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DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-149[illegible] DATE: JAN 12 1979

MATTER OF: Non-Recourse Loans to Limited Partnership Small Business Investment Companies

DIGEST: Small Business Administration (SBA) has legal authority under Small Business Act, as amended, to make non-recourse loans to limited partnership small business investment companies (SBICs) thereby limiting its creditor rights to assets of partnership. Although legislative history of statute authorizing licensing of limited partnership SBICs is inconclusive, there is no statutory prohibition on SBA's legal authority in this regard and SBA does have specific authority under Small Business Act to make loans to SBICs on such terms and conditions as it deems appropriate. Moreover, SBA's contractual agreement to waive its rights as creditor against personal assets of general partner appears valid under State law.

This decision to the Administrator of the Small Business Administration (SBA) is in response to the request of the former Acting Administrator for our concurrence in SBA's opinion that it has authority to make non-recourse loans to small business investment companies (SBICs) established as limited partnerships pursuant to section 106 of Pub. L. No. 94-305 (June 4, 1976), 90 Stat. 663, 666.

When the Small Business Investment Act of 1958, 15 U.S.C. §§ 661 et seq., was originally enacted, section 301 of the act, 15 U.S.C. § 681, required SBICs to be incorporated bodies organized and chartered pursuant to State law. Section 106 of Pub. L. No. 94-305 amended section 301 of the 1958 Act to extend SBA's authority to license SBICs to include limited partnerships existing under State law.

On October 29, 1976, SBA published proposed regulations applicable to limited partnership SBICs. 41 Fed. Reg. 47502 (1976). The proposed regulations required the articles of the limited partnership SBICs to provide for a sole corporate general partner organized under State law solely for that purpose. The regulations further proposed to hold the corporate general partner of the limited partnership personally liable to SBA for any monies loaned to the SBICs under section 303(b) of the Small Business Investment Act, 15 U.S.C. § 683(b), to the extent that partnership assets were insufficient to satisfy such debts.

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Thus the proposed SBA regulations would have retained the statutory right of a creditor of a limited partnership, pursuant to the Uniform Limited Partnership Act, to subject the separate assets of the general partner to its claim in the event of a deficiency in partnership assets. The proposed regulations further indicated that SBA was considering its legal authority and the administrative desirability of agreeing to "waive" its rights against the separate assets of the corporate general partner. Comments were specifically requested by SBA concerning this question. After reviewing the comments, which were unanimous in stating that subjection of the separate assets of the corporate general partner to possible claims by SBA would "severely limit the use of the limited partnership form," SBA determined that the use of non-recourse financing for this type of SBIC "is essential to insure the fullest use of the new legislation."

As a general matter, the law applicable to limited partnerships is contained in the Uniform Limited Partnership Act (ULPA), which has been adopted in most States as well as the District of Columbia. Its provisions would apply to SBICs established as limited partnerships since 15 U.S.C. § 681 specifically provides that an SBIC "shall be an incorporated body or a limited partnership organized and chartered or otherwise existing under State law * * *."

Section 9(1) of the ULPA explains the status of a general partner in a limited partnership as follows:

> "A general partner shall have all the rights and powers and be subject to all of the restrictions and liabilities of a partner in a partnership without limited partners * * *."

The basic operation of a limited partnership and the responsibilities of both the limited and general partners under ULPA has been described as follows:

> "* * * Generally, the limited partnership is a business form intermediate between a partnership and corporation. It consists of general partners who have all the rights, duties and obligations of partners in an ordinary partnership and limited partners whose positions are somewhat akin to shareholders in a corporation. The general partners conduct the business and are personally liable to

> ~~guaranty~~. The liability of limited partners on the partnership obligations is limited to the amount of their contributions. They do not participate in management of the limited partnership on pain of losing their limited liability." (Emphasis added.) Pelopsky v. Fidelity Lease Limited, 517 S.W.2d 420, 423 (Civ. App. Tex. 1974).

Although SBA's submission recognizes that the general partner of a limited partnership is personally liable under ULPA for the debts of the partnership, SBA asserts that it has authority to waive its rights to recover from the separate assets of the general partner. First, SBA relies on the Senate committee report's explanation of the provision contained in the bill (S. 2498, 94th Congress) ultimately enacted as Pub. L. No. 94-305. The report reads in pertinent part as follows:

> "In implementing this section directed at encouraging the formation of new SBICs it is expected that SBA would design regulations to limit the liability of the partners in an unincorporated company and to protect the investment of Government funds." Sen S. Rep. No. 94-420, 8 (1975).

SBA's submission states that since the only party in a limited partnership whose liability is unlimited is the general partner, he is "the only party whose liability could be limited as instructed by Congress * * *."

The quoted explanation from the Senate report was made with respect to a different provision that was much broader and provided that SBICs could include "a partnership, association, or other generally recognized business organization." Subsequently the language of this section was modified, with the accompanying explanation contained in the conference report:

> "The Senate bill authorizes unincorporated entities to be licensed by SBA as small business investment companies.
>
> "The House amendment does not contain any comparable provision.

> "The conference substitute authorizes limited partnerships with a corporate general partner to be licensed by SBA as small business investment companies." See H. Rep. No. 94-1115, at 12 (1976).

Although our review of the legislative history of this provision did not reveal any additional explanation of the language finally adopted, it is conceivable that the conference committee agreed to the limited partnership form with a corporate general partner in order to implement the recommendation contained in the Senate report "to limit the liabilities of the partners." This is possible since the specific purpose of the limited partnership is to limit the liability of the non-managing partners. Moreover, the requirement that the general partner be incorporated further limits the personal liability of the individual members of the corporation. If this was the intention of Congress in adopting this language, further limitations on the liability of the members of the partnership might not have been considered desirable.

We believe that the legislative history as discussed above is inconclusive. However, other contentions advanced in the SBA submission are sufficient, in our view, to support the instant proposal.

As stated in SBA's submission there is no statutory prescription in the Small Business Investment Act or elsewhere that would necessarily prohibit SBA from granting financing to a limited partnership SBIC without resource to the personal assets of the corporate general partner. Moreover, section 303 of the Act as amended, 15 U.S.C. § 683, which sets forth the terms and conditions under which SBA may make loans to SBICs, specifically provides that SBA can make loans (by purchasing or guaranteeing debentures issued by SBICs) "on such terms and conditions as it deems appropriate pursuant to regulations issued by the Administration." In this regard SBA's submission reads in pertinent part as follows:

> "SBA has determined that the use of non-recourse financing for partnership SBICs is necessary to greatest use of such organizations, and would not place the SBA in a less favorable position than that where financing is provided to a corporate SBIC. SBA believes that the use of non-recourse financing for partnership SBICs would attract additional investors and capital into the SBIC program, which is consistent with and in

> furtherance of the policy of the Small Business Investment Act and the intent of Congress in passing Public Law 94-305."

Accordingly, since SBA has made the determination that the use of non-recourse financing for limited partnership SBICs is necessary to effectively utilize this type of organization and thereby effectuate the general purpose of the Small Business Investment Act and the specific intent of Congress in enacting Pub. L. No. 94-305, we believe that SBA does have the statutory authority under 15 U.S.C. § 683 to promulgate regulations providing for such non-recourse loans.

Moreover, in SBA v. McClellan, 364 U.S. 446 (1960), cited by SBA in its submission to us, SBA's authority to give up certain of its rights in order to provide additional security to private banks cooperating with SBA in its loan program was upheld by the Supreme Court. That case involved a question of SBA's authority to agree by contract to transfer a portion of the funds obtained in a bankruptcy proceeding, pursuant to the Government's statutory priority, to private banks in order to induce them to participate with it in making loans to small business borrowers. In upholding SBA's authority in this regard, the Supreme Court observed:

> "* * * The Small Business Administration is authorized to enter into contracts calculated to induce private banks to make loans to small businesses. The contract involved in this case, by providing additional security to the private bank at the Government's expense, is well adapted to that end. Indeed, in many cases such a contract may be the only way the administration could induce private bank participation in a necessary loan. * * *" 364 U.S. at 452.

We agree with SBA that the decision in the McClellan case supports its position here, i.e., that SBA has authority, in effect, to waive its rights as a creditor under BLPA if such waiver is considered necessary in order "to obtain the greatest participation by investors in SBIC partnerships."

We are also in agreement with SBA's position that two relatively recent decisions, B-181432, March 13, 1975 and February 19, 1976--in

which we ruled that SBA could not waive provisions in the guarantee agreement between SBA and lending institutions requiring lenders, as a condition precedent to SBA's guarantee, (1) to pay the guarantee fee at the time a loan is disbursed and (2) to provide SBA with timely notice should the borrower default--are not applicable to the case at hand. Those cases involved SBA's authority to waive rights already accrued under existing contracts, whereas the present issue is whether SBA can, prior to the initiation of a program, agree to waive certain property rights it would otherwise have.

We do believe that one issue not touched upon in SBA's submission merits some discussion. As indicated above, section 301 of the Small Business Investment Act, as amended, 15 U.S.C. § 681, provides that SBICs, whether established as corporations or limited partnerships, must be "organized and chartered or otherwise existing under State law." Therefore, since most States have adopted ULPA which specifically provides that limited partnerships must have a general partner with the same liability as the partners in an ordinary partnership, i.e., unlimited personal liability, a question may arise as to whether SBA's "waiver" of its rights against the separate assets of the corporate general partner would be valid under State law. However it appears that agreements between a creditor and a partnership entered into at the time the debt is created exempting the members of the partnership from personal liability and providing that the creditors shall look only to the assets of the partnership for the payment of the debt are generally held to be valid and enforceable under State law. See, e.g., Harris Machine Foundry & Supply Company v. J. K. Harris Interests, 26 S.W.2d 449 (Civ. App. Tex. 1930); First National Bank of New Bedford v. Chartier, 25 N.E.2d 733 (Sup. Jud. Ct. Mass. 1940); B-OK, Inc. v. Storey, 473 P.2d 426 (Ct. App. Wash. 1970). Although these cases deal with the rights of partners in an ordinary partnership to enter into contracts limiting their personal liability to creditors, we believe that the general partner in a limited partnership necessarily has the same right to limit his liability pursuant to section 9(1) of ULPA. In this connection we would point out that SBA's waiver of its right as a creditor to look to the separate assets of the corporate general partner would in no way affect the liability of this partner under ULPA with respect to any transactions involving parties other than SBA.

In accordance with the foregoing, we concur with SBA's opinion that it has legal authority to make non-recourse loans to limited

partnership [illegible]. Our opinion is limited to the legal issues involved and is not intended in any way to indicate our approval of the administrative desirability of this type of financial arrangement.

R. F. KELLER

Deputy Comptroller General
of the United States