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PERSPECTIVE

High court likely to confirm a trust's right to be partner in partnership

By Shawn Kerendian,
Joshua Taylor and Avi Pariser

The California Supreme Court recently granted a petition for review of the 2nd District Court of Appeal's decision *Han v. Hallberg*, 35 Cal. App. 5th 621 (2019), which primarily addresses whether a trust can be a partner in a partnership. The 2nd District held that a trust can be a partner, overturning the trial court's finding to the contrary, and opined that its conclusion was simply incontrovertible based on plain meaning of the statutory definitions of "person" and "partnership" in the California Corporations Code. In finding that a trust can be a partner to a partnership agreement, the *Hallberg* court expressly disagreed with a prior holding of the Court of Appeal, 4th District case *Presta v. Tepper*, 179 Cal. App. 4th 909 (2009), which found that an ordinary, express family trust is merely "a relationship by which one person or entity holds property for the benefit of some other person or entity," and therefore was not an entity capable of serving as a partner.

For the reasons discussed below, we expect the California Supreme Court to uphold the right of a trust to be a partner in a partnership.

Background Facts

In 1975, four dentists formed a general partnership. The

partners subsequently executed an amendment to the partnership agreement, allowing the estate of a deceased partner to retain the interest of the deceased partner and continue operation of the partnership, conditioned on the estate no-

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tifying the surviving partners within 90 days of the deceased partner's death; without such notice, the surviving partners had the option to buy out the deceased partner's share.

In 1994, the partners amended the partnership agreement, allowing one of its partners, Dr. Richard Hallberg, to assign his individual interest in the partnership to Dr. Hallberg as trustee of the Richard W. Hallberg Trust. All of the partners consented to the assignment. Years following the assignment, Dr. Hallberg appointed his son, Richard Hallberg Jr., as co-trustee of the trust. In 2009, Hallberg Jr. became the sole trustee of the trust, and in 2010, Dr. Hallberg passed.

Following Dr. Hallberg's death, Hallberg Jr. did not

notify the surviving partners of his intention to retain the trust's interest in the partnership, and the surviving partners sent Hallberg Jr. a letter informing him that they intended to purchase Dr. Hallberg's interest in the partnership pursuant to the

buy-out provision of their partnership agreement. Hallberg Jr. objected, and asserted that pursuant to the 1994 amendment, the partnership interest was owned by the trust at the time of Dr. Hallberg's death, not by Dr. Hallberg individually, and consequently, Dr. Hallberg's death did not trigger the notice or buy-out provisions of the partnership agreement. Unsurprisingly, litigation ensued, and in 2011, two of the surviving partners filed a complaint seeking, among other relief, an injunction that would require Hallberg Jr. to comply with the terms of the buyout-on-death provision.

The trial court found in favor of the surviving partners, holding that the trust was not a "separate legal entity" capable of owning an interest in a

partnership, and that Dr. Hallberg was indeed the partner whose death triggered the buy-out provision of the agreement. The trial court further held that it was bound to follow *Presta*, which held that family trusts are not capable of being partners to a partnership agreement. (As opposed to institutional trusts, which would be considered entities capable of acting as partners.) Hallberg Jr. appealed, arguing that Dr. Hallberg was not the trustee of the trust, nor a partner, at the time of his death, and could not have been the holder of the partnership interest, but that, the trust itself was the partner.

The appellate court agreed with Hallberg Jr., finding that Dr. Hallberg was neither a partner nor a trustee at the time of his death, and that the trust was the partner to the partnership agreement. The court's holding is based, in part, on the plain meaning of Corporations Code Sections 16101 and 16601.

Corporations Code Section 16101

Corporations Code Section 16101(9) defines a partnership as "an association of two or more persons to carry on as co-owners of a business for profit." And Section 16101(13) defines a "person" for these purposes as: "an individual, corporation, business trust, estate, trust ... or any other legal or commercial entity." (Emphasis added.)

The *Hallberg* court found that “there is simply no way to get around [the] point” that, based on the plain meaning of the definition of “person” in Section 16101(9), a business trust, an estate, and a trust, are all “persons” as defined by the statute, and are all therefore capable of serving as a partner under the law. Further, the *Hallberg* court held that it could not escape the fact that once a partner transfers his interest in a partnership to a trust, the death of the partner does not trigger any buyout-on-death provision of the partnership agreement, because the deceased former partner no longer holds any interest individually in the partnership.

Corporations Code Section 16601

The *Hallberg* court further noted that Corporations Code Section 16601 incontrovertibly contemplates a trust acting as a partner to a partnership. Section 16601 provides a comprehensive list of the events that cause the dissociation of a partnership, including in the event a trust serves as one of the partners. Section 16601 subdivision (8) provides that “[i]n the case of a partner that is a trust or is acting as a partner by virtue of being a trustee of a trust, [dissociation is caused by] distribution of the trust’s entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee.” Not only does the statute clearly contemplate a trust serving as a partner, but the statute itself provides that a

trust is not dissociated by transfer of an interest in a partnership to a successor trustee, or, by exclusion, by the death of the transferee.

Presta v. Tepper

In holding that the trust was serving as a partner at the time of Dr. Hallberg’s death, the *Hallberg* court expressly rejected the prior holding in *Presta*. There, two men entered into a partnership agreement in their capacities as trustees of their family trusts. As in *Hallberg*, the agreement in dispute included a buyout-on-death provision requiring that upon the death of a partner, the partnership would purchase his interest. After one partner died, his widow refused to sell his interests in the partnership, arguing that the trust, not the decedent, was the partner, and that the partner’s death did not trigger the buyout-on-death provision.

The *Presta* court disagreed, finding that the trust at issue was not capable of being

partner to an agreement. Faced with the plain meaning of Corporations Code Section 16101’s definition of “person,” the *Presta* court relied heavily on subdivision (13)’s closing phrase that defines “person” as “any other legal or commercial entity.” The court interpreted the inclusion of this phrase to mean that the word “trust”, previously listed in this statutory definition of “person,” refers only to trusts which are “legal entities”; further holding that real estate investment trusts and/or trust companies would qualify, but that an ordinary express family trust would not.

Conclusion

Although the *Presta* and *Hallberg* courts reached opposite conclusions regarding the right of a trust to be a partner in a partnership, they have one similarity: Both courts believed their rulings effectuated the intent of the partners. In *Presta*, relying on language in the partnership agreement mandating a buyout of a deceased part-

ner’s interest, the court held in favor of the surviving partner as the partnership agreement would have compelled a buyout whether the deceased partner’s interest was held individually or in a trust. In *Hallberg*, in siding with the successor of the deceased partner, the court found compelling the right of the estate of a deceased partner to have the initial right to *retain* the deceased partner’s interest in the partnership, and expressly found the other partners’ position that they “expected to control the membership of the partnership” upon the death of a partner as incapable of “withstand[ing] scrutiny.”

The *Presta* court, in order to reach the equitable outcome, was compelled to undertake a tortured reading of the Corporations Code, a circle that cannot be squared. The *Hallberg* court, with both law and equity united, artfully corrected the mistakes of *Presta*, and it is now up to the California Supreme Court to affirm *Hallberg*’s holding. ■

From left: **Shawn S. Kerendian** is the managing partner of Keystone Law Group, P.C. **Joshua D. Taylor** is a partner with Keystone and **Avi I. Pariser** is an associate with the firm.

