y. P'SHIP LAW § 126 (McKinney 2019).

[110] *See* REVISED UNIF. P'SHIP ACT § 202. The comment to section 202 explains, however, that this language merely codifies the judicial interpretation of sections 6 and 7 of the UPA. *Id.* § 202 cmt.

contribute or contributing money or property to the business."[111] Courts have looked at these factors in the aggregate,[112] holding that evidence of all five factors is conclusive evidence of a partnership, whereas evidence of only one factor is not evidence of a partnership.[113] Not all factors, however, must be present to find that a partnership exists.[114]

Even when a state partnership act contains the same language, judicial gloss may vary considerably. For example, the Utah Partnership Act, which follows RUPA § 202 verbatim,[115] was interpreted by the Utah Supreme Court as requiring evidence of:

> [1] a community of interest in the performance of the common purpose, [2] a joint proprietary interest in the subject matter, [3] a mutual right to control, [4] a right to share in the profits, and [5] unless there is an agreement to the contrary, a duty to share in any losses which may be sustained.[116]

---

[111] TEX. BUS. ORGS. CODE ANN. § 152.052(a).

[112] *See, e.g.*, Reservoir, Inc. v. Truesdell, 1 F. Supp. 3d 598, 608 (S.D. Tex. 2014) (noting that Texas courts employ a "totality-of-the-circumstances test" in applying the five factors).

[113] *See, e.g.*, Nguyen v. Hoang, 507 S.W.3d 360, 372 (Tex. App. 2016) ("[A] partnership does not exist as a matter of law when there is no evidence as to any of the five factors, and conclusive evidence of only one factor will normally be insufficient to establish the existence of a partnership." (quoting Rojas v. Duarte, 393 S.W.3d 837, 841 (Tex. App. 2012))).

[114] *See, e.g.*, Sewing v. Bowman, 371 S.W.3d 321, 333–35 (Tex. App. 2012) ("[W]hether a [Texas] partnership exists is to be determined by looking at the 'totality of the circumstances' and considering 'all of the evidence bearing on the [Texas Revised Partnership Act (TRPA)] partnership factors.' . . . The expression-of-intent factor [for the formation of a partnership] requires 'an inquiry separate and apart from the other factors,' and [Texas] courts should 'only consider evidence not specifically probative of the other factors.' [Texas] [c]ourts should review the 'putative partners' speech, writings, and conduct' in determining whether the parties had expressed an intent to be partners. Additionally, 'there must be evidence that both parties expressed their intent to be partners.'. . . [Plaintiff] presented sufficient evidence on four of the five TRPA factors indicating the existence of a partnership agreement." (citations omitted) (first quoting Ingram v. Deere, 288 S.W.3d 886, 886 (Tex. 2009); then quoting *id.*; then quoting *id.* at 900; then quoting *id.* at 899; and then quoting *id.* at 900)). In *Ingram v. Deere*, the Texas Supreme Court held that the statute does not require proof of all of the listed factors and therefore profit sharing is not required. 288 S.W.3d at 898–99. The court applied a "totality-of-the-circumstances" test in which profit sharing continued to be an important factor in determining partnership. *See id.* at 891, 898–99 (noting that, of the five evidentiary factors that Texas law requires be considered in determining whether a partnership has been created, "absence of any evidence of the factors will preclude the recognition of a partnership," while "conclusive evidence of all of the . . . factors will establish the existence of a partnership as a matter of law"); Westside Wrecker Serv., Inc. v. Skafi, 361 S.W.3d 153, 165, 166 (Tex. App. 2011) (same).

[115] *Compare* UTAH CODE ANN. § 48-1d-202 (West 2019), *with* REVISED UNIF. P'SHIP ACT § 202.

[116] *Ellsworth Paulsen Constr. Co.*, 183 P.3d at 252, 255 (using the test that originated with joint ventures to prove existence of a partnership and affirming the reversal of summary judgment for the plaintiff because a factual issue existed regarding the sharing of losses).

No matter the approach taken, once a general partnership exists the parties involved become subject to the legal consequences—for better or for worse.

B. The Consequences of General Partnership

Once a court finds that the parties formed a partnership to co-own a business for profit, then the real fun begins. If the parties are partners in a general partnership, then their relationship will have all the consequences of a general partnership. Note that the consequences could be financially significant. Though the parties in these cases are fighting over whether there is a partnership, they are really fighting over personal liability and claims of breach of fiduciary duty and possible regurgitation of profits or damages. Disputes over partnership formation may be among purported partners or between a third party and the purported partners. Default partners or early-stage partners may believe that they were acting as independent business participants and not welcome these types of consequences; intentional partners may act strategically by contesting the existence of a partnership after conditions change.

The hallmarks of a general partnership are as follows: partners owe fiduciary duties to the entity and each other; parties retain personal liability for partnership obligations; the partners have the right to co-manage the business of the partnership; the partners have the right to an equal share of the profits of the partnership; and the partnership has vicarious liability for the torts of the partners. Though scholars tend to think of default governance rules as the rules that most parties would choose had they intentionally bargained for a set of governance rules, some of the governance rules of a general partnership are the exact rules that most business parties would not and actually do not choose.[117] In particular, the creation of hybrid entities (LPs and LLCs) was a result of the desire of parties to contract out of general partnership governance rules, specifically personal liability, while retaining the sole preferred characteristic: passthrough taxation.[118]

In a general partnership, partners may not amend their partnership agreement, even in writing, to eliminate personal liability to third parties.[119] On the other hand, organizers of LPs and LLCs in some states can, if the

---

[117] *See* Shawn Bayern, *Three Problems (and Two Solutions) in the Law of Partnership Formation*, 49 MICH. J.L. REFORM 605, 606 (2016).

[118] *See* Christine Hurt, *Partnership Lost*, 53 U. RICH. L. REV. 491, 499–521 (2019) (tracing the rise of the LP from the passage of the corporate tax in 1913 through the explosive popularity of the LLC following the "check-the-box" regulations).

[119] REVISED UNIF. P'SHIP ACT § 105(c) (prohibiting a partnership agreement from varying the provisions section 307 of RUPA, which governs the rights of third parties to sue the partnership and partners for partnership debts).

parties agree, waive the fiduciary duties of managers,[120] and even corporate articles of incorporation can limit liability of officers and directors for breach of fiduciary duties.[121]

In addition, business owners would generally prefer claims on profits to correspond to past investor contributions, such as LP contributions, LLC contributions, or the number of corporate shares purchased; however, partnership law declares all partners equal owners regardless of capital or labor invested unless otherwise specified. In the absence of an agreement, partners have equal rights to co-manage (voting rights)[122] and equal rights to distributions of profits.[123] If no other business form is chosen, however, the default form is a general partnership, with all of its default characteristics.

For purposes of exploring the various ways in which disputes may arise in the absence of or prior to incorporation of a legal entity, consider a hypothetical startup business, SeedsNThings, and three founders (FounderA, FounderB, and FounderC). The founders agreed to "work on" developing a subscription-based gardening box delivery service based on algorithms devised to match gardeners with plant seeds and bulbs. The only formal contract they have is a contract between SeedsNThings and a manufacturer of boxes designed to ship organic material in compostable boxes, CompostBox, Inc.

1. Partner v. Partner

The default partnership doctrine is often invoked in internal disagreements—one purported partner claiming another partner wronged them, whether by breaching fiduciary duties, breaching an oral partnership agreement, or not recognizing a claim to sharing in firm profits.

For example, imagine that the founders of SeedsNThings never gave much thought to incorporation. After all, they have not begun to advertise for subscribers and are working on their website and matching algorithm. After completing the algorithm, however, FounderA and FounderB exclude FounderC from being able to access the website or any of the market research data they have collected. They continue the business as a separate business, owned by the two of them and possibly others. FounderC seems to have been treated unfairly. If SeedsNThings had incorporated from the outset, then the parties would have negotiated how many shares each shareholder would own based on contributions of labor and property, avoiding

---

[120] *See, e.g.*, DEL. CODE ANN. tit. 6, §§ 17-1101(c)–(d), 18-1101(b)–(c) (West 2019).

[121] *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 102(b)(7), 122(17) (West 2019).

[122] REVISED UNIF. P'SHIP ACT § 401(h) ("Each partner has equal rights in the management and conduct of the partnership's business.").

[123] *Id.* § 401(a) ("Each partner is entitled to an equal share of the partnership distributions . . . .").

later confusion. If the parties later had disagreements, then the majority of the board could legally fire FounderC from any office they held, and a majority of the shareholders could oust her from the board, absent any contractual protections FounderC may have negotiated. In the majority of jurisdictions,[124] a court might step in to protect FounderC if the actions rise to the level of shareholder oppression,[125] an admittedly high bar. If the founders had organized as an LLC, then the outcome would depend on whether the LLC were member-managed or manager-managed, and whether the founders had waived or limited fiduciary duties in the organizing documents.[126] Similarly, if the founders had formed an LP, then an alienated limited partner would have little recourse, particularly if the founders had waived or limited fiduciary duties of the general partner.[127]

In our case, SeedsNThings has not organized as any firm; at first glance, an ousted founder may seem stuck without any options. Somewhat

---

[124] At least forty U.S. jurisdictions recognize some type of claim for shareholder oppression. *See* Douglas K. Moll, *Shareholder Oppression and the New Louisiana Business Corporation Act*, 60 LOY. L. REV. 461, 462 (2014). Some notable jurisdictions, however, do not recognize such a claim. *See, e.g.*, Ritchie v. Rupe, 443 S.W.3d 856, 868, 891 (Tex. 2014) (refusing to recognize a common law claim of shareholder oppression, denying the imposition of a receivership based on "illegal, oppressive, or fraudulent" actions, and reversing a jury verdict (quoting TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (2013)). The Supreme Court of Delaware rejected the shareholder oppression doctrine in 1993, though more recent cases have perhaps reached similar results with breach of fiduciary claims. *Compare* Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del. 1993) ("It would do violence to normal corporate practice and our corporation law to fashion an ad hoc ruling which would result in a court-imposed stockholder buy-out for which the parties had not contracted."), *with* Shawe v. Elting, 157 A.3d 152, 169 (Del. 2017) (affirming order of judicial dissolution in a case in which a shareholder created an oppressive environment for another shareholder). The facts in *Shawe v. Elting*, however, were particularly egregious. *See* 157 A.3d at 156–57.

[125] *See* Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1220–29 (2009).

[126] *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1101(c) ("To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing."). Whether managers in an LLC have fiduciary duties by default at all is an open question in Delaware. *See* Zimmerman v. Crothall, 62 A.3d 676, 702 n.145 (Del. Ch. 2013) ("The Delaware Supreme Court has not yet definitely determined whether the LLC statute imposes default fiduciary duties."); Michael Despres, Comment, *Alternative Entities and Fiduciary Duty Waivers in Delaware*, 2015 BYU L. REV. 1347, 1359.

[127] DEL. CODE ANN. tit. 6, § 17-1101(d) ("To the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by provisions in the partnership agreement; provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing.").

counterintuitively, if the founder can prove that the three formed a default partnership, then FounderC could have more protections than she would otherwise have as a shareholder, and definitely more than as an LLC member or LP member in a firm that had waived fiduciary duties. If a court finds that the founders formed a partnership, whether they thought they were forming a "partnership" or not, then FounderA and FounderB may have breached the duty of loyalty owed to FounderC.

a. Partnership Duty of Loyalty

The duty of loyalty is comprised of several parts. Under this fiduciary duty, partners must account and hold in trust any profits derived from using partnership property or from appropriating a partnership opportunity.[128] In addition, partners must refrain from dealing with the partnership when conflicted and from competing with the partnership.[129] If a court finds that a partnership exists and that one partner breached partnership duties,[130] then the breaching partner would have to regurgitate profits from the partnership opportunity or pay damages for competing with the partnership.[131] In this case, FounderA and FounderB breached the duty of loyalty by starting a competing business using partnership property.[132] FounderC would be enti-

---

[128] REVISED UNIF. P'SHIP ACT § 409(b)(1)(B)–(C).

[129] *Id.* § 409(b)(2)–(3) ("The fiduciary duty of loyalty of a partner includes the duties . . . to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a person having an interest adverse to the partnership; and to refrain from competing with the partnership in the conduct of the partnership's business before the dissolution of the partnership."). The UPA does not specify the duties that partners owe to one another, but section 21 of the UPA, entitled "Partner Accountable as Fiduciary," states:

> 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.

UNIF. P'SHIP ACT § 21(1). Additionally, the UPA incorporates the law of agency. *Id.* § 4(3). Under agency law, all fiduciaries have the duty of loyalty. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 (AM. LAW INST. 2006) ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship.").

[130] A mere finding of a default partnership does not entitle any partner to damages; a finding of a breach of partnership duties is then required. *See, e.g.*, VIDIVIXI, LLC v. Grattan, 155 F. Supp. 3d 476, 481–82 (S.D.N.Y. 2016) (finding evidence of a de facto partnership but no evidence of breach).

[131] REVISED UNIF. P'SHIP ACT § 410(b) ("A partner may maintain an action against the partnership or another partner, with or without an accounting as to partnership business, to enforce the partner's rights and protect the partner's interests, including rights and interests under the partnership agreement or this [act] or arising independently of the partnership relationship.").

[132] One could also argue that the original partnership was intact, but FounderC was expelled, requiring the other partners to buy out his one-third partnership share.

tled to damages, usually the value of her partnership interest but possibly punitive damages as well.[133]

Though the parties did not fully litigate the Facebook and Snapchat cases discussed *supra*, the plaintiffs argued that the defendants had breached partnership duties.[134] Using partnership property, such as the computer code, name, logo, and possibly the business model, for non-partnership use would constitute a breach of the duty of loyalty.[135] In addition, creating a different entity to compete with the original partnership in the same or similar business, while still a partner, would also breach the duty of loyalty.[136]

b. Right to Equal Share of Profits

Other times, a party will want to exclude a purported partner from the splitting of profits of the business. If SeedsNThings does not form an incorporated entity or at least execute a detailed partnership agreement before launching, then the law would allocate any profits generated by the business pro rata among the partners. Both the UPA[137] and RUPA[138] give partners the default right to split profits equally, regardless of the individual contributions of partners of capital or services.[139] Even in an intentional general partnership, partners may choose a different allocation of profits based on capital contributions, management expertise, and time spent participating in the business. Absent evidence of an agreement otherwise, however, if a

---

[133] *See, e.g.*, Shaw v. Schlaifer, No. B279600, 2018 WL 1703977, at *9–10 (Cal. Ct. App. Apr. 9, 2018) (upholding a jury finding of repudiation of informal partnership and conversion, which could support punitive damages based on malice, fraud, or oppression).

[134] *See supra* Part I.A–B.

[135] *See* Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 78 B.U. L. REV. 523, 534 (1993) ("The fiduciary duty to account for any property, profit, or benefit obtained without consent . . . appl[ies] only to the period of conduct and winding up." (footnotes omitted)).

[136] *Id.* at 556 (noting that the RUPA amendments of 1992 specify that the duty not to compete is only for the duration of the partnership, not prior to formation or during winding up).

[137] UNIF. P'SHIP ACT § 18(a) ("Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property and share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied . . . .").

[138] REVISED UNIF. P'SHIP ACT § 401(a) ("Each partner is entitled to an equal share of the partnership distributions . . . .").

[139] Under both the UPA and RUPA, partners are not entitled to remuneration for services to the partnership, given that all partners are expected to co-manage the partnership. *See id.* § 401(j) ("A partner is not entitled to remuneration for services performed for the partnership, except for reasonable compensation for services rendered in winding up the business of the partnership."); UNIF. P'SHIP ACT § 18(f) ("No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.").

court finds that a general partnership has been formed, then the profits would be split equally between or among the partners. FounderA and FounderB may dispute FounderC's role as a partner in their partnership, particularly once the partnership is profitable. This dispute may arise out of opportunism or out of a reasonable belief that FounderC's contributions are not as valuable.[140] Absent an agreement, however, a court will not be able to allocate profits based on desert or merit but pro rata.

c. Other Partnership Rights

The existence of a partnership gives parties the right to inspect books and records[141] and also the right to certain information disclosures and an account of partnership financial affairs.[142] This right enables partners to enforce other rights, such as the right to an equal share of profits. Exiled partners, such as FounderC, may not know the partnership is profitable because they are not included in important meetings or given access to financial information.

Just as "[h]appy families are all alike, but each unhappy family is unhappy in its own way,"[143] formal partnerships are all similar, but disputed partnerships are dysfunctional in their own ways. Parties may allege partnerships in enterprises involving marital relationships, nonmarital romantic

---

[140] In the Urban Decay dispute discussed *supra*, Sandra Lerner and David Soward believed that, at most, Patricia Holmes had come up with the "idea" for the company that Lerner and Soward later built with their own capital, expertise, and connections. *See* Holmes v. Lerner, 88 Cal. Rptr. 2d 130, 133 (Ct. App. 1999); *supra* Part I.C. According to Holmes, Soward told her that a 1% or 2% interest might be applicable, but 5% was "high for an idea." *Holmes*, 88 Cal. Rptr. at 135. Holmes, however, argued that she was a founder, and won. *Id.* at 137–38.

[141] REVISED UNIF. P'SHIP ACT § 408(b) ("On reasonable notice, a partner may inspect and copy during regular business hours, at a reasonable location specified by the partnership, any record maintained by the partnership regarding the partnership's business, financial condition, and other circumstances, to the extent the information is material to the partner's rights and duties under the partnership agreement or this [act]."); UNIF. P'SHIP ACT § 19 ("[E]very partner shall at all times have access to and may inspect and copy any of [the partnership books].").

[142] REVISED UNIF. P'SHIP ACT § 408(c)(1)–(2) (providing that the partnership must furnish "without demand, any information concerning the partnership's business, financial condition, and other circumstances which the partnership knows and is material to the proper exercise of the partner's rights and duties" and also must furnish "on demand, any other information concerning the partnership's business, financial condition, and other circumstances" if not unreasonable or improper); UNIF. P'SHIP ACT § 20 ("Partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or partner under legal disability."); *id.* § 22 ("Any partner shall have the right to a formal account as to partnership affairs . . . .").

[143] LEO TOLSTOY, ANNA KARENINA 3 (Constance Garnett trans. 1901) (ebook).

relationships,[144] familial relationships,[145] friendships, officemates,[146] subcontractors,[147] vendors,[148] insurers,[149] and acquaintances. Parties may dispute that an informal partnership exists strategically, particularly after a relationship sours, to retain profits for themselves or to avoid sharing losses. On the other hand, parties may sincerely believe that preliminary actions in fledgling businesses, or parallel business activities, do not create an actual general partnership. Proper planning can protect unwitting parties from both being unexpectedly characterized as partners with others and also being strategically ousted from the fruits of their efforts in pursuit of a joint endeavor.

2. Partner v. Third Party

Though most partnership formation disputes are between purported partners, a dispute may arise in which a third party alleges the existence of a partnership between or among parties to increase chances of full recovery in a contract or tort dispute. If SeedsNThings does not pay CompostBox's invoices, then CompostBox may believe it has a greater ability to collect what it is due by suing the founders as partners in a general partnership. By proving an informal partnership, the claimant then can recover from business assets and also personal assets of all partners,[150] or the business assets of

---

[144] *See, e.g.*, Carlson v. Ismail, No. 3-11-0566, 2012 WL 7006508, at *1, *7–8 (Ill. App. Ct. Sept. 13, 2012) (holding that a twenty-year relationship among two individuals who lived together and owned property together was not a de facto partnership).

[145] *See, e.g.*, Firestone v. VanHolt, 186 S.W.3d 319, 328–29 (Mo. Ct. App. 2005) (denying a motion for summary judgment because competing testimony was given as to whether the brothers had an agreement to split roofing profits).

[146] *See, e.g.*, Snyder v. Dunn, 638 N.E.2d 744, 747 (Ill. App. Ct. 1994) (concluding that physicians who shared office space but filed separate tax returns and kept separate bank accounts were not partners).

[147] *See, e.g.*, Sys. Dev. Integration, LLC v. Comput. Scis. Corp., 739 F. Supp. 2d 1063, 1085 (N.D. Ill. 2010) (affirming the lower court's finding that a subcontractor and contractor did not form a partnership through emails using the term "partner" in the "colloquial" sense).

[148] *See, e.g.*, OnMedia Intern., Inc. v. Coca-Cola Co., Nos. 1-13-3669, 1-14-0011, 2015 WL 9392850, at *6 (Ill. App. Ct. Dec. 22, 2015) (holding that the lower court properly granted summary judgment because there was insufficient evidence supporting the existence of a partnership between Coca-Cola and the supplier of the beverage carrier).

[149] *See, e.g.*, *In re* Senior Living Props., L.L.C., 309 B.R. 223, 255 (Bankr. N.D. Tex. 2004) (holding that an insurance company that sold a surety bond with a complex reimbursement agreement to a nursing home debtor was a partner of the debtor and subject to liability).

[150] REVISED UNIF. P'SHIP ACT § 306(a) ("Except as otherwise provided in subsections (b) [liabilities incurred before becoming a partner] and (c) [liabilities incurred while a limited liability partnership], all partners are liable jointly and severally for all debts . . . ."); UNIF. P'SHIP ACT § 15 ("All partners are liable (a) [j]ointly and severally for everything chargeable to the partnership under sections 13 [wrongful act] and 14 [breach of trust and] (b) [j]ointly for all other debts and obligations of the partnership . . . ."). Under RUPA, creditors must exhaust the assets of the

corporate would-be partners.[151] Third parties could also rely on a related doctrine, partnership by estoppel.[152]

If the venture had chosen to create any other entity, then the venture would have had limited liability automatically; therefore, unexpectedly being characterized as a partnership would be an unwelcome surprise to most venturers.[153] Sole proprietorships, however, which constitute over two-thirds of all business ventures,[154] do not have limited liability,[155] so the outcome would not be worse than presuming that two sole proprietors could engage in business activities without becoming a partnership.[156] Personal

---

partnership before executing a judgment against partners in most circumstances. REVISED UNIF. P'SHIP ACT § 307(d).

[151] *See, e.g.*, Big Easy Cajun Corp. v. Dall. Galleria Ltd., 293 S.W.3d 345, 348–49 (Tex. App. 2009) (holding that the management fees based on the stores' gross receipts did not make a shopping center operator a partner in the mall for the purposes of liability for one of the lessee's debts).

[152] UNIF. P'SHIP ACT § 16(1) ("When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership . . . ."); *accord* REVISED UNIF. P'SHIP ACT § 308. Partnership by estoppel is a doctrine related to apparent authority of agents (or nonagents) to bind principals and does not rely on the formation of an actual partnership under the statute. *See* Elizabeth R. Darby, *Relations Between Attorneys: When Does a Partnership Exist?*, 18 J. LEGAL PROF. 319, 326–27 (1993) ("Even if a partnership does not expressly exist between attorneys, a partnership by estoppel may be found to protect third parties."). Purported partners may not make a claim under partnership by estoppel. *See, e.g.*, DeCristofaro v. Nest Seekers E. End, LLC, No. 35876-11, 2017 WL 350803, at *10 (N.Y. Sup. Ct. Jan. 11, 2017).

[153] Note, however, that though corporations, LLCs, and LPs automatically have limited liability, in practice, smaller businesses may be able to insulate owners from the unexpected tort claimant, but not contract parties who may ask for personal guarantees of loans and real estate leases. *See* Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310, 2350 (2005) (stating that personal guarantees "are ubiquitous in small business [bankruptcy] cases"); Joseph F. Cudia, Note, *Personal Guarantees: Recent Cases Setting Dangerous Precedent*, 10 OHIO ST. BUS. L.J. 1, 8–9 (2015) (examining the crucial role that personal guarantees play in small business lending, franchise agreements, and commercial leases).

[154] JOINT COMM. ON TAXATION, JCX-3-18, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2018, at 32 tbl.A-4 (2018) [hereinafter JOINT COMM. ON TAXATION, JCX-3-18] (providing data showing that, in 2015, nonfarm sole proprietorships constituted 25,226,245 tax filers, compared to 1,632,229 C corporations; 4,487,336 S corporations; 3,715,187 taxable partnerships (LLCs, LPs, LLPs, and GPs); and 1,841,542 farms).

[155] Mitchell F. Crusto, *Extending the Veil to Solo Entrepreneurs: A Limited Liability Sole Proprietorship Act (LLSP)*, 2001 COLUM. BUS. L. REV. 381, 417–26 (arguing for a limited liability regime for sole proprietors, who have personal liability for direct acts and vicarious acts of agents).

[156] *See* Harry Herzog, *Choosing the Correct Entity*, 36 CORP. COUNS. REV. 215, 222 (2017) ("Clients come to you with a sole proprietorship, but you should never form one. Clients come to you with a general partnership that they have either intentionally formed or formed as a matter of law through their ignorance and obliviousness as to the law regarding partnership formation. Both

liability for sole proprietors and partners in a general partnership is a well-known feature of those business forms, so liability is not an absurd or unfair result.[157]

Though third parties can prove the existence of a general partnership under the statute to impose liability appropriately on participants acting without a limited liability shield, a potentially abusive strategy has emerged that involves related corporations and shareholders and their corporations.[158] Claimants against one corporation allege that the debtor corporation and a related corporation formed a default partnership and, therefore, the related corporation should be liable for the obligations of the subsidiary.[159] Similarly, third-party claims of default partnership can be used to try to reach the assets of a spouse of a shareholder,[160] or the assets of a corporation controlled by the debtor's spouse, by alleging that one spouse was in a partnership with the entity controlled by a different spouse.[161] This creative allegation attempts to achieve the same result as piercing the veil,[162] without meeting state-specific veil-piercing alter ego tests or reverse veil-piercing tests, which generally require a showing of fraud or illegitimate purpose.[163]

---

provide no tax advantage and no liability shield, and it is our responsibility to move them out of the sole proprietorship or general partnership into a better entity.").

[157] *See, e.g.*, McDonald v. Millaudon, 5 La. 403, 407 (1833) (reasoning that if Louisiana law did not provide for implied partnerships, then "it should be immediately changed by the legislature; for no state of things could be readily conceived, more injurious to the public interests, which would more embarrass commercial transactions, or furnish greater facilities to the commission of fraud").

[158] *See, e.g.*, NMRO Holdings, LLC v. Williams, No. 1960 WDA 2016, 2017 WL 4782793, at *6 (Tex. App. Oct. 24, 2017) (upholding the trial court's finding that the plaintiff had failed to raise a fact issue regarding a de facto partnership claim as an alternative to piercing the veil, joint enterprise, and conspiracy in an attempt to impose liability on the debtor's wife's unrelated business).

[159] *See, e.g.*, PPG Architectural Finishes Inc. v. N. Siperstein West-End Paint Co., No. 10-16-00326-CV, 2018 WL 1474171, at *1 (Pa. Super. Ct. Mar. 26, 2018); Pertuis v. Front Roe Rests., Inc., 817 S.E.2d 273, 281 (S.C. 2018) (reversing the lower court's determination that three S corporations were "amalgamated" into a "de facto partnership," bypassing the internal affairs doctrine that would normally apply to a veil-piercing claim).

[160] *See, e.g.*, Palasota v. Doron, No. 10-16-00326-CV, 2018 WL 2054511, at *4 (Tex. App. May 2, 2018) (reversing summary judgment for the appellant creditor on the basis that there was no evidence that the appellee spouse was in a partnership with her husband and brother-in-law who were concrete contractors).

[161] *See, e.g.*, *NMRO Holdings*, 2017 WL 4782793, at *1.

[162] *See, e.g.*, *Best Cartage, Inc.*, 727 S.E.2d at 299–330 (allowing the theory of de facto partnership between two related corporations to proceed even though the court upheld the dismissal of the veil-piercing claim); *cf.* McCormick v. City of Dillingham, 16 P.3d 735, 743 (Alaska 2001) (affirming the lower court's proceeding to bench trial on a veil-piercing theory even though the plaintiff originally pled a de facto partnership theory because either way the defendant had been put on notice of potential personal liability).

[163] *See* SSP Partners v. Gladstrong Invs. (USA) Corp., 275 S.W.3d 444, 452 (Tex. 2008).

The claim could also be used as an easier route to enterprise liability or amalgamation.[164] To date, these allegations have had mixed success.[165]

III. In Defense of the "De Facto" Partnership

The default partnership doctrine provides the protections necessary for innovation, collaboration, and entrepreneurship outside of formal legal entities. Section A of this Part discusses the need for such a doctrine.[166] Section B explores possible substitutes to the default partnership doctrine and eliminates them as viable alternatives.[167] Section C demonstrates that general partnerships remain sufficiently commonplace such that a default doctrine still adequately serves as a backstop for modern firms.[168] Section D argues that the default partnership doctrine plays a valuable role in lowering the internal transaction costs of a firm.[169] Lastly, Section E dispels the notion that, analogous to non-compete convenants, the default partnership doctrine stifles innovation and draws an important distinction between the employer-employee relationship and that among partners.[170]

A. Default Categorization as Necessary Backstop

The general partnership, as the only legal entity that exists without formal incorporation, operates as an important backstop. Without a default categorization, the many businesses that operate without formal agreements or filings would have to rely on a combination of contract law, property law, and agency law. Partnership law is more efficient and applicable.

---

[164] *See, e.g.*, *Pertuis*, 817 S.E.2d at 281 (reversing the appellate court's holding that three corporations with the same owners and lack of corporate formalities could be treated as one de facto partnership); *see also* Adair B. Patterson, Comment, Pertuis v. Front Roe Restaurants, Inc.*: Equity Restores the Corporate Veil in Single-Business Enterprise Theory*, 70 S.C. L. Rev. 891, 892 (2019) (discussing the holding in *Pertuis v. Front Roe Restaurants, Inc.* and its test to establish a "single business enterprise").

[165] *See, e.g.*, Alford v. Access Indus., Inc., No. 1:15-CV-59, 2016 WL 3460775, at *6–9 (E.D. Tex. Feb. 8, 2016); *NMRO Holdings*, 2017 WL 4782793, at *6 (affirming the dismissal of a claim alleging that a debtor had formed a de facto partnership with a spouse's limited liability company, thereby allowing the assets of the LLC to be used to satisfy judgment against the debtor). *But see* Bradson Mercantile, Inc. v. Vanderbilt Indus. Contracting Corp., 883 F. Supp. 37, 48 (W.D.N.C. 1995) (holding that the wife of a shareholder of a parent company may be found to be in a de facto partnership with the shareholder and a subsidiary).

[166] *See infra* Part III.A.

[167] *See infra* Part III.B.

[168] *See infra* Part III.C.

[169] *See infra* Part III.D.

[170] *See infra* Part III.E.

1. Intentional, Informal General Partnership

Many business venturers may intentionally do business without a formal agreement, operating on trust, family ties, and community norms. The law of general partnership provides a set of governance rules to use in times of dispute or dissolution that are generally useful for most small business dealings.[171] Quite often, the doctrine protects parties who operate in a culture of trust with spouses or family members until there is a breakdown in the relationship.

Consider common-law marriage, a doctrine that historically served to protect parties' expectations when they cohabitated, agreed to be married, and held themselves out as such without a formal religious or governmental ceremony.[172] The doctrine served mostly those of small means, protecting both wives and children of the relationship.[173] Without this backstop, romantic partners could act strategically with one another, expressing marital intent until it might serve them to deny it. In addition, widowed spouses might have no claim to decedents' property for themselves or their children against other family members.[174] In previous centuries, parties who set up housekeeping together and had children seemed to be nothing if not married; the law and society had no other real categories for them. In modern times, social norms have changed such that many individuals choose to live with a romantic partner without the legal backstop of marriage;[175] "de fac-

---

[171] *See Prefatory Note to Uniform Partnership Act (1997)*, REVISED UNIF. P'SHIP ACT (UNIF. LAW COMM'N 1997, amended 2013) ("The Uniform Partnership Act (1994) ('Revised Act' or 'RUPA') gives supremacy to the partnership agreement in almost all situations. The Revised Act is, therefore, largely a series of 'default rules' that govern the relations among partners in situations they have not addressed in a partnership agreement. The primary focus of RUPA is the small, often informal, partnership. Larger partnerships generally have a partnership agreement addressing, and often modifying, many of the provisions of the partnership act.").

[172] *See generally* Sarah Primrose, Note, *The Decline of Common Law Marriage & the Unrecognized Cultural Effect*, 34 WHITTIER L. REV. 187, 191–201 (2013) (tracing the history of common-law marriage from ancient Rome to present-day United States).

[173] *See* Ashley Hedgecock, Comment, *Untying the Knot: The Propriety of South Carolina's Recognition of Common Law Marriage*, 58 S.C. L. REV. 555, 560 (2007).

[174] *Cf.* Peter Nicolas, *Common Law Same-Sex Marriage*, 43 CONN. L. REV. 931, 936 (2011) (noting that New Hampshire will not recognize the common-law marriage doctrine if both purported spouses are alive but will invoke it for "probate and inheritance purposes").

[175] *See* June Carbone & Naomi Cahn, *Nonmarriage*, 76 MD. L. REV. 55, 99 (2016) ("While some couples treat cohabitation as a form of 'trial marriage,' to see whether or not they are compatible, for others, a decision to move in together may have simply been a matter of convenience—a way to save money or to find a place to stay in a new city."); *cf.* Emily J. Stolzenberg, *The New Family Freedom*, 59 B.C. L. REV. 1983, 2025–26 (2018) (arguing that doctrines such as common-law marriage threaten "the new family freedom" because "[a]lthough relationship-based doctrines do a reasonably good job of addressing dependency when the poorer party prevails, they effectively reject the richer party's claim to choose his family obligations" (footnote omitted)).

to" marriage probably would not satisfy the preferences of most unmarried romantic cohabitants.[176] Commercial norms, however, do not supply an alternative dominant paradigm of business participants working together on a venture without assuming some sort of business relationship. A default general partnership doctrine still seems necessary, even with the availability of quick, online incorporation (like matrimony).

2. Intentional, Pre-formal General Partnership

Other times, co-entrepreneurs with little time or experience for legal formalities race to perfect the business, not the entity. A savvy legal advisor might counsel forming an entity from the outset, even if the nascent business never gets off the ground.[177] Startup founders, however, may rationally choose not to go to the expense of seeking expert advice in those early stages.[178] Allowing collaborating parties to treat one another according to the "morals of the marketplace" in the absence of a partnership agreement, even when the relationship meets the hallmarks of a partnership, is not conducive to collaboration or entrepreneurship. In many ways, the default partnership doctrine is pro-innovation and pro-business because it allows participants to take business risks and make firm-specific investments in early-stage businesses.

3. Default Partnership Doctrine Is Limited by Definition

Though this Article began with one large jury verdict directly attributable to the default partnership doctrine[179] and two large settlements reason-

---

[176] Currently, there are no more than nine states that recognize the common-law marriage doctrine. *See* Primrose, *supra* note 172, at 190 (listing, as of 2013, Alabama, Colorado, Kansas, Rhode Island, South Carolina, Iowa, Montana, Oklahoma, and Texas as recognizing the doctrine). According to Professor Primrose, the decline of the doctrine in the twentieth century was not merely due to increased urbanization, literacy, and bureaucracy; states wished to control marriage "to prevent interracial marriage" and other types of unwanted relationships. *Id.* at 198–99.

[177] The transaction costs of creating a firm to hold a business that never materializes are not zero, however. Incorporated firms may not simply be abandoned; they must be formally dissolved by a majority of the owners. In a two-person firm, this may mean unanimous action. *See, e.g.*, MODEL BUS. CORP. ACT § 14.02 (AM. BAR ASS'N 2016) (providing a mechanism for dissolution that entails a board of directors proposal, then a vote "consisting of a majority of the votes entitled to be cast" by the shareholders).

[178] *See* Susan C. Morse & Eric J. Allen, *Innovation and Taxation at Start-up Firms*, 69 TAX L. REV. 357, 357–58 (2016) ("Therefore, a start-up considering income tax planning must balance, on one hand, the advantage of a reduction in tax due on any future profit against, on the other hand, the disadvantage of reducing business spending, which, as a result of the capital constraint, reduces the firm's expected probability of success.").

[179] *See supra* Part I.C.

ably related to it,[180] courts are constrained to applying the doctrine only to relationships that meet the statutory definition. Moreover, the doctrine has been in use since at least the first Uniform Partnership Act in 1914, and the courts are not full of unintentional partners being roped together judicially into default partnerships.[181]

One of the most important elements, if not *the* most important element, of a default partnership, is intent of the parties.[182] Courts look to see whether the parties intended to co-own a business—whether the parties called it a partnership or not.[183] If the parties did not intend a joint operation, then a court will not impose a partnership on them. The parties do not have to recognize that their venture will be characterized as a partnership, but the parties should always subjectively understand that they are in some sort of business together.[184] Partners acting strategically will disavow any intent to do business together, but courts will look to objective indicia of intent. If none can be found, then courts will conclude that the element of intent has not been satisfied.

---

[180] *See supra* Part I.A–B.

[181] A search on Westlaw of all state cases between July 23, 2004, and July 31, 2019, yields eighty-two cases that mention a "de facto partnership." *State Cases*, WESTLAW EDGE, https://1.next.westlaw.com/Browse/Home/Cases/StateCases (search "'de facto partnership' & DA(aft 07-22-2004 & bef 08-01-2019)"). Of that group, only twenty-nine were unique cases that involved parties disputing the designation of partnership in a claim properly asserted and considered by the court. Of those twenty-nine cases, only seven involved a plaintiff that had alleged a partnership being granted some sort of relief, whether reversal of a dismissal or summary judgment, or affirmation of a lower ruling. This twenty-four percent success rate is, of course, subject to the common criticisms of appellate opinion research: that litigants and appellants are self-selecting; that cases being litigated are more difficult and have closer facts; and that appellate courts review lower courts with some level of deference. In addition, the twenty-nine cases are from fourteen states, and those states that use the phrase "de facto partnership" may be less inclined to use the doctrine, whereas states that use the phrase "informal partnership" or "default partnership" may embrace the doctrine in a more positive way. The distinction also may be from court to court, and not state to state. During the same time period, "implied partnership" appears in eighty-two cases. *Id.* (search "'implied partnership' & DA(aft 07-22-2004 & bef 08-01-2019)"). "Informal partnership" appears in fifty-eight cases. *Id.* (search "'informal partnership' & DA(aft 07-22-2004 & bef 08-01-2019)"). And "default partnership" only appears once. *Id.* (search "'default partnership' & DA(aft 07-22-2004 & bef 08-01-2019)"). Some cases involving the doctrine merely use the phrase "general partnership." *See, e.g.*, Enter. Prods. Partners, L.P. v. Energy Transfer Partners, L.P., 529 S.W.3d 531, 533 (Tex. App. 2017).

[182] Courts look to both subjective intent of the partners and objective manifestations, which may be indicia of subjective partnership intent. *See* HURT & SMITH, *supra* note 85, § 2.04.

[183] *See, e.g.*, City of Corpus Christi v. Bayfront Assocs., Ltd., 814 S.W.2d 98, 109 n.4 (Tex. App. 1991) ("[A] duck which is called a horse does not become a horse; a duck is a duck.").

[184] *See, e.g.*, *In re* Moon Estate, No. 294176, 2011 WL 254934, at *5–6 (Mich. Ct. App. Jan. 27, 2011) ("Even the complete absence of subjective intent to form a partnership is not dispositive to whether a partnership exists. The key is that the parties associate themselves to run a business for profit as co-owners, 'regardless of their subjective intent to form such a legal relationship.'" (citation omitted) (quoting Byker v. Mannes, 641 N.W.2d 210, 215 (Mich. 2002))).

One may object, however, to the harsh or surprising consequences of the default partnership doctrine. Without the ability to claim a default partnership, participants would need another legal claim to restore expectations. The following discussion explores some alternatives.

B. Viable Alternatives to UPA/RUPA Default Partnership Status Are Lacking

Without a robust legal doctrine to govern informal partnerships, intentional partners would be able to strategically disavow a partnership, leading to unfair results. If the default partnership doctrine can be overprotective, giving purported partners the full panoply of general partnership rights and duties, then one might argue that a less-intrusive legal doctrine could protect the unfairly ousted founder in proportion to that founder's contributions to the venture. If states decided to veer from the UPA and RUPA statutory definition of partnership, what would take its place?

1. The De Facto Corporation Doctrine

Particularly in cases in which the parties seem to contemplate incorporation in some form at a later date, one might argue that the de facto corporation doctrine is more applicable than the de facto partnership doctrine. After all, default rules should try to capture the agreement that the parties would have struck had they bargained, and most parties contemplating a business venture would bargain for limited liability, which the de facto corporation doctrine provides for certain unincorporated entities. In corporate law, the de facto corporation doctrine has saved many a businessperson from personal liability for at least a century.[185] The de facto corporation doctrine, however, applies only to *defective* incorporations or *delayed* incorporations, not to lengthy time periods of conducting business without incorporation or prior to incorporation.[186] Moreover, the de facto corporation doctrine works to insulate participants from personal liability to third parties, not to insulate them from fiduciary duties to one another.

---

[185] *See* Edward H. Warren, *Collateral Attack on Incorporation*, 20 HARV. L. REV. 456, 456–61 (1907) (comparing the de facto corporation doctrine to similar de facto doctrines involving purported public officers, landowners, and parents); Note, *De Facto Corporations*, 16 HARV. L. REV. 362, 362–63 (1903) (discussing the then recent cases involving the de facto corporation doctrine).

[186] *See* Brown v. W.P. Media, Inc., 17 So. 3d 1167, 1170 (Ala. 2009) (holding that Alabama law allows for an "improperly formed corporation" to be treated as a corporation if a "bona fide and colorable attempt has been made to create a corporation" (quoting Eagerton v. Second Econ. Dev. Coop. Dist. of Lowndes Cty., 909 So. 2d 783, 789 (Ala. 2005))).

The de facto corporation doctrine recognizes that sometimes equity compels courts to treat a business as a *common-law* corporation in fact, even though it has not met the legal requirements of a de jure corporation. For owners of a business to claim that they should be considered a de facto corporation, state courts generally require that owners make a bona fide attempt to incorporate[187] and have a colorable claim that the statute has been followed, combined with conducting the business as a corporation.[188] The Model Business Corporation Act (MBCA), however, currently provides only that "persons purporting to act as or on behalf of a corporation, knowing there was no incorporation under this Act, are jointly and severally liable for all liabilities created while so acting."[189] Despite the MBCA's attempt to limit the use of the doctrine and current ambivalence,[190] cases nev-

---

[187] *See, e.g.*, Trs. of Empire State Carpenters Annuity, Apprenticeship, Labor-Mgmt. Cooperation, Pension & Welfare Funds v. Rodrigue, No. 13-CV-5760(JS)(SIL), 2017 WL 1180513, at *8 (E.D.N.Y. Mar. 29, 2017) (upholding the trial court's finding that a business should not be treated as a de facto corporation "in the absence of any evidence of an attempt to organize the entity as a corporation").

[188] *See, e.g.*, Trs. of Peninsula Annual Conference of the Methodist Church, Inc. v. Spencer, 183 A.2d 588, 592 (Del. Ch. 1962) ("The general rule with regard to the existence of a de facto corporation requires (1) a special act or general law under which a corporation may lawfully exist; (2) a *bona fide* attempt to organize under the law and colorable compliance with the statutory requirements; and (3) actual user or exercise of corporate powers in pursuance of such law or attempted organization."); *In re* Estate of Hausman, 921 N.E.2d 191, 193 (N.Y. 2009) (restating the New York de facto corporation doctrine as requiring "(1) a law under which the corporation might be organized, (2) an attempt to organize the corporation and (3) an exercise of corporate powers thereafter"). Another subset of cases involves corporations that temporarily lose their legal status because of administrative action. *See, e.g.*, L-Tec Elecs. Corp. v. Cougar Elec. Org., Inc., 198 F.3d 85, 87 (2d Cir. 1999) ("[W]e see convincing signs in New York case law that a company dissolved for failure to pay franchise taxes can be considered a de facto corporation."); *In re* Estate of Greb, 848 N.W.2d 611, 620 (Neb. 2014) (holding that a firm continued as a de facto corporation after its dissolution, in part because it continued conducting business and observing corporate formalities).

[189] MODEL BUS. CORP. ACT § 2.04. Drafters of the 2016 Model Business Corporation Act (MBCA) state that liability is only imposed on those who "know" there has been no incorporation, thus recognizing limited liability if the incorporator does not "know" that the incorporation has failed. *Id.* § 2.04 cmt. ("Ordinarily, only the filing of articles of incorporation should create the privilege of limited liability. Situations may arise, however, in which the protection of limited liability arguably should be recognized even though the simple incorporation process established by the Act has not been completed.").

[190] The early versions of the MBCA arguably eliminated the doctrine following commentary that it should be abandoned. *See* Alexander Hamilton Frey, *Legal Analysis and the "De Facto" Doctrine*, 100 U. PA. L. REV. 1153, 1178 (1952); *see, e.g.*, Timberline Equip. Co., Inc. v. Davenport, 514 P.2d 1109, 1110 (Or. 1973) (holding that the 1950 and 1969 versions of the MBCA, which were the working models for the Oregon statute, abrogated the common-law doctrine). Revisions to the MBCA in 1984 modified section 2.04 to its current language. Timothy R. Wyatt, *The Doctrine of Defective Incorporation and Its Tenuous Coexistence with the Model Business Corporation Act*, 44 WAKE FOREST L. REV. 833, 836 (2009). These revisions specified five examples where limited liability should protect purported corporate shareholders: (1) participants

ertheless arise, though incorporation is much simpler and easier in today's world of electronic filing.[191] Although some states reject the doctrine altogether,[192] many courts have applied the de facto corporation doctrine to LLCs[193] and LPs.[194]

Because the doctrine is generally focused on whether a participant in an enterprise has limited liability, it is ordinarily used as a defense against a claim by a third party to the corporation.[195] In similar settings, it can be used against a third party who wishes to claim that a contract executed in the corporation's name is void because the corporation was not a legal entity at the time of execution.[196] In both these situations, courts also focus on whether the third party believed that the counterparty was a corporation and

---

honestly and reasonably are mistaken that articles of incorporation have been filed by an attorney; (2) articles of incorporation are sent by mail and delayed or rejected; (3) a contract party urges execution of contract, knowing that entity has not been incorporated; (4) contract party believed entity was a corporation and had no expectation of personal liability of owner; and (5) inactive investors who believed incorporators would not do business until incorporation. *See* MODEL BUS. CORP. ACT § 2.04 official cmt. (AM. BAR ASS'N 1984 & 1992 Supp.); Emeka Duruigbo, *Avoiding a Limited Future for the De Facto LLC and LLC by Estoppel*, 12 U. PA. J. BUS. L. 1013, 1031–37 (2009). These scenarios, however, do not appear in the current version of the MBCA, revised in 2016. *See* MODEL BUS. CORP. ACT § 2.04 (AM. BAR ASS'N 2016).

[191] *See* Mark J. Loewenstein, *Rationalizing Entity Law: Corporate Law and Alternative Entities (Part I)*, 2013 BUS. L. TODAY 1, 3 ("Corporate law has moved away from the concept of de facto corporations, in part because it has become easier to form corporations.").

[192] *See, e.g.*, Thomas E. Rutledge, *Shareholders Are Not Fiduciaries: A Positive and Normative Analysis of Kentucky Law*, 51 U. LOUISVILLE L. REV. 535, 536 n.5 (2013) ("Kentucky does not recognize a 'common law' or 'de facto' corporation.").

[193] *See, e.g.*, Duray Dev., LLC v. Perrin, 792 N.W.2d 749, 759 (Mich. Ct. App. 2010) (reversing trial court findings on the grounds that the de facto corporation doctrine applies to LLCs); *In re Estate of Hausman*, 921 N.E.2d at 194 (holding that the LLC in question did not meet the test for a de facto LLC); *see also* Duruigbo, *supra* note 190, at 1038–41 (surveying the landscape for a de facto LLC doctrine in all fifty states).

[194] *See, e.g.*, Vulcan Furniture Mfg. Corp. v. Vaughn, 168 So. 2d 760, 764 (Fla. Dist. Ct. App. 1964); *cf.* UNIF. LTD. P'SHIP ACT § 306(a) (UNIF. LAW COMM'N 2001, amended 2013) (stating that "[e]xcept as otherwise provided in subsection (b), a person that makes an investment in a business enterprise and erroneously but in good faith believes that the person has become a limited partner in the enterprise is not liable for the enterprise's obligations" if that person takes certain steps upon disclosure of the mistake).

[195] *See, e.g.*, *L-Tec Elecs. Corp.*, 198 F.3d at 87 (holding that the lower court did not err in granting summary judgment to individual defendants who would not be personally liable under the de facto corporation doctrine).

[196] *See, e.g.*, Lehlev Betar, LLC v. Soto Dev. Grp., Inc., 15 N.Y.S.3d 168, 169–70 (App. Div. 2015) (holding that the de facto corporation doctrine applied to an LLC that was formed after purportedly taking title to real property, therefore quieting title to that property); Le Oceanfront, Inc. v. Lands End of Emerald Isle Ass'n, 768 S.E.2d 15, 21 (N.C. Ct. App. 2014) (holding that a corporation that incorporated forty-nine minutes after purchasing property was a de facto corporation and was the legal owner of the property).

thus a limited liability entity.[197] Because courts often take into account the expectations of the plaintiff third party, the de facto corporation doctrine is frequently considered as or conflated with estoppel.[198]

The de facto corporation doctrine exists to preserve the expectations of founders and third parties when technical defects have prevented incorporation. The doctrine would not work to resolve disputes between parties who have not chosen to incorporate or at least not *yet* chosen to incorporate. In fact, some parties may have consciously chosen not to incorporate. If a default doctrine exists to give the set of rights and obligations to parties that they would have chosen (or thought they had chosen), then for many parties operating in the beginnings of a business venture, formation as a corporation may not be a good default rule at all. Absent some type of affirmative step to incorporate, an assumption that the parties would eventually incorporate as a corporation is unfounded.[199] Without some evidence that parties have moved toward incorporation as a corporation, LLC, or LP, or held themselves out as such in good faith, the de facto corporation (or LLC or LP) doctrine does not seem appropriate.

Moreover, the de facto corporation doctrine does not speak to affairs inside the firm. The de facto corporation doctrine does not assign rights and obligations to would-be officers and directors, determine which parties are shareholders, or allocate profits as dividends. The doctrine works in a narrow space in both substance and in time.

---

[197] *See, e.g.*, *Le Oceanfront, Inc.*, 768 S.E.2d at 21 (stating as part of the de facto corporation doctrine that "the persons affected thereby have acquiesced therein" and naming as the affected parties both the seller of the property and the de facto corporation purchaser (quoting Pocahontas Fuel Co. v. Tarboro Cotton Factory, 93 S.E. 790, 793 (N.C. 1917))).

[198] *See, e.g.*, Posner v. City of New York, No. 11 Civ. 4859(JMF), 2014 WL 185880, at *6 (S.D.N.Y. Jan. 16, 2014) ("[T]he *de facto* corporation doctrine is a doctrine of estoppel . . . ."); First Cmty. Bank, N.A. v. Cmty. Youth Ctr., 81 Va. Cir. 416, 422 (Cir. Ct. 2010) (finding that a corporation still existed after termination of its corporate existence because it continued its operations and thus "should be deemed a corporation by estoppel"); *see also* Norwood P. Beveridge, *Corporate Puzzles: Being a True and Complete Explanation of De Facto Corporations and Corporations by Estoppel, Their Historical Development, Attempted Abolition, and Eventual Rehabilitation*, 22 OKLA. CITY U. L. REV. 935, 939–40 (1997) (discussing the blurred distinction between "promoter's contracts, de facto corporations, and corporations by estoppel," despite there being historically three separate doctrines).

[199] *See, e.g.*, *Annual Report Statistics*, DEL. DIV. CORPS. (2018), https://corpfiles.delaware.gov/Annual-Reports/Division-of-Corporations-2018-Annual-Report.pdf [https://perma.cc/L48G-6M59] (noting that in 2018 Delaware had 157,142 LLCs formed in the state, compared to 44,669 corporations).

2. Why Not Contract Law?

As litigants often point out, these cases could be determined by looking to contract law.[200] A partnership agreement is merely a type of contract, so contract law may be more useful than an invasive partnership doctrine that creates a judicially imposed structure with many more rights and obligations than a simple contract. As defendants point out, however, plaintiffs face a difficult challenge in alleging the existence of an oral contract or a written contract from various communications, documents, and actions. Though an implicit understanding to form a partnership-like relationship may not satisfy the default partnership doctrine because the basic agreement is too vague, the default partnership doctrine allows for much more ambiguity than contract law.[201]

Defendants understand that contract law is far more exacting than partnership law, and few plaintiffs would have the ability, without a written partnership agreement, to prove the existence of an oral contract that would protect their contributions and interest in business profits. To prove that two parties had an implied contract to jointly engage in an endeavor and to share in any profits, that contract would need to have mutual assent to enter into the contract,[202] some sort of bargained-for consideration,[203] and specific terms for enforcement and remedy purposes.[204]

---

[200] *See, e.g.*, Grunstein v. Silva, No. 3932-VCN, 2014 WL 4473641, at *2 (Del. Ch. Sept. 5, 2014) (holding that although the highly sophisticated parties seemed to have had some agreement about certain terms of the anticipated partnership, other terms the parties seemed to view as essential were constantly under negotiation, making an oral partnership harder to prove for the plaintiff whose credibility was called into question by a perjury conviction), *aff'd sub nom.* Dwyer v. Silva, 113 A.3d 1080 (Del. 2015); Wnuk v. Doyle, 623 S.E.2d 740, 742 (Ga. Ct. App. 2005) (holding that no partnership existed where a purported partner acknowledged that she would have to contribute some money to pay for her partnership interest but the amount was indefinite because the "omission of the essential term of contract consideration rendered the alleged verbal agreements too indefinite to be enforced"); Price v. Vattes, 161 S.W.3d 397, 401–02 (Mo. Ct. App. 2005) (affirming the lower court's summary judgment order against the plaintiff-appellant because no legal partnership had been formed where plaintiff-appellant failed to show: who the partners were; what their shares in the firm were; what business the alleged partnership conducted; and his authority to contribute to the corporation, which was the alleged partnership's sole asset); Zelina v. Hillyer, 846 N.E.2d 68, 71 (Ohio Ct. App. 2005) (holding that the appellant boyfriend failed to show that he and his girlfriend reached a meeting of the minds about the essential nature and terms of their partnership in various properties and investments).

[201] *See, e.g.*, Forino Barbieri, LLC v. Barbieri, No. CV065002411S, 2008 WL 344680, at *3 (Conn. Super. Ct. Jan. 23, 2008) ("[T]he Court can only find that a de facto business relationship existed at will between these two individuals. There was never a real 'meeting of the minds' between the parties. The day-to-day, job-to-job relationship did not constitute an enforceable contractual relationship.").

[202] RESTATEMENT (SECOND) OF CONTRACTS § 1 (AM. LAW INST. 1981) ("A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."); *id.* § 2(1) ("A promise is a manifestation of

Many scholars refer to firms as a "nexus of contracts," so rethinking informal partnerships as a bundle of contracts is not novel.[205] Attempting to enforce each of the necessary contracts that constitute the firm, thereby giving parties the benefit of being in the firm, however, would be impossible. In comparing contract law with copyright law, which this Article discusses *infra*, Professor Shyamkrishna Balganesh distinguishes the nature of contract with that of copyright, a distinction that applies a fortiori to partnership law:

> As a species of promising, contract law is thought to enable parties to subordinate themselves to each other's wills in the pursuit of a common end. The core idea is thus that in so promising, each party subjects himself/herself to the other party rather than the common end in question. This in turn generates an obligation—to the other contracting party—which produces its own set of normative ideals and behavioral motivations. The obligation to the other party—not the final goal—forms contract law's exclusive concern . . . .[206]

A firm is not just one contract with one goal or a set of contracts with individual goals; it is a set of contracts with one evolving goal. To enforce one of those contracts against a purported partner is to obtain just a thin slice of what the actual agreement was. In a partnership, one partner does not merely make a promise to another partner; the partners make mutual agreements regarding the collective, and all duties to one another flow from

---

intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."); *id.* § 3 ("An agreement is a manifestation of mutual assent on the part of two or more persons. A bargain is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances.").

[203] *See id.* § 17 (providing that, generally, "the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration"); *see also* Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708, 709–10 (2007) (describing how the law of contracts will not enforce a unilateral promise, though moral rules would require the keeping of that promise).

[204] RESTATEMENT (SECOND) OF CONTRACTS § 33(1) ("[An offer] cannot be accepted so as to form a contract unless the terms of the contract are reasonably certain."); *id.* § 33(2) ("The terms of a contract are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy.").

[205] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310–11 (1976).

[206] Shyamkrishna Balganesh, *Unplanned Coauthorship*, 100 VA. L. REV. 1683, 1734–35 (2014) (footnote omitted) (arguing that the "mutual intent" requirement of copyright should not be analyzed in a purely contractual sense); *see also* Robin Kar, *Contract as Empowerment*, 83 U. CHI. L. REV. 759, 774 (2016) (theorizing contract law through an "empowerment" lens, which would allow courts to enforce contracts beyond the subjective will of the contracting parties, instead of a "promise" lens).

the duties to the collective. The remedy for a breach of those duties is far more fulsome than the remedy for the breach of one promise with specific enough terms to be proven in a court of law.[207]

Partnership law arises out of both agency law and contract law.[208] To form a partnership, parties merely have to agree to co-own a business for profit, and some terms may be left ambiguous. A partnership is quintessentially an agreement to agree in the future. The court does not need specific terms of the partnership to enforce the default rules of general partnership given by the state statute, and drafters of the UPA attempted to circumvent the rigors of contract law by using the phrase "association."[209] The parties do not need to supply consideration, and some courts apply the Statute of Frauds differently in the implied partnership context than in the implied contract context.[210] Most importantly, plaintiffs would not have to prove breach of a specific provision of a partnership agreement but can instead prove a breach of fiduciary duty, which arises from the mere existence of a partnership.[211] Though contract parties may follow the letter of the contract if not the spirit, restrained by only the weak contractual duty of good faith and fair dealing, partners owe to one another fiduciary duties, which are

---

[207] *See, e.g*, Ramone v. Lang, No. Civ.A. 1592-N, 2006 WL 905347, at *1 (Del. Ch. Apr. 3, 2006) (finding no binding contract and no de facto partnership but allowing "discrete and focused relief" under the doctrine of promissory estoppel).

[208] REVISED UNIF. P'SHIP ACT § 119 cmt. ("For this act, the common law rules of contract and agency are among the most important supplemental 'principles of law.'"). *But see* UNIF. P'SHIP ACT § 4(2)–(3) (UNIF. LAW COMM'N 1914) (incorporating the laws of estoppel and agency, but not contract, into the UPA).

[209] *See* UNIF. P'SHIP ACT § 6(1) cmt. ("To say that the association must be created by contract, is not only unnecessary, but in view of the varied use of the word 'contract' in our law, if the word is used an explanation would have to be made as to whether the contract could be implied, and if so, whether it could be implied in law or only implied as a fact. By merely saying that it is an association these difficulties are avoided.").

[210] *See, e.g.*, HSqd, LLC v. Morinville, No. 3:11-cv-1225(WWE), 2012 WL 2088698, at *7 (D. Conn. June 8, 2012) (holding that the statute of frauds was inapplicable when the partnership agreement could have been performed within one year); W.G. Wade Shows, Inc. v. Spectacular Attractions, Inc., No. 6:19-CV-03119-SRB, 2019 WL 3254796, at *2 (W.D. Mo. July 19, 2019) ("Missouri's statute of frauds 'does not apply to an oral contract of partnership which fixes no definite duration, since it is susceptible of dissolution within one year and becomes, in effect, a partnership at will.'" (quoting Grissum v. Reesman, 505 S.W.2d 81, 88–89 (Mo. 1974))); Gelman v. Buehler, 936 N.Y.S.2d 154, 156 (App. Div. 2012) (holding that the statute of frauds is inapplicable when there is partial performance of the partnership agreement), *rev'd*, 20 N.Y.3d 534 (2013); Pugliese v. Mondello, 871 N.Y.S.2d 174, 177 (App. Div. 2008) ("[T]he statute of frauds is generally inapplicable to an agreement to create a joint venture . . . .").

[211] *See, e.g.*, Kahn Creative Partners, Inc. v. Nth Degree, Inc., No. CV 10-932-JST (FFMx), 2011 WL 1195680, at *10 (C.D. Cal. Mar. 29, 2011) (dismissing claims of breach of oral contract and partnership agreement, but not dismissing claims of breach of partnership duties in an implied partnership).

much broader.[212] Furthermore, damages for breach of fiduciary duty may be different from damages for an "efficient breach."[213]

3. Why Not Property Law?

Some disputed partnerships build a business around a specific piece of property: an online platform (Facebook) or a mobile application (Snapchat); a brick-and-mortar storefront for goods or services; or real estate. Other businesses are built on improvements to existing business models (Urban Decay's edgy cosmetics and trade dress) with few capital assets. Some of the former types of these disputes might be remedied through claims that the co-founder owns a percentage of the income streams generated by a mobile application or a commercial building. Perhaps a tenancy in common[214] or joint tenancy,[215] if proved, could reach a similar result in some subset of cases. If real property is involved, however, documentation will be necessary to claim some sort of joint ownership. In any event, proving the joint ownership of any type of property could be difficult unless the property is titled appropriately. More importantly, one of the essential features of partnership law is that an entity owns the assets of the partnership, rather than the partners having joint ownership of the assets.[216] This prevents the joint owners from selling partnership property without consent, which is also prohibited for partnership interests.[217]

For example, if FounderA and FounderB agree to pool resources and purchase a taco truck, then they jointly own the taco truck. They each have the right to employ the truck for individual purposes and keep the income,

---

[212] *Cf.* Paul MacMahon, *Good Faith and Fair Dealing as an Underenforced Legal Norm*, 99 MINN. L. REV. 2051, 2056 (2015) (noting the "gap between the rhetoric of good faith and fair dealing and the reality of judicial practice").

[213] *Cf.* Richard R.W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568, 571–73 (2006) (expounding on Oliver Wendell Holmes's assertion that "[t]he duty to keep a contract at common law . . . means a prediction that you must pay damages if you do not keep it,—and nothing else" and arguing that efficiency is not the only path to the same expectation of contract damages (quoting O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897))).

[214] A tenancy in common gives two or more persons an undivided fractional ownership interest in real property. Tenancies in common do not have a right of survivorship.

[215] Some states provide for a common-law joint tenancy for real property, but other states have a statutory method. *See, e.g.*, N. William Hines, *Joint Tenancies in Iowa Today*, 98 IOWA L. REV. 1233, 1238–71 (2013) (describing the history of joint tenancies in Iowa from a common-law "four unities" test to codification).

[216] REVISED UNIF. P'SHIP ACT § 501 ("A partner is not a co-owner of partnership property and has no interest in partnership property which can be transferred, either voluntarily or involuntarily.").

[217] *Id.* § 502 cmt. (allowing only the transfer of a "transferable interest," which does not give the transferor management rights but only rights to distributions that the transferor would otherwise receive).

subject to overlapping uses. If FounderA and FounderB agree to form a taco truck business and pool resources to purchase a taco truck, however, the outcome is quite different. Neither FounderA nor FounderB have the right to retain income for use of the truck. Both founders have the right to co-manage the business, which uses the truck, but neither can use the truck for their own purposes without permission. If either founder creates logos, trade dress, recipes, jingles, client lists, or other types of business property, that property belongs to the partnership. If a third party offers to purchase the business, the price of the going concern should be more than just the fair market value of the taco truck and assorted equipment.

4. Why Not Copyright Law?

For some types of startup businesses, the co-founders may reduce their contributions to the creation of a single corpus of partnership property, such as a piece of computer software or artistic work, subject to copyright. Under federal copyright law, "authors of a joint work are coowners of copyright in the work."[218] This promising statutory protection has appeal over a strict contractual regime because copyright law, like partnership law, does not depend on a formal agreement.[219] The Copyright Act defines "joint work" as "a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole."[220] Courts, however, have narrowed this definition considerably so that most works have one or few authors.[221]

Whether a copyrightable work is a joint work centers not only on whether each contribution is copyrightable but also on the intent of the parties to be joint authors. Mere ideas are not copyrightable.[222] And, if one au-

---

[218] 17 U.S.C. § 201(a) (2018).

[219] *See* Balganesh, *supra* note 206, at 1687 (noting that courts could have established individual authorship as the default regime, which would then require co-authors to opt out of the regime by engaging in formal contracting).

[220] 17 U.S.C. § 101.

[221] *See* F. Jay Dougherty, *Not a Spike Lee Joint? Issues in the Authorship of Motion Pictures Under U.S. Copyright Law*, 49 UCLA L. REV. 225, 256 (2001) (reasoning that courts have imposed additional requirements to prove joint authorship "because of the significant consequences" of granting rights in future profits); Mary LaFrance, *Authorship, Dominance, and the Captive Collaborator: Preserving the Rights of Joint Authors*, 50 EMORY L.J. 193, 200 (2001) (critiquing the holding in *Aalmuhammed v. Lee*, 202 F.3d 1227 (9th Cir. 2000), and the notion that creative control by one contributor makes it more likely that the contributor will be considered the sole author because the more contributors there are, the more likely that one will have creative control).

[222] Oren Bar-Gill & Gideon Parchomovsky, *Law and the Boundaries of Technology-Intensive Firms*, 157 U. PA. L. REV. 1649, 1682 (2009) (noting that those attempting to establish ownership

thor is the "dominant" author, then that dominant party must intend to share the authorship with the other contributor.[223]

Claims of joint authorship of a literary work, musical work, motion picture, or even computer software, may be difficult because contributions are made at different times, so intent to merge the works may vary over time.[224] Also, whether a contribution merges with the original work or creates a derivative work may be at issue, as well as whether the contribution was an idea or an expression.[225] These types of issues are generally not at the center of a claim of default partnership. Intent to co-own a business is a factor for the default partnership doctrine, but the parties do not have to intend to be partners in a partnership. In addition, courts do not look merely to the intent of the dominant party in a default partnership and, furthermore, do not even analyze whether one party is dominant at all.

Furthermore, many default partnership cases do not involve copyrightable property, such as literary works, musical works, motion pictures, pictorial, graphic, and sculptural works,[226] or even computer code.[227] Copyright

---

of ideas could not resort to copyright or property law but have resorted (generally unsuccessfully) to other doctrines, such as unjust enrichment or contracts).

[223] *See* George W. Hutchinson, *Can the Federal Courts Save Rock Music?: Why a Default Joint Authorship Rule Should Be Adopted to Protect Co-Authors Under United States Copyright Law*, 5 TUL. J. TECH. & INTELL. PROP. 77, 78 (2003) ("The courts have subverted their rights by engendering a system that allows the dominant author, who typically has more leverage in the transaction, to dictate the respective rights."); Roberta Rosenthal Kwall, *The Author as Steward "For Limited Times*,*"* 88 B.U. L. REV. 685, 695 (2008) (book review) ("Moreover, by virtue of its inevitable operation, the mutual-intent standard privileges the dominant author over the non-dominant author.").

[224] *Cf.* Abraham Bell & Gideon Parchomovsky, *Copyright Trust*, 100 CORNELL L. REV. 1015, 1016 (2015) (proposing a legal doctrine that would create a default copyright trust for collaborative works, thereby giving the dominant author management power, but also giving other contributors ownership rights, noting that in many realms "all works emanate from the labor of multiple individuals as a matter of course").

[225] In the Facebook litigation discussed *supra*, the defendants strenuously argued that the Facebook website and source code were not owned by ConnectU. *See* Defendants Mark Zuckerberg, Facebook, Inc., Dustin Moskowitz, Andrew McCollum and Facebook LLC's Memorandum of Points and Authorities in Support of Their Motion for Summary Judgment on Plaintiffs' Claim of Copyright Infringement at 1, ConnectU, Inc. v. Facebook, Inc., No. 07-cv-10593-DPW, 2009 WL 3460760, (D. Mass. Sept. 30, 2009) ("Plaintiffs . . . cannot identify any protectable original expression allegedly copied by Defendants . . . to support their claim of copyright infringement." (footnote omitted)); *supra* Part I.A.

[226] 17 U.S.C. § 102(a) (granting copyright protection for "original works of authorship fixed in any tangible medium of expression, now known or later developed," including "(1) literary works; (2) musical works, including any accompanying words; (3) dramatic works, including any accompanying music; (4) pantomimes and choreographic works; (5) pictorial, graphic, and sculptural works; (6) motion pictures and other audiovisual works; (7) sound recordings; and (8) architectural works").

[227] The discussion over whether computer code, as software or algorithm, is better suited to patent protection, copyright protection, or neither, is ongoing. *See, e.g.*, Clark D. Asay, *Software's*

law does not protect ideas or even innovation—only the expression of the innovation.[228] In these cases, even if copyright protection of joint works were robust and otherwise available, parties would still need to resort to the default partnership doctrine. Finally, property law of any kind, including copyright, does not capture the full nature of the agreement to co-own a business for profit like the default partnership doctrine.

C. The General Partnership Form Is Not Obsolete

One argument against the default partnership doctrine is that too many business participants opt out of general partnership for it to be a default. If commerce needs a backstop for unincorporated ventures, then an entity with unlimited personal liability and default fiduciary duties seems inappropriate.[229] Perhaps a statutory solution could ascribe a limited set of general partnership attributes to unincorporated firms unless the duration or formalities of the venture suggest that the parties truly intended a general partnership and not just a pre-corporation, pre-LLC, or pre-LP during some developmental phase.[230]

First, general partnerships are not obsolete and are intentionally chosen by a significant number of firms. General partnerships are not formally organized by filing with the Secretary of State of any jurisdiction, so the number of newly formed general partnerships by year is unavailable. The Department of Treasury, however, does compile data on the number of tax returns filed each year from different types of business filers. In the most recent year of available data, 575,000 general partnerships filed tax returns, compared to 414,000 LPs and 2,433,000 LLCs.[231] In addition, 140,000 limited liability partnerships (LLPs) filed tax returns, and LLPs are general partnerships with certain types of limited liability but the remaining panoply of general partnership duties, obligations, and rights.[232] So, there are approximately seventy-

---

Copyright Anticommons, 66 EMORY L.J. 265, 276 (2017) (suggesting that the number of possible copyright holders in a single software package might chill the use of the software for productive uses); Pamela S. Chestek, *A Theory of Joint Authorship for Free and Open Source Software Projects*, 16 COLO. TECH. L.J. 285, 308 (2018) (explaining how the concept of dominant author and joint work is not applicable to open source software, which is modified and improved by many authors).

[228] *See* Bar-Gill & Parchomovsky, *supra* note 222, at 1685.

[229] *See* Bayern, *supra* note 117, at 607 ("Given how easy it is to avoid this liability by means of entirely formal planning, it is unclear why the law should preserve it at all." (footnote omitted)).

[230] *See id.* at 614.

[231] JOINT COMM. ON TAXATION, JCX-42-17, PRESENT LAW AND DATA RELATED TO THE TAXATION OF BUSINESS INCOME 42 tbl.2 (2017).

[232] *Id.*

two percent more general partnerships than LPs, hence presuming a general partnership for an unincorporated entity is not outlandish.

1. Limited Liability Preference

In addition, though it is more likely that a firm would pick a limited liability entity such as an LLC or corporation than remain a pure (non-LLP) general partnership,[233] the vast majority of individual business participants remain sole proprietors[234] when they could easily convert to one-shareholder corporations (retaining tax advantages through an S Corporation or disregarded entity rules) or one-member LLCs.[235] Though escaping personal liability might seem a priority for small businesses, other factors appear to drive many business owners to retain personal liability in a sole proprietorship. For two or three business participants acting as sole proprietors, finding themselves in a general partnership together would add not only the possibility of being liable for another partner's actions but also having their own liability spread among the other partners as well. Some situations involve limited liability entities, such as LLCs or corporations, being found to be in partnership with one another. Again, the personal liability aspect of that situation would have already been guarded against by the first incorporation, and the joint aspect of liability might be ameliorated by the risk-spreading among the partners.

Finally, limited liability is a protection against third parties, and other doctrines that allow unincorporated entities to gain limited liability prior to incorporation do so only if it does not defeat expectations of a third party. The formalities of incorporation serve the exact purpose of signaling to third parties that liability is limited, so bestowing default partnerships with some sort of limited liability would frustrate that purpose.

2. Elimination of Fiduciary Duties Preference

The other governance rule that the default partnership doctrine imposes on possibly unsuspecting participants is that partners owe fiduciary duties to one another and the partnership. If any other entity were the default,

---

[233] *Cf.* Claire Hill & Richard Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 SEATTLE U. L. REV. 1173, 1187 (2010) (tracing some of the excesses in investment banking that led to the financial crisis to the conversion of investment banks from general partnerships to limited liability entities).

[234] For example, nonfarm sole proprietorships made up over two-thirds of all businesses filing U.S. tax returns in 2015. *See* JOINT COMM. ON TAXATION, JCX-3-18, *supra* note 154, at 32 tbl.A-4.

[235] *See* Bayern, *supra* note 117, at 626 (arguing that retaining vicarious liability in a default partnership cannot be justified when such liability is easily avoidable).

however, then the managers of that entity would also have fiduciary duties. So, courts would be limited in how they allocate management and duties. Corporations, LLCs, and LPs have default fiduciary duties, so veering away from the default partnership model does not seem to accomplish much. One reason why the de facto corporation doctrine does not actually create a corporation, but merely gives life to the corporation the founders completed paperwork to create, is that courts will not step in to give officer titles or board positions (or general partner/manager positions) to the parties.

Were RUPA amended so as to give a more limited suite of duties to default partners, that modified doctrine might not reflect the wishes of the owners. Though many jurisdictions allow LLCs and LPs to waive fiduciary duties of managers, it is not clear that waiver is the preferred route, particularly in small, two- or three-person partnerships.[236] Though publicly traded partnerships may waive fiduciary duties frequently,[237] and large general partnerships are not common,[238] personal partnerships in which all parties have access to confidential information and management control may decide to retain all fiduciary duties.

D. Partnership Law and Theory of the Firm

When FounderA, FounderB, and FounderC agree to "co-own a business for a profit," this is a much different agreement than a mere agreement to co-own a taco truck or even a set of contracts relating to the use and maintenance of a taco truck owned by one of the founders.[239] Creating a set

---

[236] *See* Peter Molk, *How Do LLC Owners Contract Around Default Statutory Provisions?*, 42 J. CORP. L. 503, 522–25 (2018) (presenting findings from a sample of operating agreements from Delaware and New York LLCs that around 40% of agreements waived the duty not to compete and 40% waived the business opportunity doctrine, meaning that more than half of owners with enough forethought to incorporate in a manager-friendly jurisdiction such as Delaware did not waive them).

[237] *See* Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J .CORP. L. 555, 558 (2012) (reporting that eighty-eight percent of publicly traded alternative entities (LPs and LLCs) "totally waive the fiduciary duties of managers or eliminate liability arising from the breach of fiduciary duties").

[238] Though there are more general partnerships than limited partnerships, limited partnerships report substantially more profits than general partnerships. *See, e.g.*, Ron DeCarlo & Nina Shumofsky, *Partnership Returns*, *Tax Year 2016*, STAT. INCOME BULL., Spring 2019, at 45, 76, tbl.8 (providing the number of partnerships that submitted tax returns by type of partnership for the 2016 tax year); *id.* at 77 tbl.9b (showing the net income of all domestic general partnerships and domestic limited partnerships). In the 2016 tax year, according to the Internal Revenue Service, 423,406 limited partnerships reported a net income $319 billion, compared to 545,000 general partnerships that reported $111.7 billion. *See id.* at 76 tbl.8, 77 tbl.9b. Additionally, in the same year, general partnerships averaged 4.2 partners, while limited partnerships averaged 27.4 partners. *See id.* at 76 tbl.8, 77 tbl.9c.

[239] *See supra* Part III.B.2–3.

of contracts to cover every contingency, every anticipated and unanticipated source of opportunism, every change in law, tastes, and markets, is costly if not impossible.[240] Transaction-cost economics argues that formation of firms can be superior over contracting because of costs endemic to contract negotiation: negotiating complete contracts can be time-consuming and burdensome; parties may be loath to make asset-specific investments without the stability of a long-term contract; and parties may be able to extract monopolistic rents in contracting after asset-specific investments are made by the other party.[241] Even without transaction costs, however, firms create an environment in which existing resources can be exploited and new resources created that could not exist in a mere nexus of contracts. Inside the firm, default fiduciary duties serve to fill in the gaps in the necessarily incomplete agreement to form the firm. The contractarian view of the firm analogizes it to a set of contracts, and thus urges that parties may contract around various default characteristics of the firm; however, this does not change the premise that a firm has default characteristics that a set of contracts, if it could exist, does not have.[242]

Though this Article does not have the space to thoroughly analyze the default partnership doctrine through the various perspectives on the theory of the firm, the basic premise that a firm is essentially different from the property it holds or the contracts that constitute it informs the proposition that the default partnership doctrine serves a different, and possibly more valuable, role than contract law or property law alone.[243]

E. Partnership Law and the Covenant Not to Compete

This Article argues that the default partnership doctrine encourages collaboration and information-sharing, and that collaboration is critical to innovation and entrepreneurship. During the last decade, scholars have separately argued that the pervasive practice of established firms, particularly technology firms, to require employees to execute restrictive covenants not to compete with their former firm upon departure discourages collaboration,

---

[240] *See* R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 392 (1937) ("We may sum up this section of the argument by saying that the operation of a market costs something and by forming an organisation and allowing some authority (an 'entrepreneur') to direct the resources, certain marketing costs are saved.").

[241] Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 239–42 (1979).

[242] Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-contractarians*, 65 WASH. L. REV. 1, 45–47 (1990).

[243] *Cf.* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000) (proposing the theory that business firms "provide for the creation of a pattern of creditors' rights—a form of 'asset partitioning'" that contract alone cannot establish).

innovation, and entrepreneurship.[244] If this Article is arguing that co-founders should not be free to abandon nascent firms without consequence and compete against them, then the default partnership doctrine might be seen as a limitation on entrepreneurship, much like covenants not to compete.[245] The default partnership doctrine, however, is not at cross-purposes with the trend not to limit the movement of human capital.

The easy distinction between partnership situations and employment situations is that partners are not employees.[246] Presumably, partners have more power than employees[247] and can negotiate the partnership agreement that protects their interests.[248] Furthermore, partnerships are essentially vol-

---

[244] *See* Orly Lobel, *The New Cognitive Property: Human Capital Law and the Reach of Intellectual Property*, 93 TEX. L. REV. 789, 794 (2015) ("In the past two decades, scholars from a wide variety of disciplines have warned against the overexpansion of knowledge controls through IP policy."); *see, e.g.*, On Amir & Orly Lobel, *Driving Performance: A Growth Theory of Noncompete Law*, 16 STAN. TECH. L. REV. 833, 838 (2013); Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 579 (1999) (theorizing that California's restrictions on covenants not to compete explain the growth of Silicon Valley, compared to Massachusetts's Route 128, due to the increased knowledge transfer from employee mobility); Robert W. Gomulkiewicz, *Leaky Covenants-Not-to-Compete as the Legal Infrastructure for Innovation*, 49 U.C. DAVIS L. REV. 251, 251 (2015) ("The flow of information that naturally occurs when employees change firms plays a vital role in spurring innovation.").

[245] Harsh critics of covenants not to compete and other limitations on competition have pilloried the Winklevoss brothers, who claimed to have formed a partnership with Mark Zuckerberg. *See* ORLY LOBEL, TALENT WANTS TO BE FREE: WHY WE SHOULD LEARN TO LOVE LEAKS, RAIDS, AND FREE RIDING 2 (2013) ("Intuitively, we know that the abstract idea of a social network is very different from actually building one and that society is better off allowing talented people to freely compete and flow between creative ventures.").

[246] Following the rise of large general partnerships doing business as LLPs, with both equity and nonequity "partners," issues have arisen under employment law whether certain partners should be categorized as owner-employers or as protected employees. *See* Douglas R. Richmond, *The Contemporary Legal Environment and Employment Claims Against Law Firms*, 43 TEX. TECH L. REV. 471, 505–06 (2011) (discussing the landmark case of *EEOC v. Sidley Austin Brown & Wood*, which led to a $27.5 million settlement for older partners who were demoted after preliminary court holdings in the plaintiffs' favor); *see also* EEOC v. Sidley Austin Brown & Wood, 315 F.3d 696, 707 (7th Cir. 2002) (ordering the five hundred partner law firm to fully comply with the subpoena because facts existed, including that the firm was managed by a self-perpetuating, unelected management committee, to question whether demoted partners were employees under federal law).

[247] *See* Stephanie Plamondon Bair, *Innovation Inc.*, 32 BERKELEY TECH. L.J. 713, 757 (2017) ("In the organizational context, the power disparities that exist between employer and employee have been well studied. This power dynamic, generally understood to favor employers, may result in employers providing suboptimal work environments to their employees." (footnote omitted)).

[248] In a partnership in which partners negotiate an agreement, partners do not necessarily know if they will be the withdrawing partner and therefore may not bargain for stringent exit policies. "Easy exit" could be in the way of returning capital contributions or not enforcing provisions relating to soliciting clients or requiring a lengthy notice of withdrawal. *See* Gibbs v. Breed, Abbott & Morgan, 710 N.Y.S.2d 578, 580 (App. Div. 2000) (involving a partner departure in which

untary; partners always have the power to leave, even if that withdrawal is wrongful. And, at the termination of the partnership, all duties to the other partners and the partnership disappear.[249] Partners may not compete with one another while the partnership is ongoing, but departing partners can, even during the winding-up of the partnership.[250]

Mark Zuckerberg characterized his relationship with the Winklevoss brothers as an employment relationship or independent contractor relationship.[251] On the surface, Zuckerberg's settlement with the Winklevoss brothers may be seen as similar to other employees that leave one technology firm to join another. Zuckerberg was more likely a partner with the Winklevosses, however, meaning that he was in an organization in which he stood to share in a great upside for the bargain of fiduciary duties, liability, and risk of loss. Had he told the Winklevoss brothers that he did not want to work with them, and then later formed his own firm, then no fiduciary duties would be implicated, and Facebook would have been born without a shadow of wrongdoing.

Employees have a much different bargain. Some employees have access to confidential information and know-how, but others do not. Some employees have bargaining power; others do not. Covenants not to compete may protect information but most likely just seek to get monopolistic rents in the market for labor.[252]

The default partnership doctrine does not encourage monopolies in the market for owners. The doctrine does not seek to keep partners in partnerships, only to protect their contributions and efforts while in those partnerships and govern the termination of the relationship.

---

the partnership waived a forty-five day notice provision of an intention to withdraw); Christine Hurt, *The Limited Liability Partnership in Bankruptcy*, 89 AM. BANKR. L.J. 567, 574 (2015).

[249] *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. c (AM. LAW INST. 2006) ("An agent's fiduciary duty to a principal is generally coterminous with the duration of the agency relationship."). Illustration No. 7 following comment c to section 801 gives the example of an apartment broker who, after no buyers emerge, purchases the apartment for himself, thus terminating the agency relationship. *See id.* The agent's subsequent purchase of the adjacent apartment, which the principal had desired for himself, was not a breach of duty because any duties expired with the termination of the relationship. *See id.*

[250] *See* REVISED UNIF. P'SHIP ACT § 409(b)(2) (defining the duty not to compete as "competing with the partnership in the conduct of the partnership's business before the dissolution of the partnership").

[251] In court documents, Zuckerberg "admit[ted] that [he] did work related to the [Winkelvosses'] HC website, but den[ied] that he was 'engaged' to do so." Answer of All Defendants to First Amended Complaint, *supra* note 45, ¶ 14.

[252] *See* Amir & Lobel, *supra* note 244, at 845–46 ("However, broadening the [antitrust] inquiry beyond controls over goods and services necessitates a fuller examination of the ways human capital controls create monopolies over knowledge and skill.").

IV. AVOIDING IMPLIED PARTNERSHIP STATUS

The default partnership doctrine proves a useful default characterization for parties who did not distill an agreement to do business to a written agreement due to inattention or intent. Parties familiar with the doctrine, however, may want to avoid being characterized as a default, implied, or informal partnership at any point in a particular business relationship. They may prefer to be merely contract parties or begin negotiations to be a different entity.

A. Agreeing Not to Agree

Courts often focus on the element of intent as a requirement to "co-own a business for profit."[253] The opposite should also be true; the intent not to form a general partnership should be dispositive, at least between would-be partners. Therefore, the court should honor parties' agreements, particularly written ones, to create a non-partnership relationship.

Under statutory law, however, the non-partnership relationship that is purportedly created should not be merely a partnership in everything but name. Parties should not intend to co-own a business but be able to disclaim the consequences of partnership even though they create a functional partnership. Just as parties are not able to disclaim agency relationships merely by agreements between principals and agents, partners should not be able to avoid legal consequences merely by stipulating to a different label.[254] In particular, joint actors may not disclaim partnership or agency relationships by fiat because of the external consequences to third parties who may otherwise rely on the objective characteristics of the relationship.[255] Among themselves, however, purported partners should be able to agree on which rights and obligations they would have with one another, as well as how to allocate profits and losses and how to divide managerial powers.

One way to accomplish this would be for early-stage businesses to contractually agree to whether or not they will be a general partnership, and if so, what parts of the general partnership statute they will alter by agreement. Many aspects of the general partnership, however, are not able to be modified by agreement, including personal liability to third parties.[256] Even

---

[253] *See supra* Part II.A.1.

[254] RESTATEMENT (THIRD) OF AGENCY § 1.02 ("Whether a relationship is characterized as agency in an agreement between parties or in the context of industry or popular usage is not controlling.").

[255] *See, e.g.*, Huntsville Golf Dev., Inc. v. Whitney Bank, 2014 WL 2973106 (N.D. Ala. 2014); Cajun Elec. Power Coop. v. McNamara, 452 So. 2d 212 (La. App. 1984). Note that state statutes authorizing the formation of limited liability entities require those entities to adopt nomenclature that signals limited liability to third parties, such as "Inc." or "L.P."

[256] REVISED UNIF. P'SHIP ACT § 105(c)(3).

internal aspects, such as fiduciary duties, may not be completely eliminated, but they may be tailored.[257]

B. The Pre-organization Danger Zone

The danger zone for most business co-participants may be the dawn of the relationship.[258] Parties may desire to form a general partnership but are still negotiating the terms; for those parties to suddenly have a pro rata partnership thrust upon them when certain terms necessary to them had not been finalized would seem unfair.[259] Similarly, parties desiring to form a different entity, but still in the negotiation stages of the structure of that entity, would also not want a pro rata partnership superimposed on their nascent firm. Finally, parties in exploratory or developmental discussions and activities, who have not yet decided whether to enter into a joint enterprise, should be able to do so without fear of being found to have formed a disadvantageous entity unwittingly.

For most parties, if they take the time to negotiate their rights and obligations, they may decide that a general partnership form may not be optimal. If those parties wish to avoid the default partnership doctrine, they should create a different organizational structure to hold their joint businesses.[260] The easiest way for parties to avoid the potentially unwanted consequences of default partnership is to create a different entity through formal incorporation as a corporation, LP, or LLC.[261] Once a startup business becomes an incorporated entity, then that business will not be deemed a default partnership.[262]

---

[257] *Id.* § 105(d) (allowing the partnership agreement to alter or eliminate some aspects of fiduciary duty).

[258] *See* Tremblay, *supra* note 5, at 277 (noting that courts have held that the intent to co-own a business can cover plans for future business activity, and a partnership may be found even when no business has begun).

[259] *See* Grunstein v. Silva, No. 3932-VCN, 2014 WL 4473641, at *33 (Del. Ch. Sept. 5, 2014) (holding that though some evidence pointed to a default partnership, the plaintiff had not met the evidentiary burden where parties exchanged multiple drafts of unsigned agreements and had not agreed on essential terms), *aff'd sub nom.*, Dwyer v. Silva, 113 A.3d 1080 (Del. 2015).

[260] REVISED UNIF. P'SHIP ACT § 202(b) ("An association formed under a statute other than this [act], a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this [act].").

[261] *See* Leahy, *supra* note 21, at 252 (arguing that negotiating venturers should "(1) form a filing entity for their nascent venture and (2) specify that this entity will be the exclusive vehicle for their joint venture").

[262] *See, e.g.*, D'Orazio v. Mainetti, 805 N.Y.S.2d 455, 456 (App. Div. 2005) ("They cannot be partners *inter sese* and a corporation as to the rest of the world." (quoting Weisman v. Awnair Corp. of Am., 144 N.E.2d 415, 418 (N.Y. 1957)); McCormick v. Dunn & Black, P.S., 167 P.3d 610, 615–16 (Wash. Ct. App. 2007) (holding that a corporation cannot also be a de facto partnership among the shareholders, even if they participate equally).

For sophisticated parties exploring complex ventures that may evolve and progress through negotiations, the consequences of being in a default partnership may be quite harsh.[263] In this case, rather than relying on letters of intent disclaiming a partnership, forming an LLC to explore a joint venture may be the optimal structure.[264] Then, the parties may decide for themselves if they want to be able to compete with one another or usurp business opportunities in certain areas with impunity.

CONCLUSION

Business actors who choose to go into business with one another and intend on sharing profits and losses from that business form a general partnership under state partnership law, whether they intend this characterization or not. For most parties, the default rights and duties will probably serve their intentions well. Firms with a few owners working together probably would not want to give their partners the right to steal partnership property or opportunities to compete using partnership information and ideas. Firms might choose to opt out of limited liability if they thought about it, but the general partnership for very small firms is no different qualitatively than a sole proprietorship. Most contract parties to any small business would want protections from limited liability anyway, so the end result might be the same. If the parties took the time to bargain, they might come up with something similar to a general partnership, even if it was a member-managed LLC with the understanding that personal guarantees to lenders and landlords might be required.

On the other hand, some parties may be somewhat surprised to find themselves legally yoked to other business participants without an easy exit. Partnership is inherently consensual however; if parties wish to opt out of the general partnership regime, the law gives them plenty of options. The

---

[263] *See* Grunstein v. Silva, C.A. No. 3932-VCN, 2014 WL 4473641, at *33 (Del. Ch. Sept. 5, 2014), *aff'd*, 113 A.3d 1080 (Del. 2015); *see also* Tremblay, *supra* note 5, at 300 (describing "drift" phenomenon in which "startups often begin with a loose coalition of actors developing an idea . . . with some participants drifting away to other projects and new helpers showing up").

[264] *See* Enter. Prods. Partners, L.P. v. Energy Transfer Partners, L.P., 529 S.W.3d 531, 545 (Tex. App. 2017) (reversing the trial court's judgment that sophisticated business parties created a default partnership, given that letters of intent disclaiming partnership created a condition precedent to a business venture). In that case, the initial documents outlined a different venture than the one that emerged and was signed by different parties than those that allegedly breached default partnership duties. *See* Petition for Review at 20–21, Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P., 593 S.W.3d 732 (Tex. 2020) (No. 17-0862), 2017 WL 6814900 (describing how a 2011 letter disclaiming obligations among the parties was not followed as the venture evolved and grew). The case was upheld on appeal, however, under freedom of contract principles. *Energy Transfer Partners, L.P.*, 593 S.W.3d at 740–42.

easiest way to avoid being characterized as a partner in a default partnership is to become an owner in a different firm, with limited liability and negotiated rights and duties, prior to doing business. Though the line between "mulling a business" and "doing business" may be fuzzy, parties should be able to signal the requisite intent *not* to be partners by being corporate shareholders, LLC members, or limited partners instead.

Finally, the de facto partnership doctrine is a feature of partnership law, not a bug. The doctrine protects the expectations of the unwary, who may face opportunistic business partners who strategically attempt to disavow doing business together for various profit-driven reasons. Having a backstop against this type of opportunism helps promote collaboration and innovation—hallmarks of entrepreneurship.