

EITF Abstracts (DRAFT¹)

Issue No. 04-5

Title: Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004; November 17–18, 2004; March 17, 2005; June 15–16, 2005

References: FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*
FASB Statement No. 5, *Accounting for Contingencies*
FASB Statement No. 57, *Related Party Disclosures*
FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*
FASB Statement No. 154, *Accounting Changes and Error Corrections*
FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*
AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements*
APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*
APB Opinion No. 20, *Accounting Changes*
APB Opinion No. 29, *Accounting for Nonmonetary Transactions*
AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*

ISSUE

1. For many years, financial statement preparers and auditors have debated how to evaluate whether a partnership is controlled by one of its partners. Recent guidance provided in Interpretation 46(R)² regarding "kick-out" rights in the context of evaluating variable interests

¹ This draft abstract was prepared to facilitate discussion of the guidance on which the Task Force reached its consensus and contains all substantive aspects of the consensus. The final abstract, which will be included in the next update for *EITF Abstracts*, may contain nonsubstantive editorial revisions.

² Refer to paragraph B20 of Interpretation 46(R).

and consolidation of variable interest entities has renewed the debate over what considerations are relevant in determining whether the general partners control a limited partnership. In practice today, the question of whether a partnership is controlled by one of its partners is typically addressed by analogizing to the guidance in SOP 78-9, which specifically provides guidance on the accounting for investments in real estate ventures, including investments in corporate joint ventures, general partnerships, limited partnerships, and undivided interests. Very little authoritative guidance exists for purposes of assessing whether the limited partners rights are *important rights* that, under SOP 78-9, might preclude a general partner from controlling a limited partnership. As a result, differing views in practice about what rights constitute important rights have evolved over time.

2. The issue is when a general partner, or the general partners as a group, controls a limited partnership or similar entity when the limited partners have certain rights.

Scope

3. The scope of this Issue is limited to limited partnerships³ or similar entities (such as limited liability companies that have governing provisions that are the functional equivalent of a limited partnership) that are not variable interest entities under Interpretation 46(R). This Issue does not apply to a general partner that, in accordance with generally accepted accounting principles, carries its investment in the limited partnership at fair value with changes in fair value reported in a statement of operations or financial performance. That is, if an enterprise is required to apply the consolidation guidance included in ARB 51 and Statement 94 to its investment in a limited partnership, it is within the scope of this Issue.⁴ This Issue also is not intended to change current guidance in Issue No. 00-1, "Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures," on when it is appropriate for a general partner to use the pro rata method of consolidation for its investment in a limited partnership.

³ When used throughout this Issue, the term *limited partnerships* shall mean either a limited partnership or a similar entity.

⁴ This guidance applies to not-for-profit entities that are required to apply the consolidation guidance in ARB 51 and Statement 94 for their investments in partnership entities.

4. The Task Force acknowledged that when a limited partnership has multiple general partners, the determination of which, if any, general partner within the group controls and, therefore, should consolidate the limited partnership is based on an analysis of the relevant facts and circumstances.⁵ If no single general partner in a group of general partners controls the limited partnership, the guidance in this Issue need not be applied. The Task Force agreed that guidance on determining which general partner in a group of general partners should consolidate is beyond the scope of this Issue. However, a Task Force member observed that the concepts in this Issue may be helpful in determining whether a single general partner in a group of general partners controls a limited partnership, particularly in relation to assessing whether the combined rights of the other general partners and the limited partners taken together overcome a conclusion that a single general partner controls a limited partnership.

EITF DISCUSSION

5. The Task Force reached a consensus that the *general partners*⁶ in a limited partnership should determine whether they control a limited partnership based on the application of the framework in paragraphs 6–21.

Presumption of Control

6. The general partners in a limited partnership are presumed to control that limited partnership regardless of the extent of the general partners' ownership interest in the limited partnership.⁷ The assessment of whether the rights of the limited partners⁸ should overcome the presumption of control by the general partners is a matter of judgment that depends on facts and circumstances. If the limited partners have either (a) the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause or (b)

⁵ In situations involving multiple general partners, entities under common control are considered to be a single general partner for purposes of applying the guidance in this Issue.

⁶ The term *general partners* refers to one or more general partners and has this meaning when used in the context of this Issue.

⁷ The Task Force observed that an entity has financial statement and disclosure alternatives that may provide additional useful information. For example, an entity may highlight the effects of consolidating a limited partnership by providing consolidating financial statements or separately classifying the assets and liabilities of the limited partnership(s) on the face of the balance sheet.

⁸ The term *limited partners* refers to one or more limited partners and has this meaning when used in the context of this Issue.

substantive participating rights, the general partners do not control the limited partnership. Further guidance on each of these concepts is provided below.

Do the limited partners have the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause?⁹

7. For purposes of this Issue, the rights underlying the limited partners' ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners are collectively referred to as kick-out rights. The determination of whether the kick-out rights are substantive should be based on a consideration of all relevant facts and circumstances. Substantive kick-out rights must have both of the following characteristics:

- a. The kick-out rights can be exercised by a single limited partner or a vote of a simple majority¹⁰ (or a lower percentage) of the limited partners voting interests held by parties other than the general partners, entities under common control with the general partners or a general partner, and other parties acting on behalf of the general partners or a general

⁹ *Without cause* means that no reason need be given for the dissolution (liquidation) of the limited partnership or removal of the general partners. *With cause* generally restricts the limited partners' ability to dissolve (liquidate) the limited partnership or remove the general partners in situations that include, but that would not be limited to, fraud, illegal acts, gross negligence, and bankruptcy of the general partners.

¹⁰ To illustrate the application of the "simple majority" threshold, consider the following examples in which the limited partnership agreement requires a simple majority of the limited partners voting interests to remove the general partner: (1) Assume that a limited partnership has 3 limited partners, none of which have any relationship to the general partners, and that each holds an equal amount of the limited partners voting interests (33.33 percent). In this case, applying the simple majority requirement in the partnership agreement would require a vote of no more than two of the three limited partners to remove the general partners. Accordingly, a provision that entitles any individual limited partner to remove the general partner or a provision that requires a vote of two of the limited partners to remove the general partner would meet the requirements of paragraph 7(a) for a substantive kick-out right. However, if a vote of all three limited partners is required to remove the general partner, the right would not meet the requirements of paragraph 7(a) for a substantive kick-out right because the required vote is greater than a simple majority of the limited partners voting interests. (2) Consider the same facts as in Example 1, except that there are two limited partners that each hold an equal interest. In this case, a "simple majority" of the limited partners voting interests would require a vote of both limited partners, so a provision entitling any individual limited partner to remove the general partner or a provision that requires a vote of both limited partners to remove the general partner would meet the requirements of paragraph 7(a) for a substantive kick-out right. (3) Consider the same facts as in Example 1, except that there are 100 limited partners that each hold an equal interest. In this case, a "simple majority" of the limited partners voting interests would require a vote of 51 limited partners, so a provision that requires a vote of less than 52 limited partners to remove the general partner would meet the requirements of paragraph 7(a) for a substantive kick-out right. However, if a vote of 52 or more limited partners is required to remove the general partner, that provision would not meet the requirements of paragraph 7(a) for a substantive kick-out right because the required vote is greater than a simple majority of the limited partners voting interests.

partner. The Task Force observed that a kick-out right that contractually requires a vote in excess of a simple majority (such as a supermajority) of the limited partners voting interests to remove the general partners may still be substantive if the general partners could be removed in every possible voting scenario in which a simple majority of the limited partners voting interests vote for removal. That is, there is no combination of the limited partners voting interests that represents at least a simple majority of the limited partners voting interests that cannot remove the general partners.¹¹ The Task Force believes that all relevant facts and circumstances should be considered in assessing whether other parties, including, but not limited to, those defined as related parties in Statement 57, may be acting on behalf of the general partners in exercising their voting rights as limited partners. Similarly, in assessing whether a single limited partner has the ability to remove the general partners, consideration should be given to whether other parties, including, but not limited to, those defined as related parties in Statement 57, may be acting with the limited partner in exercising their kick-out rights.

- b. The limited partners holding the kick-out rights have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. Barriers include, but are not limited to:
 - (1) Kick-out rights subject to conditions that make it unlikely they will be exercisable, for example, conditions that narrowly limit the timing of the exercise

¹¹ To illustrate this concept, consider the following examples based on a limited partnership agreement that requires a vote of 66.6 percent of the limited partners voting interests to remove the general partner:

Scenario 1: There are 3 independent limited partners that each hold an equal percentage (33.33 percent) of the limited partner voting interest. A vote of 2 of the 3 limited partners represents 66.7 percent of the limited partners voting interests, which also represents the smallest possible combination of voting interests that is at least a simple majority of the limited partners voting interests. Assuming there are no barriers to the exercise of the kick-out rights, the kick-out rights in this scenario meet the simple majority requirement and therefore represent substantive kick-out rights that overcome the presumption of control by the general partners.

Scenario 2: There are 3 independent limited partners that hold 45 percent (LP1), 25 percent (LP2), and 30 percent (LP3) of the limited partners voting interests, respectively. To remove the general partners, a vote of LP1 in combination with either LP2 or LP3 would be a simple majority of the limited partners and would satisfy the 66.6 percent contractual requirement. In contrast, a vote to exercise the kick-out right by LP2 and LP3 also would represent a simple majority of the limited partners; however, their voting interests (55 percent) would not meet the required threshold of 66.6 percent to remove the general partners. Accordingly, the kick-out right under this scenario would be assessed as nonsubstantive because the smallest possible combination (LP2 and LP3) that represents at least a simple majority of the limited partners voting interests cannot remove the general partners. Assuming the limited partners do not possess substantive participating rights, the presumption of control by the general partners is not overcome.

- (2) Financial penalties or operational barriers associated with dissolving (liquidating) the limited partnership or replacing the general partners that would act as a significant disincentive for dissolution (liquidation) or removal
- (3) The absence of an adequate number of qualified replacement general partners or the lack of adequate compensation to attract a qualified replacement
- (4) The absence of an explicit, reasonable mechanism in the limited partnership agreement or in the applicable laws or regulations, by which the limited partners holding the rights can call for and conduct a vote to exercise those rights
- (5) The inability of the limited partners holding the rights to obtain the information necessary to exercise them.

8. For purposes of applying paragraph 7, the limited partners' unilateral right to withdraw from the partnership in whole or in part (withdrawal right) that does not require dissolution or liquidation of the entire limited partnership would not overcome the presumption that the general partners control the limited partnership (that is, the withdrawal right is not deemed to be a kick-out right). The requirement to dissolve or liquidate the entire limited partnership upon the withdrawal of a limited partner or partners is not required to be contractual for a withdrawal right to be considered as a potential kick-out right.

9. If, based on the preceding evaluation, the limited partners possess substantive kick-out rights, presumption of control by the general partners would be overcome and each of the general partners would account for its investment in the limited partnership using the equity method of accounting.

Do the limited partners have substantive participating rights?

10. If the limited partners have substantive participating rights, the presumption of control by the general partners would be overcome and each of the general partners would account for its investment in the limited partnership using the equity method of accounting. Substantive participating rights provide the limited partners with the ability to effectively participate in

significant decisions that would be expected to be made in the ordinary course of the limited partnership's business.

11. The Task Force agreed that "participating rights" are different from "protective rights." All limited partners' rights could be described as "protective rights," but some rights also allow the limited partners to participate in certain financial and operating decisions of the limited partnership that are made in the ordinary course of business (referred to as participating rights). The Task Force agreed that limited partners' rights that are only protective in nature (referred to as "protective rights") do not overcome the presumption that the general partners control the limited partnership. The Task Force agreed that limited partners' rights, individually or in the aggregate, that provide the limited partners with the right to effectively participate in significant decisions that would be expected to be made in the ordinary course of the limited partnership's business while being protective of the limited partners' investment overcome the presumption that the general partners control the limited partnership.

12. For purposes of applying this framework, decisions made in the ordinary course of business are defined as decisions about matters of a type consistent with those normally expected to be addressed in directing and carrying out the limited partnership's current business activities, regardless of whether the events or transactions that would necessitate such decisions are expected to occur in the near term. However, it must be at least reasonably possible that those events or transactions that would necessitate such decisions will occur. Ordinary course of business does not include self-dealing transactions with the general partners.

13. The Task Force reached a consensus that the following guidance should be considered in evaluating whether rights held by the limited partners overcome the presumption of control by the general partners.

Protective Rights

14. The Task Force believes that limited partners rights (whether granted by contract or by law) that would allow the limited partners to block the following limited partnership actions would be

considered protective rights and would not overcome the presumption of control by the general partners.

- a. Amendments to the limited partnership agreement.
- b. Pricing on transactions between the general partners and the limited partnership and related self-dealing transactions.
- c. Liquidation of the limited partnership initiated by the general partners or a decision to cause the limited partnership to enter bankruptcy or other receivership.
- d. Acquisitions and dispositions of assets that are not expected to be undertaken in the ordinary course of business. (Limited partners' rights relating to acquisitions and dispositions that are expected to be made in the ordinary course of the limited partnership's business are participating rights. Determining whether such rights are substantive requires judgment in light of the relevant facts and circumstances—see "Factors to Consider" and Exhibit 04-5A.)
- e. Issuance or repurchase of limited partnership interests.

15. The Task Force considered the above to be illustrative of some, but not all, of the protective rights that often are provided to limited partners.

Substantive Participating Rights

16. The Task Force believes that limited partners' rights (whether granted by contract or by law) that would allow limited partners to effectively participate in the following actions of the limited partnership should be considered substantive participating rights and would overcome the presumption that the general partners control the limited partnership:

- a. Selecting, terminating,¹² *and* setting the compensation of management responsible for implementing the limited partnership's policies and procedures
- b. Establishing operating *and* capital decisions of the limited partnership, including budgets, in the ordinary course of business.

¹² Rights held by the limited partners to remove the general partners from the partnership should be evaluated as kick-out rights pursuant to paragraph 7 of this Issue. Rights of the limited partners to participate in the termination of management (for example, management is outsourced to a party other than the general partner) or the individual members of management of the limited partnership may be substantive participating rights.

17. The Task Force believes that in evaluating the limited partners' rights to determine whether they are substantive, *participation* means the ability of the limited partners to approve or block actions proposed by the general partners. That is, the general partners must have the limited partners' agreement to take the actions outlined above in order for the rights to be substantive participating rights. Participation does not require the ability of the limited partners to initiate actions.

18. The Task Force considered the rights described in paragraph 16 to be illustrative of substantive participating rights, but not necessarily an all-inclusive list. The Task Force believes that the rights noted above are participating rights because, in the aggregate, the rights allow the limited partners to effectively participate in the decisions that occur as part of the ordinary course of the limited partnership's business and are significant factors in directing and carrying out the activities of the limited partnership. Individual rights, such as the right to veto the termination of management responsible for implementing the limited partnership's policies and procedures (if management is outsourced—via contract with a third party—by the general partners), should be assessed based on the facts and circumstances to determine if they are substantive participating rights in and of themselves. However, limited partners' rights that appear to be participating rights but that by themselves are not substantive (see "Factors to Consider" and Exhibit 04-5A) would not overcome the presumption of control by the general partners in the limited partnership. The likelihood that the veto right will be exercised by the limited partners should not be considered when assessing whether a limited partner right is a substantive participating right.

Factors to Consider

19. The Task Force agreed that the following factors should be considered in evaluating whether limited partners' rights that appear to be participating are substantive rights—that is, whether these factors provide for effective participation in significant decisions related to the limited partnership's ordinary course of business:

- a. The limited partnership agreement needs to be considered to determine at what level decisions are made—by the general partners or by the limited partnership as a whole—and the rights at each level also should be considered. In all situations, any matters that can be put to a vote of the limited partnership must be considered to determine if the limited partners, individually or in the aggregate, have substantive participating rights by virtue of their ability to vote on matters submitted to a vote of the limited partnership. Determination of whether matters that can be put to a vote of the limited partners, or the vote of the limited partnership as a whole, are substantive should be based on a consideration of all relevant facts and circumstances.
- b. Relationships between the general partners and the limited partners (other than investment in the common limited partnership) that are of a related-party nature, as defined in Statement 57, should be considered in determining if the participating rights of the limited partners are substantive. For example, if the limited partner in a limited partnership is a member of the immediate family of the general partners of the limited partnership, then the rights of the limited partner likely would not overcome the presumption of control by the general partners.
- c. Certain limited partners' rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the limited partnership. The Task Force concluded that limited partners' rights related to items that are not considered significant for directing and carrying out the activities of the limited partnership's business are not substantive participating rights and would not overcome the presumption of control by the general partners. Examples of such limited partners' rights relate to decisions about location of the limited partnership's headquarters, name of the limited partnership, selection of auditors, and selection of accounting principles for purposes of separate reporting of the limited partnership's operations.
- d. Certain limited partners' rights may provide for the limited partners to participate in significant decisions that would be expected to be made in certain business activities in the "ordinary course of business"; however, the Task Force concluded that the existence of such

limited partners' rights should not overcome the presumption that the general partners have control if it is remote¹³ that the event or transaction that requires the limited partners' approval will occur.

- e. General partners who have a contractual right to buy out the interest of the limited partners in the limited partnership for fair value or less should consider the feasibility of exercising that contractual right when determining if the participating rights of the limited partners are substantive. If such a buyout is prudent, feasible, and substantially within the control of the general partners, the general partners' contractual right to buy out the limited partners demonstrates that the participating right of the limited partners is not a substantive right. The existence of such call options, for purposes of this Issue, negate the participating rights of the limited partners to approve or veto an action of the general partners rather than create an additional ownership interest for the general partners. It would not be "prudent, feasible, and substantially within the control of the general partners" to buy out the limited partners if, for example, (a) the limited partners control technology that is critical to the limited partnership or (b) the limited partners are the principal source of funding for the limited partnership.

20. The examples in Exhibit 04-5A are presented to illustrate how to assess individual limited partners' rights under the consensus in this Issue.

Initial Assessment and Reassessment of Limited Partners' Rights

21. The assessment of limited partners' rights and their impact on the presumption of control of the limited partnership by the general partners should be made when an investor(s) first becomes a general partner(s) and should be reassessed at each reporting period thereafter for which financial statements of the general partner(s) are prepared.

Transition

22. The Task Force reached a consensus that for general partners of all new limited partnerships formed and for existing limited partnerships for which the partnership agreements are modified,

¹³ *Remote* is defined in Statement 5 as "the chance of the future event or events occurring is slight."

the guidance in this Issue is effective after June 29, 2005. The Task Force also reached a consensus that for general partners in all other limited partnerships, the guidance in this Issue is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005, and that application of either Transition Method A or Transition Method B, described below, would be acceptable.

Transition Method A

23. For existing limited partnership agreements that have not been modified, the guidance should be applied in financial statements issued for the first reporting period in fiscal years beginning after December 15, 2005. Earlier application is encouraged. Thus, for a public company with a fiscal year ending on December 31, the guidance must be applied no later than the beginning of the first quarter of 2006, based on agreements in effect at the time of adoption. For a company with a fiscal year ending on December 31 that does not issue interim financial statements, the guidance must be applied in the annual statements as of the beginning of the year ended December 31, 2006.

24. The effect of initially applying this guidance for existing limited partnership agreements should be accounted for in a manner similar to a cumulative-effect-type adjustment. Thus, financial statements for prior years should be presented as previously reported, and the cumulative effect, if any, of adopting the guidance on the amount of retained earnings (or other appropriate components of equity or net assets) at the beginning of the period in which this guidance is first applied should be included in the opening balance of retained earnings (or other appropriate components of equity or net assets) in the period of the change. For entities that elect to early-adopt this consensus in an interim period, any cumulative-effect-type adjustment should be recognized in retained earnings (or other appropriate components of equity or net assets) as of the beginning of the year of adoption. That is, the entity should continue to apply the provisions of Statement 3 with the exception that the cumulative-effect-type adjustment should be recognized in beginning retained earnings (or other appropriate component of equity or net assets) for that fiscal year. The effect on the opening balance sheet of adopting the new accounting principle should be disclosed in the year of adoption. Disclosure of the pro forma effects of application on net income is not required.

25. Generally, a change in accounting for a general partner's interest in a limited partnership from the equity method of accounting to consolidation or a change from consolidation to the equity method would not result in an adjustment to previously reported equity or net income. However, a change from the equity method to consolidation could result in a cumulative-effect adjustment if losses that would not have been recognized under the equity method are required to be recognized in consolidation or vice versa (see paragraph 15 of ARB 51 and paragraph 19(i) of Opinion 18). Other items that would have been accounted for differently in prior financial statements if this guidance had been applied *should not be adjusted*.¹⁴

Transition Method B

26. Alternatively, for existing limited partnership agreements that have not been modified, this guidance may be applied by retrospective application. If an entity applies this consensus through retrospective application, it should apply the guidance in paragraphs 7–8 and 10 of Statement 154 and provide the disclosures required by paragraph 17 of Statement 154. If an entity applies this guidance retrospectively, it should apply it to all existing limited partnership agreements based on the facts and circumstances at the time each investment was made and it should consider changes made in later periods. Other items that would have been accounted for differently in prior financial statements if this guidance had been applied *should be adjusted* in the financial statements under Transition Method B. Under Transition Method B, retrospective application is not required for investments in limited partnerships for which the entity is no longer a general partner as of the date that the guidance in this consensus is adopted.

Board Ratification

27. At its June 29, 2005 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

¹⁴ For example, an exchange of securities accounted for based on recorded amounts, under the presumption that control had not been obtained (pursuant to paragraph 21 of Opinion 29 and Issue No. 01-2, "Interpretations of APB Opinion No. 29"), would not be adjusted to reflect the original exchange as a business combination even if application of the guidance in this Issue suggests that one party had obtained control. In addition, previously recorded intercompany profit elimination entries would not be revised to reflect the impact had an investment been consolidated rather than accounted for under the equity method or vice versa.

STATUS

28. No further EITF discussion is planned.

Exhibit 04-5A

EXAMPLES OF HOW TO ASSESS INDIVIDUAL LIMITED PARTNERS' RIGHTS UNDER ISSUE 04-5

The Task Force agreed that the following examples would facilitate the understanding of how to assess whether the rights of the limited partners should be considered protective or participating and, if participating, whether the rights are substantive. Although these examples illustrate the possible assessments of individual limited partners' rights, the evaluation of limited partners' rights should consider all of the factors identified in "Factors to Consider" to determine whether the limited partners' rights, individually or in the aggregate, provide for the limited partners to effectively participate in significant decisions that would be expected to be made in the "ordinary course of business."

Example 1

The rights of the limited partners relating to the approval of acquisitions and dispositions of assets that are expected to be undertaken in the ordinary course of business may be substantive participating rights. Rights related only to acquisitions that are not expected to be undertaken in the ordinary course of business usually are protective and would not overcome the presumption of control by the general partners in the limited partnership. Whether the right to approve the acquisition or disposition of assets is "in the ordinary course of business" should be based on an evaluation of the relevant facts and circumstances. In addition, if approval by the limited partners is necessary to incur additional indebtedness to finance an acquisition that is not in the limited partnership's ordinary course of business, then the approval by the limited partners would be considered a protective right.

Example 2

Existing facts and circumstances should be considered in assessing whether the rights of the limited partners relating to a limited partnership incurring additional indebtedness are protective or participating rights. For example, if it is reasonably possible or probable that the limited partnership will need to incur the level of borrowing that requires limited partner approval in its ordinary course of business, the rights of the limited partners would be viewed as substantive participating rights.

Example 3

The rights of the limited partners relating to dividends or other distributions may be protective or participating and should be assessed in light of the available facts and circumstances. For example, rights to block customary or expected dividends or other distributions may be substantive participating rights, while rights to block extraordinary distributions would be protective rights.

Example 4

The rights of the limited partners relating to a limited partnership's specific action (for example, to lease property) in an existing business may be protective or participating and should be assessed in light of the available facts and circumstances. For example, if the limited partnership had the ability to purchase, rather than lease, the property without requiring the approval of the limited partners, then the rights of the limited partners to block the limited partnership from entering into a lease would not be substantive.

Example 5

The rights of the limited partners relating to a limited partnership's negotiation of collective-bargaining agreements with unions may be protective or participating and should be assessed in light of the available facts and circumstances. For example, if a limited partnership does not have a collective-bargaining agreement with a union or if the union does not represent a substantial portion of the limited partnership's work force, then the rights of the limited partners to approve or veto a new or broader collective-bargaining agreement are not substantive.

Example 6

Provisions that govern what will occur if the limited partners block the action of the general partners need to be considered to determine whether the rights of the limited partners to block have substance. For example, if (a) the limited partnership agreement provides that if the limited partners block the approval of operating and capital budgets, then the budgets simply default to last year's budgets adjusted for inflation and (b) the limited partnership operates in a mature business for which year-to-year operating and capital budgets would not be expected to vary significantly, then the rights of the limited partners to block the approval of the operating and capital budgets do not allow the limited partners to effectively participate and are not substantive.

Example 7

Limited partners' rights relating to the initiation or resolution of a lawsuit may be considered protective or participating depending on the available facts and circumstances. For example, if lawsuits are a part of, or are expected to be a part of, the limited partnership's ordinary course of business, as is the case for some insurance entities, then the limited partners' rights may be considered substantive participating rights.

Example 8

The limited partners have the right to veto the annual operating and capital budgets for the first X years of the limited partnership. Based on the facts and circumstances, during the first X years of the limited partnership this right may be a substantive participating right. However, following Year X there is a significant change in the exercisability of the limited partners' right (for example, the veto right terminates). As of the beginning of the period following Year X, since that right no longer exists, the presumption that the general partners control the partnership would not be overcome.