Comment

The Expansion of Limited Liability: A Comment on Limited Partnerships

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1. *Introduction*

What explains the development of different types of structures for conducting business? What type of regulation is appropriate for these business structures? These are two of the most important questions for those involved in commercial law research. In this Comment I endeavour to answer the second question as it relates to one particular type of business structure — limited partnerships.[1]

Increasing attention is being given to limited partnerships. This attention has focused upon five issues. First, the fact that a majority of states have now enacted legislation permitting limited partnerships — two of these states doing so within the past two years.[2] Second, the advantages that a limited partnership has when compared to a company and a general partnership.[3] Third, the removal of the tax advantage applicable to limited partnerships in the 1992-3 federal budget.[4] Fourth, whether the new tax policy will eliminate the use of limited partnerships in major infrastructure investments which typically need significant capital expenditure before generating revenue and often accumulate large tax deductions, particularly during the construction phase of the project.[5] Fifth, the decision of the Australian Securities Commission (ASC)

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1 There is brief discussion of the first question as it relates to limited partnerships in Part 2.

2 *Partnership (Limited Partnerships) Act* 1992 (Vic); *Partnership (Limited Partnership) Amendment Act* 1991 (NSW); *Partnership (Limited Liability) Act* 1988 (Qld); *Limited Partnerships Act* 1909 (WA); *Limited Partnerships Act* 1908 (Tas). For discussion of the Queensland legislation, see Queensland Law Reform Commission, *Working Paper on a Bill to Establish Limited Partnerships*, Working Paper No 27 (1984); Fletcher, K, "Limited Partnerships" (1989) 19 *QL Soc J* 285. For discussion of the New South Wales legislation, see Lumsden, A, "Limited Partnerships" (1992) 6 *Commercial LQ* (No 2) 21. Limited partnership legislation has been recommended for the Australian Capital Territory: see ACT Attorney General's Department, *Review of ACT Partnership Law Consultative Document* (1991). Limited partnerships had their origin in Italy during the Middle Ages. For discussion of the history of limited partnerships, see Scammell, E H and Banks, R C, *Lindley on the Law of Partnership* (15th edn, 1984) at 925-932.

3 See below nn11-13 and accompanying text.

4 Prior to the 1992-3 budget, limited partnerships had a significant tax advantage over other business structures such as companies in that they allowed the flow through of partnership losses to individual partners which could be offset against a partner's other assessable income. From 1995-6, limited partnerships will be taxed in the same way as companies. The Budget Statements provide the following justification for this policy: "Limited partnerships are comparable to companies in providing limited liability investment vehicles ... In this light it is considered that the tax advantages over a company's structure are inappropriate and have the potential to erode the revenue base unduly." *Sydney Morning Herald*, 19 August 1992 at 27.

5 *Aust Business Monthly*, November 1992 at 88-94; *Aust Financial R*, 14 September 1992 at 35.

that general exemptions from the fundraising provisions of the *Corporations Law* should not be given to limited partnerships unless an exemption is consistent with ASC policy and that limited partnerships must meet the same standards of investor protection as other prescribed interest schemes.[6]

In all of this discussion concerning limited partnerships, two important issues have not been addressed. These two issues are central to the question posed in the opening paragraph; namely, what type of regulation is appropriate for particular business structures? The first issue is whether an expansion of limited liability into partnership law is warranted. It is surprising that there has been little discussion of this issue given that the principle of limited liability is the underpinning feature of the legislation permitting limited partnerships. Moreover, discussion of limited liability is topical given that some commentators have begun to question whether limited liability is justifiable in all of the circumstances where it now applies. Most of this discussion has occurred in the United States.[7] However, the issue has been addressed by commentators in Australia.[8] The second issue concerns the way in which the activities and operations of limited partnerships are increasingly subject to federal regulation (through taxation policy and the application of the fundraising provisions of the *Corporations Law*) albeit that these partnerships are established under state legislation. There is an important question concerning whether this is a desirable trend. These two issues are the subject of this Comment. They are discussed following a brief overview of the main features of a limited partnership.

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6 Australian Securities Commission, *Policy Statement 41: Limited Partnership Fundraising* (18 January 1993) and Corporations Regulation 1.13A. This issue was raised by the then Attorney General, Michael Duffy, in an address to the Securities Institute of Australia on 12 May 1992 where he stated that the fundraising provisions of the *Corporations Law* should normally be applicable to limited partnerships and that he was exploring, in conjunction with State Attorneys General, ways in which this could be best achieved.

7 The main contributions in this debate are the following: Posner, R A, "The Rights of Creditors of Affiliated Corporations" (1976) 43 *Uni Chicago LR* 499; Meiners, R E, Mofsky, J S and Tollison, R D, "Piercing the Veil of Limited Liability" (1979) 4 *Delaware J Corp L* 351; Halpern, P, Trebilcock, M and Turnbull, S, "An Economic Analysis of Limited Liability in Corporation Law" (1980) 30 *Toronto LJ* 117; Blumberg, P I, "Limited Liability and Corporate Groups" (1986) 11 *J Corp L* 573; Thompson, R B, "Piercing the Corporate Veil: An Empirical Study" (1991) 76 *Cornell LR* 1036; Hansmann, H and Kraakman, R, "Toward Unlimited Shareholder Liability for Corporate Torts" (1991) 100 *Yale LJ* 1879; Leebron, D W, "Limited Liability, Tort Victims, and Creditors" (1991) 91 *Columbia LR* 1565; Ribstein, L E, "Limited Liability and Theories of the Corporation" (1991) 50 *Maryland LR* 80; Easterbrook, F H and Fischel, D R, *The Economic Structure of Corporate Law* (1991) at 30-62; Grundfest, J A, "The Limited Future of Unlimited Liability: A Capital Markets Perspective" (1992) 102 *Yale LJ* 387.

8 See Rogers J, "Reforming the Law Relating to Limited Liability" (1993) 3 *Aust J Corp Law* 136; Freiberg, A, "Abuse of the Corporate Form: Reflections from the Bottom of the Harbour" (1987) 10 *UNSWLJ* 67 at 90. A recent example of the elimination of limited liability is s588v of the *Corporations Law* (introduced in the *Corporate Law Reform Act* 1992). This provision removes the limited liability that would otherwise apply between a holding company and its subsidiary where the subsidiary has engaged in insolvent trading and the holding company either was aware or should have been aware of this: see Ramsay, I M, "Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective", unpublished manuscript.

2. *Limited Partnerships: An Overview*

The key feature of limited partnerships is that, provided there is at least one general partner who has unlimited liability, the remaining partners may have limited liability. While the general partner has unlimited liability for the debts and obligations of the partnership, a limited partner's liability is limited to the amount of money which he or she has agreed to contribute to the partnership.[9] A limited partner is prohibited from taking part in the management of the business of the partnership and does not have power to bind the partnership. If an unlimited partner does take part in the management of the business of the partnership, he or she becomes liable for the debts and obligations of the partnership incurred while the limited partner takes part in the management.[10]

A limited partnership has the following additional advantages over a company and a general partnership:[11]

- relatively small initial and ongoing compliance costs (for example, requirements applicable to companies such as the need to lodge annual returns and the need for meetings do not apply);
- the terms of a limited partnership agreement will be confidential, unlike a company's memorandum and articles of association; and
- an interest in a limited partnership can be more readily transferred than an interest in a general partnership.

There are also several reasons, based upon economic efficiency, why participants may select to undertake business as a limited partnership rather than a company. In particular, the limited liability of limited partners facilitates passive ownership while the personal liability of general partners can reduce the risk that creditors of the partnership face by providing for payment in the event of insolvency.[12] The fact that limited liability is more consistent with passive rather than active ownership leads one commentator to conclude that limited partnerships are more appropriate where large amounts of equity capital are to be raised.[13]

3. *Limited Liability: An Evaluation*

It is puzzling that in all the discussion of limited partnerships, no adequate attempt has been made to evaluate whether the principle of limited liability should be extended to partnership law.[14] In order to address this issue, it is

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9 See, eg, *Partnership (Limited Partnership) Amendment Act* 1991 (NSW) s60.

10 Id, s67.

11 Lumsden, above n2.

12 Ribstein, L E, "An Applied Theory of Limited Partnership", (1988) 37 *Emory LJ* 835 at 865.

13 Id at 866.

14 It is asserted in one study recommending limited liability legislation for the Australian Capital Territory that limited liability is justified provided notice of this is drawn to the attention of those contracting with the partnership: ACT Attorney General's Department, above n2 at 10. This is not a justification for limited liability and in any event ignores the problems that limited liability creates for involuntary creditors: see nn30-33 and accompanying text. It is also stated in the ACT Report that economic neutrality between limited partnerships and companies dictates the granting of limited liability to limited partners: Id

necessary to understand why limited liability exists. The starting point is a consideration of limited liability and companies. Five reasons, based upon principles of economic efficiency, can be provided for why limited liability applies to companies.[15]

(i) Limited liability decreases the need for shareholders to monitor the managers of companies in which they invest because the financial consequences of company failure are limited. Shareholders may have neither the incentive (particularly if they have only a small shareholding) nor the expertise to monitor the actions of managers. The potential costs of operating companies are reduced because limited liability makes shareholder diversification and passivity a more rational strategy.[16]

(ii) Limited liability provides incentives to managers to act efficiently and in the interests of shareholders by promoting the free transfer of shares. This argument has two parts to it. First, the free transfer of shares is promoted by limited liability because under this principle, the wealth of other shareholders is irrelevant. If a principle of unlimited liability applied, the value of shares would be determined partly by the wealth of shareholders. In other words, the price at which an individual shareholder might purchase a share would be determined in part by the wealth of that shareholder which is now at risk because of unlimited liability. The second part of the argument (that limited liability provides managers with incentives to act efficiently and in the interests of shareholders) is derived from the fact that if a company is being managed inefficiently, shareholders can be expected to be selling their shares at a discount to the price which would exist if the company was being managed efficiently. This creates the possibility of a takeover of the company and the replacement of the incumbent management.

(iii) Limited liability assists the efficient operation of the securities markets because, as was observed in the preceding paragraph, the prices at which shares trade does not depend upon an evaluation of the wealth of individual shareholders.

(iv) Limited liability permits efficient diversification by shareholders which

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at 10. This is an assertion rather than a justification. Indeed, because limited partnerships and companies are different legal entities, it cannot simply be asserted that there should be economic neutrality between the two entities any more than it can be asserted that there should be economic neutrality between unit trusts and companies.

15 These reasons are drawn from Easterbrook and Fischel, above n7 at 41-44.

16 Easterbrook and Fischel also argue that limited liability reduces the costs of monitoring other shareholders. With unlimited liability, because any one shareholder could be responsible for all the debts of the company, it is necessary for that shareholder to ensure that other shareholders possess enough wealth to bear their share of any company debts. This requires costly monitoring of other shareholders according to Easterbrook and Fischel. This justification for limited liability has been criticised on the basis that if unlimited liability means that individual shareholders are liable for company debts only in the proportion which their investment bears to that of the total investment in the company, shareholders would not need to monitor other shareholders. This is because under proportional shareholder liability, the wealth of other shareholders is irrelevant: Presser, S B, "Thwarting the Killing of the Corporation: Limited Liability, Democracy, and Economics" (1992) 87 *Northwestern ULR* 148 at 160-161.

in turn allows shareholders to reduce their individual risk. If a principle of unlimited liability applied and a shareholder could lose his or her entire wealth by reason of the failure of one company, shareholders would have an incentive to minimise the number of shares held in different companies and insist on a higher return from their investment because of the higher risk they face. Consequently, limited liability not only allows diversification but permits companies to raise capital at lower costs because of the reduced risk faced by shareholders.

(v) Limited liability facilitates optimal investment decisions by managers. As we have seen, limited liability provides incentives to shareholders to hold diversified portfolios. Under such circumstances, managers should invest in projects with positive net present values and can do so without exposing each shareholder to the loss of his or her personal wealth. However, if a principle of unlimited liability applied, managers may reject some investments with positive present values on the basis that the risk to shareholders is thereby reduced. "By definition this would be a social loss, because projects with a positive net present value are beneficial uses of capital".[17]

There has been a significant debate in the United States concerning whether limited liability should apply to close corporations.[18] Halpern, Trebilcock and Turnbull advocate unlimited liability for this class of company because limited liability creates incentives for shareholders to transfer uncompensated business risks to creditors and thereby induces costly attempts by creditors to reduce these risks.[19] They also state that while limited liability plays an important role in organised securities markets, this is not a major factor for close corporations.[20] Easterbrook and Fischel observe that a number of reasons supporting limited liability in the context of public companies have less application to close corporations.[21] First, limited liability reduces the costs of shareholders monitoring managers. Yet in close corporations, many shareholders are involved in management making this justification less relevant. Second, limited liability promotes the free transfer of shares. Yet close corporations restrict the right of shareholders to transfer their shares so that this reason also becomes less relevant.[22] Third, other justifications for limited liability in the context of public companies — facilitating monitoring by the

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17 Easterbrook and Fischel, above n7 at 44.

18 A close corporation is one that has few shareholders and its shares are not traded on a public exchange. At the time of writing, the *Close Corporations Act* 1989 has not been proclaimed to commence because of constitutional deficiencies: see the Joint Statutory Committee on Corporations and Securities, *Close Corporations Act* 1989 (1992), paras 1.1-1.5.

19 Halpern, Trebilcock and Turnbull, above n7 at 148. Because close corporations are not subject to monitoring by the market for corporate control or the capital market, shareholders and managers of these companies may have a greater incentive to shift risk to creditors.

20 Ibid.

21 Easterbrook and Fischel, above n7 at 55-56. See also Hillman, R W, "Limited Liability and Externalization of Risk: A Comment on the Death of Partnership" (1992) 70 *Washington ULQ* 477 at 484-485.

22 Section 116 of the *Corporations Law* provides that a company may be classified as a proprietary company only if, inter alia, a provision of its constitution restricts the right of shareholders to transfer their shares.

capital market and providing an incentive for managers to act efficiently — are absent in close corporations.[23]

Yet there are reasons why limited liability should apply to close corporations. Thus, the argument that unlimited liability may undercut the ability of shareholders to diversify against specific risk applies both to public companies and close corporations. Leebron observes that for many investors in close corporations, their shareholdings represent only part of a portfolio of investments that may include a house, other real estate and various other assets.[24] Leebron argues that if all of these assets were exposed, shareholders may choose not to make investments in close corporations at all and this would seriously curtail the entrepreneurial market.[25] In addition, unlimited liability may result in excessive risk aversion by shareholders in close corporations. This becomes particularly important given the inability of these investors to adequately diversify their investments.[26]

There are similarities between close corporations and general partnerships.[27] Yet the differences between limited partnerships and general partnerships has implications for the role of limited liability. Most importantly, while close corporations (as envisaged by the *Close Corporations Act*) and general partnerships do not have a distinction between ownership and management, such a distinction is the very essence of a limited partnership. We have seen that a limited partner is prohibited from taking part in the management of the business and that if he or she does take part in the management, then the limited liability of the partner is lost.[28] What this means is that one of the important justifications for limited liability; namely, the manner in which it decreases the need for shareholders to monitor managers and thereby reduces operating costs, is particularly applicable to limited partnerships although it does not apply to general partnerships or close corporations.

Other justifications for limited liability also apply to limited partnerships. These justifications include the way in which limited liability allows more efficient diversification by shareholders and facilitates optimal investment decisions by managers. Other justifications have potential application to limited partnerships. For example, we have seen that limited liability promotes the free transfer of shares by ensuring that the value of shares is not a function of the wealth of shareholders. This justification could also apply to the transfer of interests in limited partnerships. Another major justification for limited li-

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23 Section 116 of the *Corporations Law* prohibits a proprietary company from offering its securities to the public thereby eliminating monitoring by this part of the capital market. Moreover, monitoring by the market for corporate control is reduced significantly because of the requirement that proprietary companies restrict the right of shareholders to transfer their shares.

24 Leebron, above n7 at 1628.

25 Ibid.

26 Ibid. See also Ribstein, above n7 at 101-106.

27 Companies and Securities Law Review Committee, *Report to the Ministerial Council on Forms of Legal Organisation for Small Business Enterprises* (1985), para 30. The Joint Statutory Committee argues that close corporations created by the *Close Corporations Act* are similar to partnerships in that all members may participate in management, all members are agents of the corporation, and members have a fiduciary relationship with the corporation: above n18, para 1.9.

28 Above n10.

ability is that it facilitates the organisation of the securities market and also monitoring by the capital market. These justifications have potential application to limited partnerships depending upon whether they become major public fundraising investment vehicles in Australia. This has occurred in the United States where it is estimated that there are approximately 125-150 publicly traded limited partnerships.[29] It can therefore be seen that there are a number of reasons, based upon economic efficiency, why limited partnerships should have the benefit of limited liability.

What has not been considered in the preceding discussion is whether this conclusion should be qualified because of the potential problems created by limited liability. In particular, limited liability allows investors to transfer risk to those who cannot contract to protect themselves, such as tort claimants. This can apply to both companies and limited partnerships. Two examples (drawn from case law) illustrate the problems that are created when under-capitalised companies are able to shift risk to tort claimants by utilising the principle of limited liability. Each case involved a claim to lift the corporate veil and make the holding company liable for a tort claim against its subsidiary. The first example concerns the problems resulting from asbestos mining in Australia.[30] The New South Wales Court of Appeal recently considered the appeal of an Aboriginal miner who had contracted asbestosis and who sought to make the holding company of the mine operating company liable because the subsidiary had insufficient capital to satisfy the tort claim.[31] The second example, drawn from the United States, concerns cases in which a person who owns a fleet of taxis incorporates a separate company for each taxi in order to limit the claims of tort claimants to the assets of one company.[32] The two cases represent situations where under-capitalised companies endeavour to utilise the principle of limited liability to transfer the risk of business to tort claimants. Yet Blumberg argues that the group adversely affected by limited liability is much larger than just tort claimants. It includes those employees, retail consumers and trade creditors who are unable to contract around a rule of limited liability or adjust for it by requiring (for example in the case of trade creditors) higher returns.[33]

Given these types of problems, it becomes important to consider whether there are any solutions other than the imposition of unlimited liability. This is because, as we have seen, there are a number of powerful justifications for limited liability. Moreover, even if unlimited liability does reduce the ability of participants to avoid tort liability, it has been argued that this may not necessarily assist in achieving the principal tort objectives of loss prevention and

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29 Hill, G, "Limited Partnerships: The Potential for Commercial Use in Australia" in Business Law Education Conference, *Limited Partnerships* (1992). According to this author, publicly traded listed partnerships in the United States raised approximately $2.4 billion in 1991.

30 For general discussion of these problems, see House of Representatives Standing Committee on Aboriginal Affairs, *The Effects of Asbestos Mining on the Baryulgil Community* (1984).

31 *Briggs v James Hardie & Co Pty Ltd* (1989) 7 ACLC 841.

32 For the best known of a number of court decisions where this issue is considered, see *Walkovszky v Carlton* (1966) 223 NE 2d 6.

33 Blumberg, above n7 at 616-619.

loss distribution.[34] A solution recommended by a number of commentators is that of imposing an obligation to provide adequate insurance to meet the claims of foreseeable tort claimants.[35] Another recommended solution (designed to overcome the problem of the establishment of separate companies for what is essentially a similar business — such as the taxi cases) is prohibiting controlling shareholders from limiting their liability by artificially separating a unitary business, or closely related enterprises, into separate companies.[36]

Other solutions may be possible. For example, an alternative is the imposition of civil or criminal liability upon decision makers who are involved in the commission of a tort.[37] However, what is important is that there be discussion of the relevant issues. To date there has been no principled debate concerning whether the advantages of limited liability are applicable to limited partnerships. I have observed that there are justifications for extending the principle of limited liability to limited partnerships. Yet limited liability may create problems, particularly for tort claimants harmed by an under-capitalised company or limited partnership. It is no answer to say that the existence of a general partner, as required by limited partnership legislation, will overcome these problems. It is highly likely that general partners, particularly general partners of limited partnerships involved in risky ventures, will not have significant assets. Indeed, in some circumstances, the general partner may actually be an under-capitalised company. As this discussion has demonstrated, what is required is careful evaluation of both the justifications for limited liability in the partnership context and also the means whereby the problems created by limited liability can be overcome.

4. *State versus federal regulation of limited partnerships*

The second issue which has not been addressed in the extensive debate concerning limited partnerships is the merits of state versus federal regulation of these partnerships. As a result of recent federal intervention in the operations of limited partnerships, it is now clear that there is considerable tension in the regulation of limited partnerships. Limited partnerships are established under

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34 Ribstein, L E, "The Deregulation of Limited Liability and the Death of Partnership" (1992) 70 *Washington LQ* 417 at 444-447. Ribstein argues that unlimited liability may actually reduce incentives for care by deflecting the loss from managers, who might be effectively disciplined by the risk of liability, to owners who might not be effectively disciplined: Id at 445. This is an empirical question which varies from firm to firm and on which Ribstein offers no evidence.

35 Leebron, above n7 at 1636; Clark, R, *Corporate Law* (1986) at 78. One study of limited partnerships recommends that no special tort insurance arrangements should be required because "any reform of tort insurance could not be instituted simply for one class of business tortfeasors": ACT Attorney General's Department, above n2 at 39. This ignores the precedent of compulsory public liability insurance for certain incorporated associations: Sievers, A S, *Associations Legislation in Australia and New Zealand* (1989) at 97. Moreover, if the goal is to have a mandatory fund for the payment of future claims, the banking sector provides another precedent because it is subject to mandatory capital adequacy requirements: see Weerasooria, W S, *Banking Law and the Financial System in Australia* (1988), Ch 3.

36 Leebron, above n7 at 1636.

37 Grundfest, above n7 at 422.

state legislation. However, federal regulation is evident through the taxation policy announced by the federal government in the 1992-3 budget and the announcement by the Australian Securities Commission that the fundraising provisions of the Corporations Law apply to limited partnerships.[38]

On a prior occasion, I have considered the merits of state versus federal regulation of companies.[39] In that article, I questioned the assumption of many commentators that regulation of companies by the federal government is inevitably superior to state regulation. There are of course arguments favouring federal regulation. For example, the transaction costs associated with companies doing business can be reduced if they have to deal with only one uniform national law rather than a series of different state laws. Furthermore, regulation by the federal government may overcome the incentive of state governments to externalise costs.[40] Yet what is of concern with the increasing federal intervention in the affairs of limited partnerships is the lack of appreciation of arguments favouring state government regulation.[41] First, the federal government may be more insensitive than state governments to the needs of investors and other participants in limited partnerships. Indeed, a fundamental principle of a federal system of government is that because of the enormous variety of preferences in society (including the preferences of investors), it is important to have governments with limited jurisdiction so that these preferences can more readily be satisfied. There is no reason to believe that the preferences of investors concerning the way they undertake business are uniform across Australia. An example is the use of no liability companies. Only a mining company may be incorporated as a no liability company.[42] Given the reliance of the Western Australian economy on mining,[43] it is not unexpected that 54 per cent of all no liability companies are incorporated in that State.[44]

The second reason favouring state government regulation is that a state government has less scope for enacting harmful legislation than the federal government. This is because the more local the jurisdiction of a government, the more readily people and businesses can move in order to find a more hospitable jurisdiction. In other words, each of these governments can be thought of as a substitute for the others. Third, and very importantly, allowing regulation by state governments can increase innovation and experimentation as each of these governments competes to attract business and employment. Limited partnerships are an example of this. New South Wales was not the first state to introduce legislation permitting limited partnerships. It did so be-

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38 See nn4 and 6 and accompanying text.

39 Ramsay, I M, "Company Law and the Economics of Federalism" (1990) 19 *FLR* 169.

40 This will occur where a state does not bear all of the costs of action that it undertakes. For examples of externalities, see id at 175 and 193-194.

41 Readers are referred to my prior article for more detailed discussion of these arguments and how they apply to the regulation of companies.

42 *Corporations Law*, s115(2).

43 The Western Australian government receives more in mineral royalty receipts than any other state. Moreover, in terms of turnover and value added, the mining industry contributes more to Western Australia than any other state: Australian Bureau of Statistics, *Year Book Australia 1992* at 460 and 465.

44 As at 30 June 1992, there was a total of 958 no liability companies in Australia of which 515 were incorporated in Western Australia: Australian Securities Commission, *Annual Report 1991-92* at 80.

cause it was losing investment to other states which did permit limited partnerships. This was acknowledged by the New South Wales Attorney General when introducing the Partnership (Limited Partnership) Amendment Bill:

> This [Bill] will assist business developments and attract investments to this state ... In Australia, limited partnerships have been increasingly used in the past 10 years as vehicles for ventures requiring risk capital and entrepreneurial initiative ... In many cases New South Wales investors have been involved, and if this state had limited partnership legislation, such partnerships would, in many cases, have been formed and administered here. In the absence of such legislation, they have gone to other states.[45]

The critical issue is whether the increasing federal regulation will stifle this innovation and experimentation. In some circumstances, there may need to be limits on competition among state governments.[46] Yet greater reliance on competitive production of laws and supporting institutions among state governments may result in more responsive and innovative laws and institutions.[47] For this reason, the increasing federal regulation of limited partnerships should be viewed with concern. Indeed, the federal taxation policy referred to earlier may severely restrict the use of limited partnerships as a viable investment vehicle. Evidence supporting this argument is contained in statistics on the registration of limited partnerships in New South Wales. The Department of Business and Consumer Affairs commenced registering limited partnerships in May 1992 following the enactment of the *Partnership (Limited Partnership) Amendment Act* 1991 (NSW). In the three and one half months prior to the federal budget statement on 18 August 1992, 28 limited partnerships were registered in New South Wales.[48] However, in the nine and one half months following the budget statement (ending on 31 May 1993) only eight limited partnerships were registered.[49]

5. *Conclusion*

Two arguments have been advanced in this article. First, there are a number of reasons, based upon principles of economic efficiency, why limited liability should be extended to limited partnerships. However, there needs to be a recognition of the way in which limited liability may allow investors to transfer risk to those who cannot contract to protect themselves. Some possible solutions were identified. Second, it was argued that, given the increasing federal regulation of limited partnerships, there has been a lack of appreciation of arguments supporting state regulation. Federal regulation may effectively eliminate the state government innovation of limited partnerships.

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45 Dowd, J, Second Reading Speech, Partnership (Limited Partnership) Amendment Bill, New South Wales Legislative Assembly, 9 April 1991.

46 Bebchuk, L A, "Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law" (1992) 105 *Harv LR* 1435.

47 For discussion of this issue in the context of Canadian corporate law, see Daniels, R J, "Should Provinces Compete? The Case for a Competitive Corporate Law Market" (1991) 36 *McGill LJ* 130.

48 Letter from the New South Wales Department of Business and Consumer Affairs addressed to the author and dated 9 June 1993.

49 Ibid.