



## Partnership Consent Rights: Is a Partner Required to be Reasonable?

By Demetri Datch, Linowes and Blocher LLP

**M**ost of us can relate to the stanza from Robert Burns' poem "To a Mouse": "The best laid schemes of mice and men/ Go often awry." No matter how much time and effort we spend planning for the worst, oftentimes things go wrong – things that you never saw coming. This truism is no more self-evident than in the context of a real estate partnership.

Consider the following scenario: A partnership has owned an income-producing property (e.g., an office building) for decades. The partnership agreement authorizes the general partner to make all day-to-day decisions on behalf of the partnership, subject to the other partners' rights to approve so-called 'major decisions' (e.g., the sale, financing, or refinancing of the property). Now assume that the general partner wants to sell the property but the other partners do not. Can the other partners refuse to consent without giving a reason (i.e., do the other partners have a unilateral right to withhold their consent)? After all, the partnership agreement is silent on this point, which could indicate that the parties did not intend to impose any restrictions on each partner's right to withhold its consent.

In Maryland, partners are free to contract with one another to establish a relationship by which all parties will be bound. However, despite this principle of freedom of contract, partners owe to each other (and are generally not permitted to completely contract away) certain fiduciary duties, including the duty to act in good faith and deal fairly with one another.

Accordingly, if a partnership agreement is silent with respect to the standard by which a partner's consent may be withheld, Maryland law mandates that partners act reasonably and in good faith. On the other hand, a partnership agreement may authorize a partner to withhold its consent "in its sole, absolute and arbitrary discretion," and Maryland courts will honor this provision.

The inherent fiduciary duty of good faith and fair dealing is viewed from the perspective of the party exercising its discretion (ie, the dissenting partners). So, in the hypothetical above, a court that evaluates the dissenting partners' decision to withhold consent would want to know the rationale behind such refusal. For example, if, as mentioned above, the property had been owned for decades, it is quite possible that each partner has a low tax basis in the property and if the property were sold, the partners would be subject to substantial income tax liability. Alternatively, perhaps the dissenting partners are concerned that the market conditions are not ripe for sale of the property and want to hold on to the property until the market turns (this would be a particularly relevant consideration if the property was an office building in today's local real estate market, as posited above).

There are a multitude of sound business reasons that a partner could rely upon to justify withholding its consent, and, ultimately, the facts and circumstances will dictate whether the decision is steeped in reason and made in good faith. But, do business parties really want to defer this

decision to the courts? Presumably, the resounding answer to this question is 'no'. Litigation is costly and time-consuming, and is not the ideal forum for resolving partnership disputes.

Therefore, when negotiating a real estate partnership agreement, it is imperative for the business parties to consider each partner's consent rights from the outset and the import of remaining silent concerning the standard by which a partner may withhold its consent. Oftentimes, the partnership agreement may provide that consent may not be "unreasonably withheld, conditioned or delayed," but, as noted above, this does not give a partner any more rights than it is already afforded under Maryland law. In that regard, the parties may think that, by inserting this sort of language in the agreement, they have clarified the standard by which consent may be withheld – however, the best laid schemes often go awry, and, if a partner chooses to withhold its consent, there is no way of foretelling how a court will evaluate the 'reasonableness' of the dissenting partner's decision.

Rather, if a business party wants to preserve a unilateral consent right, then it should include this as a critical business point in its negotiations and make certain that the partnership agreement reflects this right. A failure to do so could lead to all sorts of unexpected (and undesirable) consequences.

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*While the preferred choice of entity for owning real estate in the U.S. is a limited liability company (an "LLC"), the author uses the terms "partnership," "partner" and "partnership agreement" (rather than "LLC," "member," and "LLC/ operating agreement," respectively) because the default classification of a multi-member LLC under Federal income tax law is that of a partnership.*

*Md. Code, Corporations and Associations Article, §9A-103(a) and §10-302 for general partnerships and limited partnerships, respectively. For LLCs, see Md. Code, Corporations and Associations Article, §4A-102(a).*

*Md. Code, Corporations and Associations Article, §9A-103(b)(5). For LLCs, see George Wasserman & Janice Wasserman Goldsten Family LLC, et. al. v. Jack Kay, et. al., 14 A. 3d 1193, 1210 - 1211 (Md. Ct. Spec. App. 2011)*

*See Fn. 3 above. See also, Julian v. Christopher, 320 Md. 1, 575 A.2d 735 (1990) (holding that a landlord's consent to assign or sublease may not be unreasonably withheld unless the lease explicitly provides the landlord with the right to withhold consent arbitrarily).*

*Julian, 320 Md. at 11, 575 A.2d at 740 ("If the parties intend to limit the right or sublease by giving the landlord the arbitrary right to refuse to consent, they may do so by a freely negotiated provision in the lease clearly spelling out this intent.")*

*First Nat. Realty Corp. v. Warren-Ehert Co., 247 Md. 652, 657, 233 A.2d 811, 813-814 (1967) (holding that, in matters of personal discretion in contract, the party with the discretion is limited to exercising that discretion in good faith).*

*Clancy v. King, 954 A.2d 1092, 1109 (2008) (a party "may not act... out of personal spite toward his business partner... Such motivation would constitute bad faith.")*

*David A. Bramble, Inc. v. Thomas, 396 Md. 443, 465, 914 A. 2d 136, 149 (2007) ("Good faith ordinarily is a question of fact.")*

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