

The Right of Limited Partners to Sue

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Since 1 June 2007, when the amended PRC Measures for the Administration of Registration of Partnership Enterprises (Partnership Enterprise Law) was implemented, the limited partnership enterprise (LPE) has attracted many investors as a new form of partnership. Unique advantages such as the flexible governance structure, efficient contribution and distribution methods and exemption from double taxation have led to vast usage of the LPE in investment and financing. The Partnership Enterprise Law stipulates that the general partners shall conduct the partnership affairs of the LPE, while the limited partners shall neither do so nor represent the LPE in dealing with any third parties.

However, in practice, the behaviour of the general partners in conducting specific partnership affairs are diverse and complex. The LPE is in its initial phase of development in China and is rapidly developing to meet market demands, leading to frequent disputes between general partners and limited partners. Since the Partnership Enterprise Law merely provides guiding principles on relevant issues and judicial precedents are limited – some partnership agreements between partners are rather simple and fail to fill regulatory gaps – some partners find themselves unable to seek remedies when their interests are directly or indirectly infringed.

Case Study

One case particularly highlights the limited partners' right of suit. Company A is a limited partner of an LPE, whose general partner, company B, decided to invest the LPE's capital in a real estate company C (an affiliate of company B) in the form of loans. The deadlines to repay the loans expired under the agreement between company C and the LPE, and company C is obligated to repay these loans to the LPE. Nevertheless, the real estate company C did not repay the relevant principal or interest, nor did company B, the general partner of the LPE,

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ask company C to repay the loans. Thus, company A sent various letters to company B, requesting it to perform its obligation as the general partner and also, in the name of the LPE, requesting company C to pay such principal and interest. However, company B still failed to make these demands to company C. Company A therefore believed that company B failed to execute the partnership affairs, and as a result, has caused direct damages to the interests of the LPE and indirect damages to the interests of company A, the limited partner.

Analysis

Based on the facts of the case, the real estate company C is affiliated to company B. Nevertheless, Article 32 items (2) and (3) of the Partnership Enterprise Law merely provide that, a general partner of a partnership shall not have any transaction with the partnership unless otherwise agreed upon in the partnership agreement or unanimously consented by all partners. A partner shall not engage in any activities that may be prejudicial to the interest of the partnership. Thus, the relevant provisions of the Partnership Enterprise Law do not expressly classify the loan between the real estate company C and the LPE as a connected transaction, even though it may be prejudicial to the interests of the LPE. The “connected transactions” that are restricted by the Partnership Enterprise Law are the direct transactions between the general partner and the LPE. Moreover, Article 99 of the Partnership Enterprise Law provides that, if a partner engages in any business in competition with or transacting with the partnership that violates the provisions of the PEL or is in breach of the partnership agreement, the profits shall be attributed to the partnership. If a partner causes any loss to the partnership or to other partners, he shall be liable for compensation. Therefore, company A cannot request company B to bear the losses, or to claim that company C’s profits arising out of the loan belong to the LPE, based on the connected transaction between company C and the LPE.

Exercising Rights

Under these circumstances, is company A entitled to take any legal measures to protect the legitimate interests of the LPE? Although no provision in the PEL directly stipulates the right of suit of the limited partner, Article 68(2) provides that that a limited partner shall not be deemed to have conducted the partnership affairs when he brings claims or files a lawsuit against the responsible partner where his interests in the LPE are impaired; or he urges the executive partner to exercise the LPE’s rights or initiates a lawsuit in its own name, for the interests of the LPE when the executive partner fails to exercise the LPE’s rights. The provision indirectly entitles a limited partner to file a suit for the interests of the LPE when a limited partner’s interests in the LPE are impaired; and the LPE’s interests are impaired due to the general partner’s failure to exercise the LPE’s rights. The case should therefore fall within the situation provided under Article 68(2)(vii), which gives the limited partner the right to initiate a litigation in its own name for the LPE’s interests, which were impaired by the general partner’s failure to exercise the LPE’s right following the requests made by the limited partner. Thus, company A has the right, as the plaintiff for the LPE’s interests, to bring suit against the debtor of the LPE, the real estate company C.

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This article was first published in *China Law & Practice*, May/June 2014, Volume 28, Number 3.