THE PARTNERSHIP ORGANIZATIONS: AN APPRAISAL OF DOCTRINES AND PRACTICES

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i. The problem: flow of events and some confusion

The practices of the men of business do shape the norms which for a time will guide their conduct.[1] At common law, the traders' activities first felt the impact of outside restraint when the notion came that such activities must conform to a body of general customs which since the beginning has been called law merchant. In the other system of jurisprudence, where it was thought that clarity could be had through the written codes, the operations of the merchants came to be reflected in a body of civil law rules. And in certain fields, as trade usages and practices became more varied, the resulting economic relations ever more complicated, the compulsive force of such practices would take a pattern which, many tell us, is a combination of common law and civil law principles. Partnership law developed that way.[2]

The growth of business institutions started and is going on that way, chaotic and confusing, but nevertheless a growth. New practices devised by the investors to meet new needs, and a whole gamut of relationships arises. And since in every free community all lines of value relate back to the individual, a balance must be established somewhere through what we now call policy norms as developed both by courts and legislators.

And we would come across an idea such as: [3] "the standard set up by the statute is not a rule of law; it is rather a way of life * * * life in all its fullness must supply an answer to the riddle," or such epigram as: "we may well ask ourselves whether courts are not under duty to go farther and place this branch of the law upon a basis more consistent with the realities of business experience and the moralities of life." Within the context of social and economic performance, we are to consider and offer solutions to the problems of the busi-

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[1] It may be a rather naive statement, but one is easily tempted to add that the businessman is just another with a most unstable mind. Describing how courts have treated the various devices attempted to reduce the risks of the partnership relation, it was observed for example: "Taking them all together, the decisions reveal the restlessness of the businessmen under the traditional and old-fashioned partnership form; in addition, they reveal equally the capacity of the partnership form to grow and adapt itself to the needs of a changing economic setting." *Mechem on Partnership* (1935), 333.

[2] *Scrutton, Roman Law Influence*, 1 *Select Essays* 237. *See Story on Partnership* (7th Ed. 1881), viii-ix.

[3] The quotations are from: Cardozo, J., Welch v. Helvering, 290 U.S. 111, 115 (1933), and *The Nature of Judicial Process*, 152-5, respectively.

nessmen whether conducting business as a single entrepreneur, in partnership with others, through the corporate device, or through such hybrid associations as the business trust or the joint stock company.[4]

In view of certain alleged statutory advantages, the corporate device has come to be the more generally used of the conventional forms of business organization. Its use in the United States has reached such stage that it is now commonly thought that decisions affecting the whole social and economic life of the country may well be the results of deliberation made or being made in the boards of a few hundred corporations. The divorcement of ownership from control had come to be a conceded economic fact, and in a sense almost a doctrinaire.[5] We are not concerned however with the publicly-financed corporation and the diverse forms of social control being devised to restore the balance in whatever area it may have been tipped off by these so-called economic giants. We will be concerned in the meantime with the close corporation where either the equity capital is held generally within the inner circle of owner-managers, or simply that the doctrinaire alluded to takes on a less dramatic appeal.

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[4] In the Philippines. of the mentioned types of business organization, the partnership and the corporation are the only ones provided for by law. No prohibition exists, however, for the other types. The partnership organization is now governed by Articles 1767-1866 of the Civil Code of the Philippines which took effect in June 1950. The corporate device is regulated by Act No. 1459, a general enabling statute which took effect on April 1, 1906. It superseded the "sociedad anonima" of the Spanish Code of Commerce. A historical account appears in: Harden vs. Benguet Consolidated Mining Company, 58 Phil. 141.

[5] Regarding this violation of ownership-management relations, witness the contrasting themes appearing in: dissenting opinion, Brandeis, J., in Liggett v. Lee (1933), 288 U.S. 517—"Able, discerning scholars have pictured for us the economic and social results of thus removing all limitations upon the size and activities of business corporation and of vesting in their managers vast powers once exercised by the stockholders—results not designed by the state and long unsuspected. * * * The changes thereby wrought in the lives of the workers, of the owners and of the general public, are so fundamental as to lead those scholars to compare the evolving corporate system with the feudal system; and to lead other men of insight to assert that this master institution of civilized life is committing it to the rule of the plutocracy." Berle and Means, *Modern Corporation and Private Property* (1932); Schumpeter, *Capitalism, Socialism and Democracy* (1947), 141-2; Mund, *Government and Business* (1950), 60; Drucker, *The Concept of the Corporation* (1946), 1-19 and *The New Society* (1950) 1-38.

"Doubt is thrown on this conclusion when the corporate system is examined from another perspective. If the analysis begins with the largest private ownership, the picture that emerges is that a relatively small number of owning families hire and fire managers. On this showing, the private owner has not lost the private manager; rather, widely distributed and small ownership has lost to other owners, who hold the great family fortunes. For the economy as a whole, the sequence is from many to fewer ones." Lasswell and McDougal, *"Law, Science and Policy: The Jurisprudence of a Free Society"* (Mimeog. Mat. 1950), at 38.

Regarding the close corporation, a significant portion of corporate jurisprudence there is strongly indicating the idea that the businessman probably feels that he could well discharge his social functions given a wider use for informality or plain convenience than strict adherence to so-called corporate norms. The situation has been posed: "The corporate form is generally employed by a small business because the venturers want limitation of liability and certain imagined tax advantages, precisely as does the single stockholder in the one-man corporation. But at the same time, when the stockholders are more than one, they generally prefer certain of the attributes of the *partnership*, particularly with respect to control and dissolution. In effect they want an incorporated *partnership*. * * * some corporators, more than one would fancy, omit the barest minima of corporate norms. Having adopted the corporate form, some business men proceed to disregard it completely and to operate as a *partnership*." [6]

Deviations have been adopted, so far as the reported cases show, from such statutory norms such as that relating to control and management of corporate affairs, transfer of ownership of shares, perpetuity and method of dissolution. On the whole, court decisions regarding these attempted deviations are not altogether clear, at times conflicting, and most probably their final answers will rest with the lawmaking body. The Benentendi case,[7] for example, which declared invalid certain by-law provisions requiring unanimous vote in any action taken either by the directors or the stockholders, led to the amendment of the New York Stock Corporation Law. On the other hand, a nineteen-year contract entered into by three shareholders vesting in one of them, subject to the limitation contained in the arbitration clause, full authority and power to supervise and direct the operation and management of the affairs of the corporation, was held to be in contravention of the general rule that the business of the corporation shall be managed by a board of directors.[8] This decision seems to have arrested the trend toward allowing certain deviations from such statutory norm at least in the case of close corporation.

In reaffirming the orthodox rule, the court necessarily resists an extension of the *Clark* v. *Dodge* case [9] which sustained a stockholders' agreement designed for quite an analogous purpose so long as no damage, actual or prospective, is caused to any minority stock-

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[6] See Generallv: Hornstein, *Stockholders' Agreements in Closely-held Corporation* (1950), 59 Yale L. J. 1040.

A number of articles have been written by the author on various phases of corporation law. Some of his predictions however ran contrary to subsequent court decisions: e.g. his plea for the derivative suit *vis-a-vis* the later cases of Cohen v. Beneficial Industrial Loan Corp. (1949), 327 U.S. 451 and Lapchak v. Baker (1948), 298 N.Y. 89; 80 Ne. E. 2nd 751.

[7] 294 N.Y. 112, 60 N.E. 2nd 829 (1945).

[8] Long Park Inc. v. Trenton-New Brunswick Theaters Co. (1948), 297 N.Y. 174; 77 N.E. 2nd 633.

[9] (1936) 269 N.Y. 410, 199 N.E. 641 CCA New York.

holder, creditor or any bonafide purchaser, and even if such agreement impinges slightly upon the usual management prerogatives.

A number of situations may be mentioned in the field of small corporations where the incorporators' attempt to dispense with certain stereotyped requirements of the corporation statute did not meet with the approval of the court.[10] After having gone through all the formalities prescribed by the corporation statute, the small scale enterprisers would still find it necessary to work together on terms which generally characterize the partnership relations. Having eliminated at least the risk of full personal liability, a basic incident of the ordinary partnership device, through incorporation, they nevertheless would wish to conduct their enterprise by adopting some of the features of the partnership. To them, corporate transactions are so much bounded with formalities that simply make for expensive operations if not altogether unnecessary. Such permissible modes of corporate control effected through the voting trust or through an ingeniously devised stock classification, they would wish to accomplish in what they consider to be a more realistic way, namely, through some types of agreement which generally pertain to a partnership relation.

They may well assume that one of the incorporations should not transfer his interest without the consent of the others as this would be contrary to the partnership unity they contemplate. That while they set up a board of directors, they really intend to take active participation in the affairs of the enterprise not only as a means of self-employment, or to protect their respective interests, but more important, they may foresee in such management arrangement a continuing and profitable investment. Similarly, they may wish to establish such arrangement as will guard against the contingency of a participant-manager from abusing his trust relations and which would make it lawful for the others to retire his participation in the enterprise; and, as in partnership, deliver to him the value of his interest, less damages which may have been caused, at such method of valuation which may likewise be agreed upon by the parties. They may probably stipulate on the manner of sharing profits in such a way as to limit the usual directors' discretion regarding dividend declaration;[11] agree on a particular procedure to be ob-

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[10] For example: Kaplan v. Block (1944), 183 Va. 327; 31 S. Ed. 2nd 893: "Upon the charter and by-laws no action of the board of directors which is not approved by the stockholders is effective; and to make matter worse, it must be unanimously approved by them. For all practical purposes, there might as well be no board at all. A private corporation without a board is an impossible concept. Corporations were invented to circumvent the unity required in partnership. A partner who is unwilling to consent may withdraw from the partnership and dissolve it. This distinction was pointed out by Chancellor Kent as early as 1820 where he said in Livingstone v. Lynch, 4 Johns, Ch. 573, that the right of the majority to rule is one of the chief differences between corporations and partnerships."

[11] In Clark v. Dodge, *supra*, the agreement contained a clause which guaranteed the plaintiff one-fourth of the corporate income by way of salary or dividend; and by way of further assuring this, it was provided that no unreasonable or incommensurate salaries would be paid to other officers or agents which would materially affect

served in the winding up of the affairs of the enterprise upon the expiration of its term or the accomplishment of its purpose.[12] In general, there is a growing indication that the participants in the close corporation would prefer to combine their resources and efforts as real "co-owners of a business for profit" as in the case of a partnership.

On the other extreme, we have the case where an actual partnership organization has been formed. With respect to the ordinary partnership set up, the members are personally liable for the firm's obligations. The parties may reduce this risk at least with respect to certain members by organizing a limited partnership. On the whole, however, there are certain well-known risks and disadvantages which accompany the partnership organization even while such device is found to be economical and useful in certain kinds of commercial undertakings. This is particularly true in fields where large capital may not appear to be a major-income producing factor and where revenues may just as well come from the services of the participants.

Since the partnership relation is fundamentally contractual, the problem for the partners would be how and to what extent they could minimize certain of the disadvantages flowing through the relationship through their own voluntary arrangements. Within the broad limits of a few public policy restrictions, the members of a partnership would certainly be interested in making such arrangements as would reduce the ordinary risks of such device. Consistently with the expectation of having a profitable and continuously functioning organization, it would appear to be a natural objective of the partners to obtain as much as possible certain corporate advantages without actually incorporating.

The situation is thus: members of the close corporation devising means to break away from certain statutory norms which to them simply hamper efficient and economical operation. On the other side are investors who wish to adopt certain advantages that go with a corporate charter and yet would find actual incorporation not absolutely necessary for their purpose.

The rest of this paper will be devoted to a discussion of such substantive features of the partnership organization which appear tempting to members of the small corporation. Such features may be grouped into: (a) problems relating to the formation and/or existence of the partnership relation; (b) management and control; (c) allocation of the hazards of the enterprise; and (d) termination and winding up the enterprise affairs. It is thought that such prob-

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plaintiff's profit. The court construed the income clause as "whatever was left for distribution after the directors had in good faith set aside whatever they deemed wise." With respect to the provision against unreasonable salaries to other officers, the court specifically stated that such is a beneficial and not a harmful agreement.

[12] Compare: Hornstein, *A Remedy for Corporate Abuse—Judicial Power to Wind Up a Corporation at the Suit of a Minority Stockholder* (1940), 40 Col. L. Rev. 220 and *Voluntary Dissolution: A New Development in Intra-corporate Abuse* (1941), 63 Yale L. J. (64).

lems are commonly dealt with in the drafting of a typical partnership agreement.[13] Certain devices which are used to mitigate so far as possible the risks of a partnership relation and how they have been treated by the courts will be indicated every now and then in this study.

ii. *Formation and/or existence of the partnership relation:*

(a) *in general—*

One of the basic features of an ordinary partnership relation is that it is the result of the voluntary contract of the parties. As a matter of fact, in almost all the definitions of the relationship—if definition may still serve as useful tool in clarifying confusing concepts—the element of contract is fundamental.[14] Inasmuch as a

[13] Consider the following suggestions regarding the substantive parts of the articles of co-partnership: "Basically, a partnership agreement should cover the following points: (1) name and business; (2) term; (3) capital; (4) profit and loss; (5) salaries and drawings; (6) interest on capital; (7) management, duties and restrictions; (8) banking; (9) books; (10) termination; and (11) death"—Rabkin and Johnson, I *Current Legal Forms* (1948) with Tax Analysis.

Aside from such specific points as names of the partners, name of firm; date of commencement of the enterprise, description of the business, the following is considered to be deserving detailed consideration: (a) duration of the partnership; (b) the sharing of profits and allocation of losses; (c) death or retirement of a partner; (d) settlement of disputes between the partners; and (e) final winding up and liquidation. Worcester, *The Drafting of the Partnership Agreement* (1949), 63 Harv. L. Rev. 985.

For a more detailed discussion of the problem of drafting partnership agreements: Mulder and Volz, *The Drafting of the Partnership Agreement* (1949). No set formula is of course contemplated.

[14] Section 6, *Uniform Partnership Act,* now the law in twenty-eight states, gives the following definitions: "(1) A partnership is an association of two or more persons to carry on as co-owners a business for profit. (2) But any association formed under any of the other statute of this state or any other statute adopted by authority other than by the authority of this statute, is not a partnership under this Act unless such association would have been a partnership in this state prior to the adoption of this act; but this act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent therewith."

Some of the states which adopted the Uniform Partnership Act made certain modifications: California Civil Code, sec. 2400 substituted "special and mining partnership" in subdivision 2 for "limited partnership." Michigan, Comp. Laws Supp. (1945). Sec. 1946 provides that "husband and wife" may be co-partners. Nebraska, R.S. (1943) sec. 67-306, defines partnership "as an association of persons organized as a separate entity to carry on business for profit." South Dakota, S.D.C. sec. 49.0106 inserted "special" following "limited" in subdivision 2.

The *Civil Code of the Philippines,* Article 1767, states: "By the contract of partnership, two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing profits among themselves."

Lindley on Partnership (Ewell's): "To frame a definition of any legal term which shall be both positively and legitimately accurate is possible only to those who, having the legislative authority, can adopt the laws to their own definition. Other persons have to use law as they find it; and rarely indeed is it in their power to frame any

group of individuals cannot among themselves be bound under a partnership relation except by agreement express or implied,[15] it may well be said that its actual existence does not arise by operation of law. The Uniform Partnership Act [16] thus provides that persons who are not partners as to each other are not partners as to third persons.[17] Nor can any new partner be introduced into the group without the consent of all the members.[18] However, the kind of liability which goes with an ordinary partnership relation may be incurred by one under the doctrine of *estoppel* as when he represents himself, or consents to another representing to any one that he is partner in an existing partnership or with one or more persons not actual partners.[19] The *estoppel* formula, a familiar mode of judicial manipulation to reach a supposedly just result, is thus carried into the statute and imposes a partnership liability in favor of third persons where actually no partnership exists in the sense of voluntary contracting.[20]

Another traditional characteristic of the partnership is that the relationship between the members is one of mutual trust and confidence with respect to transactions involving the affairs of the firm. Such relationship goes by the description "delectus persona". In that respect, although somewhat misleading, each member is considered principal-and-agent with respect to the other.[21] The members are co-owners, and in that regard, each generally could bind the others with reference to the assets of the association and also with

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definition to which any exception may not be justly taken. All that they can usefully attempt is to analyze the meanings of the words they use, and to take care not to employ the same words in different senses, where so to do probably lead to confusion."

[15] See generally: Rizika v. Pother (1947) 72 N.Y.S. 2nd 372. Eggleston v. Eggleston (1948), 47 S.E. 2nd 243; 28 N.C. 668. In Laughlin v. Haberfelde (1946), 165 P. 2nd 544, 72 Cal. App. 2nd 780 it was held that a clause in a preliminary partnership agreement providing that a suitable partnership agreement should be written by an attorney agreeable to the parties, taken in connection with previous statements that it was the intention of the parties to form a partnership to carry out particular undertaking and to proceed to that end, implied not only that there was to be a further writing but also that such writing was to embody the terms of an existing agreement by which the parties were already bound. See also Lang v. Hester (1945), 43 A. 2nd, 137 N.J. Eq. 100.

[16] Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism* (1915), 29 Harv. L. Rev., 158—states that one of the main objectives of the Uniform Partnership Act is to end the difficulties and confusion existing in the common law of partnership.

[17] Section 7(1), *Uniform Partnership Act.*

[18] Section 18(g), *id.*

[19] Section 16(1) (a-b) and (2), *id.*

[20] McBriety v. Philipps (1942), 26 A. 2nd 400; 180 Md. 569. Under the Tennessee Code (1932 Section 7855—partnership by estoppel—a wife was not held liable to one furnishing materials to husband where the statement of the wife contained in the divorce bill that she and her husband were "proprietors" of business was made after the furnishing of the materials to husband. See also: Schutz, Baujan & Co. v. Bell (1939), 130 S.W. 2d, 149.

[21] *Crane on Partnership* (1938), 88.

respect to their separate personal property. This is true both in matters of contract as well as in tort.[22]

For purposes of clarifying the various relationships which result from the transactions of a group of individuals and in order to provide for some definite guides for the adjustment of conflicting claims which may arise in any such transactions, an elaborate set of legal rules has come to be known as partnership law. Inspite of such objectives, however, a great deal of confusion exists in the determination of partnership problems. What is thought to be a simple enough method of doing business has been embroiled, like the "corporation", between two competing modes of thought regarding the nature of partnership. One such mode of thinking maintains that the partnership is a legal person different and distinct from the individual members. The other claims that the association is a mere aggregation of individuals so that the rights and duties growing out of the enterprise activities are the rights and duties of the members.[23]

With the object of providing a fair solution on such substantive questions as that involved in determining the rights of partnership creditors and of the partners' separate creditors with respect to the firm's property, and to eliminate the harsh consequences of the common law notion of partnership as expounded in Heyden v. Heyden,[24] the aggregate theory is supposed to have been adopted by the Uniform Partnership Act. The assumption is that such a view is more in accord with business practices since third persons dealing with the partnership rely actually upon the members as individuals possessing property and conducting a successful business. Warren, arguing in support of this theses, writes that if the courts admit of even a single exception to the rule forbidding them in the absence of legislative authority, to view an association as a legal

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[22] The usual incidents of partnership as expressed in the Uniform Partnership Act, secs. 9, 18, 25 and 40, are: profit sharing, sharing of losses including impairment of contribution, participation in management, power to create liabilities and to dispose of firm property, the right to possess firm property for firm purposes, the right to share in the distribution of firm property on dissolution. Such incidents may be varied by the agreement of the partners. See: Charles v. Weed (1940), 25 N.Y.S. 2d 195; 175 Mis. 740.

[23] See: Crane, *The Uniform Partnership Act—A Criticism* (1916), 28 Harv. Law Rev. 838, where the author cites various situations illustrating the point that the courts consciously or unconsciously tending toward the entity theory, and that it is not unreasonable to expect that it may be eventually openly accepted and consistently applied if courts are not hindered in so doing. 767.

In the Philippines, under Article 1768, a partnership is a juridical personality distinct and separate from the members.

[24] 1 Salk. 292 (1693) where Lord Holt made the exposition that partners are co-owners of property as joint tenants. In such a case, the separate creditors of the partners can levy on partnership property and the purchaser may well become a tenant in common with the remaining partners. While the purchaser cannot dispose of the interests of the remaining partners, he retains possession of the property and possibly exercised such other rights as using the property for non-partnership purpose—a situation manifestly unjust to the original members. Lewis, *supra*, 163-165.

unit, they would be convicting themselves of the three-fold error of usurping legislative authority, disregarding unduly the doctrine of *stare decisis* and would throw the whole law into confusion.[25] A similar justification is offered for the entity theory in that the businessmen look upon the firm as a separate and distinct body; that in keeping partnership accounts, the firm is made debtor to each partner for what he brings into the common stock just as the partner is a debtor for what he takes out of the firm assets and that the members are agents of the firm for the transactions of its business and are sureties of the firm to the extent that the assets of the association are not sufficient to meet the partnership obligations.[26]

These two views run through a vast range of decisions involving both the substantive and procedural aspects of the partnership relations.[27] In bankruptcy proceedings, voluntary and involuntary, problems such as that relating to the adjudication of the partnership and of the individual members, administration and determination of priorities with respect to the partnership assets, the rights of the partnership creditors as distinguished from the partners' separate creditors, problems of discharge, all are being approached in terms of these competing notions about the nature of the partnership, with some courts denying and some affirming that the firm is a self-sufficient entity. On this whole confusion, one text-writer states:

> "It seems reasonably clear that the legal theory that unincorporated groups, for many purposes, to be treated as aggregates rather than as entities is too strong to be overthrown. That tradition is too ingrained in the legal profession, and, whatever its defects, it does have the merit of throwing into bold relief the unlimited personal liability of the members of such groups for acts which they have expressly or impliedly authorized. * * * Nevertheless, there are, as we have seen, situations in what seems a just result can most readily be attained by treating such groups as entities. We have seen also that there is substantial authority for so doing, some of it dating back at least a hundred years. Thus, tradition cannot be said to clearly support the view that unincorporated groups will never be viewed by the courts as entities. Yet to adopt the entity for some purposes and not for others leads to confusion, and since the aggregate theory is not likely to be abandoned, it might be adhered throughout in order that the law may be clear and predictable. Clarity and predictability are unquestionably important considerations. So important indeed that

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[25] Warren, *Corporate Advantages without Incorporation* (1929), 7-15.

[26] See: Lindley, *supra*, 1-110.

[27] See Note 25, *supra*. On the power to sue and be sued, see also: Sturges, *Unincorporated Associations as Parties to an Action* (1924), 33 Yale L. J. 383.

Compare the statement in Thomas v. Industrial Commission (1943), 10 N.W. 2nd 206; 243 Wis. 231 to the effect that the Uniform Partnership Act is founded upon the aggregate theory in respect to all substantive rights, liabilities and duties and recognition of the entity theory is solely for procedural or conveyancing purposes.

it may be worthwhile to decide a certain number of cases in a seemingly unjust way in order that legal rules may attain these desired objectives. But that clarity and predictability could in fact be attained by requiring courts in dealing with unincorporated bodies to eschew all use of the entity concept, may well be doubted. * * * That quality so far as attainable in a changing world, will doubtless come; but we venture the prediction that it will not come through a rigid adherence either to the aggregate or entity formula but rather by gradual clarification of the law in specific situations." [28]

(b) *Reducing risks of partnership relation: other types of unincorporated organizations—*

In between the traditional partnership organization and the corporatc device, are such other forms of business associations as the statutory limited partnership, the joint stock company, the business trust and, in some states, what are called mining partnership.[29] These are devices which are used to reduce, in general, certain risks which ordinarily attach to the conventional partnership organization, particularly the full personal liability incident. At the same time, through such methods of doing business, the investors could take advantage of certain corporate features as centralized management, transferability of interests and continuity of organizational existence. There are of course other forms of association which are organized for some particular purpose and usually for short duration like the joint venture, syndicate and other similar units going under various names.

With the exception of the plain joint-adventure device to which most of the rules and principles applicable to ordinary partnership also apply with respect to the rights and obligations of the parties,[30] such organizations as the statutory limited partnership, the business trust and the joint stock company are employed, as intimated beforehand, to obviate the conventional partnership norms and are governed by some special set of legal rules. In connection with the use of these devices, however—and even when the corporate form has been employed—there are situations where the investors, who would all the while assume that they could not be made responsible for firm obligations beyond their capital contributions, find themselves burdened with the same risk which was thought to have been eliminated. An inquiry along this line is thought relevant since it involved the implications of the partnership relation—implications sought for in certain cases, and in some, the investors would simply want to avoid.

[28] Dodd, *The Dogma and Practice in the Law of Associations* (1929), 42 Harv. L. Rev. 977, 1012, 1013.

[29] See note 157, *infra*. *Jones, Mining Partnership in Texas,* 42 Tex. L. Rev. 510.

[30] See: Preston v. State Industrial Accident Commission (1944) 149 P. 2nd 957; 174 Or. 553. American Mutual Liability Ins. Co. v. Hannay, Zabriskie & Daron (1941), 298 N.W. 296. In a plain joint adventure type the members are not necessarily agents of the group as in an ordinary partnership relation unless specifically provided for. Brown v. Bedell (1934), 188 N.E. 641; 263 N.Y. 177.

Those who undergo the trouble and expense of incorporation would normally be after the following advantages: (a) continuity of organizational life; (b) capacity to act as a legal unit to hold property, to enter into contract and to sue and be sued as a distinct entity; (c) centralized management through a board of directors; (d) transferability of interest; (e) limitation of or exemption from individual liability; and finally, (f) a standardized method of organization, management and finance prescribed by the corporation statutes for the protection of the stockholders and creditors, including a more or less standardized system of shareholders' relations, rights and remedies.[31] Such are the supposed benefits derivable from incorporation and which make the corporate device generally attractive than the other forms of business organization, particularly in enterprises which call for large scale capital investments. However, from the standpoint of tax economy and flexibility in operation, it is said: "It is not feasible, of course, for publicly financed corporations to operate in anything but a corporate form. For the closely-held corporation, however, corporate existence has become an expensive luxury. The partnership, despite its practical inconvenience, sometimes is the economical alternative. In contrast to the double entity taxation of the corporation-stockholder relationship, partnership income is subject to a single tax.[32]

Many of the aforementioned corporate advantages may, at least in substance, be attained without the formality of incorporation. The simplest method probably is through the limited or special partnership although of course the limited liability incident would still be a state-granted privilege. Under the Uniform Limited Partnership Act,[33] an organization comparable to a corporation could be

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[31] *Ballantine on Corporation* (1946, 13. Warren, *supra*, 18. Flint v. Stone Tracy Co. (1910), 220 U.S. 107.

[32] Rabkin and Johnson, *The Partnership Under the Federal Tax Laws*, 55 Harv. L. Rev. 909, 910. Bredell, *Re-examination of the Desirability of the Corporate Form of Business Organization*, 13 Indiana Law R. 533. Comment: Corporation and Partnership: Comparative Tax Burden, 13 Minn. L. Rev. 506—The appalling complexity and variations in the tax statutes, make it impossible to say with accuracy the tax advantages of the partnership over the corporation. See also: Klein, *Corporation v. Partnership*: Relative Tax Advantages in New York (1942), 20 Taxes 217 where the author states that in view of the continuous revision of applicable tax laws, there have been periods when under any given set of facts the corporate form is more economical than the partnership, and in other periods, under exactly similar circumstances, the reverse holds true.

[33] "The business reasons for the adoption of acts making provisions for limited or special partners is that men in business often choose to secure capital from others. There are at least three classes of contracts which can be made with those from whom the capital is secured: one, the ordinary loan on interest; another, the loan where the lender in lieu of interest takes a share in the profits of the business; third, those cases in which the person advancing secures besides a share in the profits some measure of control over the business." Commissioner's Note, section 1, *Uniform Limited Partnership Act*. Compare: Crane, *Are Limited Partnerships Necessary?* (1935), 27 Minn. Law Rev. 351.

formed. A group of individuals, called general partners, may be able to organize an association with a fairly sizeable number of investors who risk their investments for a stipulated share in the profits without further liability.[34] For the privilege of non-liability, so far as the statutes goes, complete control of the affairs of the organization is vested in the general partners, upon whose personal credit all transactions on behalf of the firm are made. The arrangement is of course subject to some type of statutory policing such as the requirement of the filing of a certificate of association. In this respect, the method of organization bears similarity to the process of incorporation.[35] The necessity for additional capital may be met through a provision permitting the admission of new limited partners, and for this purpose, some kind of priority regarding contribution or compensation by way of income may be arranged among the limited partners.[36]

The limited partnership statute restates the *Cox v. Hickman*[37] decision which, reversing the original common law view,[38] laid down the principle that while profit sharing is a prima facie evidence of the existence of a partnership relation the same is not conclusive, and that one may receive a share in the profit as payment of a debt or interest thereon, without becoming a partner in fact, or liable as though a partner to third persons.[39] Under early decisions, unlimited personal liability would be imposed upon the special or limited partners for failure to comply with the statutory requirements re-

[34] As to matters to be stated in the certificate of association: section 2, Uniform Limited Partnership Act.

[35] Section 2(a) XII, *id.*

[36] For a history of the institution: 8 Holdsworth, *History of English Laws* 195; Mitchell, *Early Forms of Partnership, 3 Select Essays, Anglo-American Legal History* 183. *Roman Law Influence, 1 Select Essays* 237. Kent, *Commentaries*, 32-36.

[37] (1860) 8 H.L. case 268. Other subsequent cases: Re English & Irish Church & University Assurance Society (1862), 1 Hem & M. 79; 1 New Rep. 192; 7 L.T. 669; 11 W.R. 225. Bullen v. Sharp (1865), L.R. 1 C.P. 86; Har. & Ruth. 117; 35 L.J.P.C. 105; 14 L.T. 73; 12 Jur. N.S. 247, 14 W.R. 338; Mollwo-March & Co. v. Court of Wards (1872), L.R. 26 P.C. 419; 9 Moo. P.C.N.S. 214 Badelay v. Consolidated Banks (1888), 38 Ch. Div. 338.

[38] For early common law views: Grace v. Smith (1775), 2 H.Bl. 998 de Gray, J.: "Every man who has share in the profits of a trade ought also to bear his share of the loss." Wough v. Carver (1793), 2 H.Bl. 235 Eyre J.: "It is plain upon construction of the agreement, it if be construed only between the Carvers and the Geislers, that they were not, nor even meant to be partners * * * But the question is whether they have not by their agreement constituted themselves partners." *Lindley on Partnership* (10th ed. 1935) at 51, *et seq.*

[39] Section 7(4), *Uniform Partnership Act:* "The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is partner in the business but no such inference shall be shown if such profits were received in payment: (a) as a debt by installments or otherwise; (b) as wages of an employee or rent to a landlord; (c) as annuity to a widow or representative of deceased partner; (d) as interest on a loan though the amount of payment vary with the profits of the business; (e) as consideration for the sale of a goodwill of a business or other property by installments or otherwise.

garding formation.[40] Obviously, this rule has been relaxed by the present good faith-substantial compliance provision of the law. This assumption may well be inferred further from the decision of the United States Supreme Court in *Giles v. Vette*.[41] In this case, two stock brokers proposed to organize a limited partnership which would take over their stock brokerage business from an original outfit. Since the New York Stock Exchange forbade affiliated firms having more than two limited partners, they organized the firm in Illinois and there executed and filed the corresponding organization papers in supposed compliance with an existing statute. It turned out that the statute under which the firm was organized had been repealed with the adoption of the Uniform Limited Partnership Act by the state of Illinois. Under the latter statute as adopted, a limited partnership cannot be formed for the purpose of engaging in the stock brokerage business. The parties did not have knowledge of this change nor could have intended to organize under it on account of the nature of their business. In a subsequent bankruptcy proceeding instituted against the firm and all the members, including the limited partners, it was held that only the general partners could be adjudicated bankrupt and that the limited partners are entitled to the benefits of section 11 of the Uniform Limited Partnership Act.[42]

By express provision of the statute, the limited partners may be held unlimitedly liable for any false statement in the certificate of association,[43] and for taking an active participation in the management of the affairs of the firm.[44]

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[40] For example. O'Connor v. Graff (1918), 186 App. Div. 116, 173 N.Y.S. 730 where the former New York statute required the filing of the certificate in such county where the partnership has a branch office and upon the failure to do so would render the special partner liable like the general partners. Henkel v. Henjman (1878), 91 Ill. 96. Compare: Manhattan Co. v. Lambert, 108 N.Y. 578.

[41] (1924) 263 U.S. 553. Section 2(2). *Uniform Limited Partnership Act.* See: *Crane on Partnership* (1938 103. *Are Limited Partnership Necessary?* (1933), 17 Minn. Law Rev. 351. See also: 36 Harv. L. Rev. 1016.

[42] Section 11. *Uniform Limited Partnership Act.* states: Status of a person believing himself to be a limited partner—"A person who has contributed to the capital of a business conducted by a person or partnership, erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or partnership carrying the business. or bound by the obligations of such person or partnership; provided that on ascertaining the mistake, he promptly renounces his interest in the profits of the business or other compensation by way of income."

[43] Section 6, *id.*

[44] Section 7, *id.* "A limited partner shall not be liable as a general partner unless in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business." He is likewise enjoined, under section 5, from having his surname appear in the firm's name, unless (a) the same is also the surname of a general partner; or (b) prior to the time of his admission as such, the business had been carried on under a name in which his surname appears.

Independently of such statutory rights [45] as access to the firm's books, right to information and accounting, to apply for judicial dissolution in certain cases, the extent to which a limited partner may be allowed to have a say in the conduct of the business as a measure of protection for his investments without impinging upon the usual control norm, will probably vary according to the circumstances of the case and will depend on how the firm actually functions and operates.[46]

A second device in which both partnership and corporation law principles may be involved in varying fact situations is the business trust. Historically, this institution owes its birth to the hostility of the legislature against corporation holding real estate for investments. As such, it had acquired a legal status since the case of *Philipps v. Blanchard*.[47] Transferability of shares as well as a centralized management are its common features.[48] Perpetual succession may readily be attained through a provision for the appointment of new trustees to succeed those who die.[49]

As far as the limited liability incident is concerned, the courts have not been consistent in their approach to the problem; and, in general, have been to some extent unwilling to permit through the trust device to obtain all the possible advantages of corporateness. If the beneficiaries, for example, in addition to dividing among themselves the profits of the trusted enterprise, exercise substantial power of control over the trustees, they would not be allowed, even by the courts which so far have treated this device with some degree of tolerance, protection under the formal ownership of the *res* by the trustees but will impose upon them the liabilities of an ordinary partner and hold the trustees mere agents.[50] In some cases, the court have gone further and refused to permit agreement surrendering all control of the enterprise to protect the beneficiaries for the debts of an enterprise the profits of which they alone reap, and

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[45] Section 10. *Uniform Limited Partnership Act.*

[46] In a situation, for example, where the special partners supply the major part of the capital of the enterprise and the managing partners receive and execute the instructions of the former. it would perhaps be too technical to locate real control in the managing partner. The operative facts approach in breaking down the parent-subsidiary insulation may be relevant: Douglas and Shark, *Insulation Through Subsidiary Corporation*. Pam. 48 No. 18 Rep. *Yale Law Journal* (December 1929) citing Cardozo, J. in *Berkey v. Third Avenue Company*, 244 N.Y. 84, 155 N.E. 58, 50 ALR 599.

[47] 130 Mass. (1884)—opinion of Holmes, J. citing also prior Massachusetts cases upholding the legality of the trust device. See: Dewing, I *Financial Policy of Corporation* (1946) 84-87.

[48] See: *6 Mass. Am.* (1933) *ch. 182—Business trust.*

[49] For example, Hart v. Seymour (1893), 147 Ill. 598, 613-615. Howe v. Howe (1899) 174 Mass. 491.

[50] For example, Frost v. Thompson, 219 Mass. 360, 106 N.E. 1009 (1914) Simpson v. Klipstein 262 Fed. 823 (D.N.J. 1920). Several courts have held that shareholders who have little or no control over the trustees are not liable as partners. Betts v. Hackathorn, 159 Ark. 621 (1923). Rhode Island Hospital Trust Co. v. Copeland, 39 R.I. 193 (1916).

the rule of non-liability of the beneficiaries in such trusts organized and conducting business in a manner similar to a corporation often rejected.[51] The unfairness of such decisions is easily seen in the case of a shareholder who, however small his fractional interest, would be liable for the contracts as well as the torts of a large, unwieldly partnership of which he is member.[52]

Again, the extent and nature of permissible participation in the management of the enterprise on the part of the beneficiaries is not all too clear from the decisions.[53] The suggestion is thus made that where a business trust is organized under a declaration of trust with the management vested in the trustee, such provisions as filling vacancies in the office of trustee, election at intervals, removal, alteration and amendment of the declaration of trust, termination of the trust, or any combination of them, should not turn the trusteeship into a partnership contrary to the intention of the parties.[54]

The joint stock company is another method adopted to obtain some of the corporate attributes. In an ordinary situation, the management is vested exclusively in a selected body, the association could acquire and convey property, bring or defend suits either through some designated officer or in the name of the firm.[55] This device, however, involves the same potential risk in which the investors holding freely transferable shares may be unlimitedly liable for the company's obligations. In fact, if restrictions are placed upon the transfer of shares the association is classified as an ordinary partnership so as to be dissolved by the death of a member. In such a contingency also the usual incidents of a partnership relation would presumably follow.[56]

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[51] For example, Thompson v. Schmitt (1925), 115 Tex. 53, 274 S.W. 554 Hamilton v. Young (1924), 116 Kan. 128; 225 Pac. 1045.

[52] Harrison v. Heathen (1843), 6 M. & G. 81; Tappan v. Bailey (Mass. 1842), Netc. 529; Ashlev v. Dowling (1909) 203 Mass. 311. 89 N.E. 434.

[53] Thus, such power-to-remove and the power-to-substitute clauses have been interpreted as to convert the trust into a partnership, altho it is not clear as to which of those powers the court attached greater significance. Frost v. Thompson, *supra*. Priestley v. Treasurer & Receiver General (1918) 230 Mass 452, 456 N.E. 100.

[54] See: Magruder, *Position of Shareholders in Business Trust* (1923) 23 Col. L. Rev. 423. Sears, *Trust Estates as Business Companies* (1921), 77-78. Burdick, *Partnership* (3rd ed. 1917), 40-41. Writhington. *Voluntary Associations in Massachusetts* (1912), Yale L. J. 311, 318-321 and *The Law of Unincorporated Association*, (1916) 30-31. Compare: Cook, *The Mysterious Massachusetts Trust* (1923). 9 A.B.A. J. 763. Dewing, *supra:* "In a period of industrial organization in which a multitude of stockholders have a theoretical but no practical voice in the selection of their managers, it may prove a wise social policy to fix the responsibility of management on a body of men who may not take refuge for the stupidity and duplicity of their actions in the plea that they are the appointed representatives of the stockholders. The trustees * * * are clearly and confessedly in a fiduciary capacity toward the stockholders or beneficiaries, and they cannot avoid responsibility." 87.

[55] Sections 2, 3, 6, 12-16 *N.Y. General Association Laws. Pennsylvania Purdon's Pa. Stat.* (1930), tit. 59 ch. 3. *Massachusetts Ann. L.* (1933), ch. 182 section 6.

[56] Haiku Sugar Co. v. Johnstone (CCA [1918] 249 F. 103).

In connection with the concentration of the powers of management, a matter which is usually the center of litigation when a third person who entered into a contract with a member would seek it to impose his rights against the firm as under the conventional partnership relations, an arrangement to that effect may be made by the agreement of the shareholders. The validity of such arrangement, apart from present statutory permission, had been sustained since *Spotswood v. Morris.*[57] As previously stated, this kind of management structure is now provided for in the statute regulating this form of business organization.[58] But such arrangement would in the ordinary case be binding only upon third persons who had knowledge thereof, actual or constructive. Such constructive notice may be inferred from the size of the organization and the method it transacts its business. In large partnerships, for example, with transferable shares, it is hardly to be expected that any one partner shall have the power to bind the others with respect to the firm's business. Thus, in *Burnes v. Pennel,* decided in 1869, the court observed: "A distinction must be made between a member of a common mercantile partnership and a shareholder in a joint stock company. No one will contend that a joint stock company would be liable on bill of exchange, drawn, accepted, or indorsed by a shareholder. * * * because it is known that the power of carrying on the business of the company * * * is vested exclusively in the directors. This shows that although a joint stock company is a partnership, it is a partnership of a different description, and attended with different incidents and liabilities from a partnership constituted between individuals who may carry on business jointly, with equal powers and without transferable shares. All who have dealings with the company knew that the authority to manage the business is conferred upon the directors, and that a shareholder as such has no power to contract for the company. For this purpose, it is wholly immaterial whether the company is incorporated or unincorporated." [59]

aa. Defective incorporation: partnership implication—

As mentioned earlier, another significant aspect of the partnership relation is involved in connection with the so-called defective corporations. This has reference to an organization which has not acquired a *de jure* status for lack of substantial compliance with the enabling statute, and also could not be judicially recognized as *de facto* corporation at least in a situation where the other party has not dealt with it as such.[60] In actions brought by third parties

[57] 12 Idaho 360. 390, 85 Pac. 1094. Spraker v. Platt, 158 App. Div. (N.Y.) 377, 143 N.Y.S., 440 where a self-perpetuating board of management was held legal.

[58] See Note 48, *supra.*

[59] 22 H.L. Case 497 per Lord Campbell.

[60] An example of the latter category: Harrill v. Davis, 168 Fed. 187 (CCA 8th 1909). Abbott v. Omaha Smelting Co., 4 Neb. 416 (1876). Hughes v. Farmers Union Produce Co. (1923) 110 Neb. 736. 194 N.W. 872 in which the "corporation" in question was held to be too defective to have even a *de facto* existence. The requisites of a *de facto* corporation is traditionally stated: (1) a charter or general law under which the such corporation might lawfully be organized; (2) an attempt to organize

against members of a defective corporation, the most frequent statement made by the courts is that the members are liable as ordinary partners. This doctrine of partnership liability, often arrived at through some sort of syllogistic process, has been criticized on a number of grounds. Further, the results of its application in various jurisdictions have not been consistent.

In support of the partnership liability formula, certain propositions [61] are offered, namely: (a) that every business must have an owner or owners; (b) that the owner or owners of a business are liable as such for its debts; (c) that the ownership of a business must be vested either in an individual as sole proprietor, or in a corporation treated in the orthodox way as a juristic person, or in a trusteeship, or in a partnership which by definition means a co-ownership of a business other than by trustees; (d) that a defective corporation as defined by the courts must be a partnership because the business is not owned by an individual or by corporation or trusteeship; (e) that the partnership must be composed of the stockholders, because, being profit sharers, they are *prima facie* partners under the Uniform Partnership Act, and that this presumption becomes conclusive when by a process of elimination, it is demonstrated that they fit into no other recognizable category which would explain their relationship to the business; and finally (f) that the stockholders' predicament presents no hardship than in other well-settled analogous cases, and if not so placed within the partnership category it would probably be impossible to establish any definite rules governing their liability.

Whatever policy considerations lie behind the partnership liability rationale, and while it may seem sound at first glance, certain harsh and unfair results may follow when rigidly applied to every factual situation. An example may be mentioned. In *New York National Exchange v. Cromwell,*[62] plaintiff instituted an action upon a note executed by the Cromwell & Glass Cold Storage Company. The company failed to record the certificate of incorporation as required by the statute. However, before the execution and delivery

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thereunder; and (3) actual user of the corporate franchise. Tulane Irrigation District v. Shepared (1902), 185 U.S. 1, 13. As to the limits and scope of the doctrine: Machen on Corporation, section 285; Warren, *Collateral Attack on Incorporation* (1907, 40 Harv. L. R. 456; *Ballantine on Corporation* (1946) *et seq.*

[61] See generally: Dodd, Partnership liability of Stockholders in Defective Corporation (1927), 40 Harv. L.R. 521 with an appendix of pertinent cases. The above summary is made in reply to the opposite view that the stockholders cannot be so held liable on the grounds that (1) the enterprise is abortive and the shareholders were only such on condition that a valid corporation be formed; (2) the shareholders did not intend to be partners; (3) the shareholders do not have the right of partners; and (4) it is unfair to treat the stockholders as co-partners.

[62] 117 Pa. 313. For other cases see Dodd, *supra.* Morawetz 2 *Modern Law of Private Corporation* (2nd ed.) section 748. *"The Problem of Individual Liability when Incorporation is Defective"*—Stevens and Larsen, *Cases on Corporation* (1947), 179-180. Carpenter, *Are Members of a Defectively Organized Corporation Liable as Partners?* (1924) 8 Minn. L.R. 409. Burdick, *Are Defectively Incorporated Associations Partnerships?* (1906) 6 Col. L. Rev. 1.

of the note the individual defendants held them personally liable on the ground that the members of a defective corporation are liable as partners and that the defendants had not given the requisite notice of their withdrawal from the partnership.

A general statement imposing partnership liability in the case of a defectively organized corporation may appear undesirably broad as it does not give for instance any basis as to who are the members who should be personally responsible for the firm's obligations nor say how many of the incidents of an actual partnership relation are involved. On the whole, the validity of the doctrine will probably depend upon a careful appreciation of the particular facts involved, such as the claim of the parties, the issues raised and the relative status of the members of the group against whom individual liability is being sought. In that respect, the following situations [63] may well be differentiated and liability imposed accordingly: (a) where the plaintiff is attempting to fix liability upon the group as a result of a contractual relationship in the formation of which he dealt with and recognized the group as an association without relying on the personal liability of the members, he should be estopped from showing that the incorporation was never attained; (b) where the plaintiff is attempting to fix the liability upon the group as a result of a contractual relationship in the formation of which he did not deal on a corporation basis:—(1) all the members actively [64] participating in the transaction should be held personally liable since it would appear that those who actively conduct the business of the corporation are under duty to see that a corporation actually exists; (2) the inactive shareholders who had no knowledge of the fact that the group has no corporate status should be held personally liable along with the active participants since it may fairly be supposed that such

[63] Compare: Magruder, *A Note on Partnership Liability of Stockholders in Defective Corporation* (1927) 40 Harv. I. Rev. 773—for the proposition that a defective corporation should be differentiated from a partnership and be dealt with as a distinct form of business association though not necessarily as one coinciding in all its incidents with the so-called *de facto* corporation. The author, for purposes of imposing unlimited liability, distinguishes between active and inactive stock holders, the latter being those who are investors merely and limit their participation at stockholders' meetings either in person or by proxy. That creditors should be permitted to sue the association in its proposed corporate name and obtain judgment which will permit levy of execution on the property of the association.

Further: Coal Co. v. Maxwell, 22 Fed. 197 (E.D. No. 1884) Brewer, J.: "I think the true rule is that: where persons knowingly and fraudulently assume a corporate existence, or pretend to have a corporate existence, they can be held liable as individuals; and where they are acting in good faith, and suppose that they are legally incorporated, and the so-called corporation assumes to do business for a series of years, and the assumed corporate existence is not challenged by the state, the shareholders cannot be made liable as if they are members of a regular partnership."

[64] See: Lewisohn, *Liability of Associate in Defective Incorporated Association* (1915), 13 Mich. L. Rev. 271, 279—states after an analysis of relevant cases that not a single decision affirmatively holds to a general personal liability a non-participating associate who had not authorized the transaction. Compare: Rainwater v. Childress, (1915), 121 Ark. 541, 182, S.W. 280.

individuals by maintaining their connection with the organization knowing of its defective set up and not taking any step to remedy the same, assented to personal liability; (3) the inactive shareholders who supposed that a corporation existed should not be held personally liable;[65] and lastly, (c) where the plaintiff is attempting to fix liability for a tort committed by the defectively organized corporation, those actively participating in or authorizing the act and those inactive members who knew of the defect may be held to a general partner liability. In the tort, problem, the court in *Bonfilo v. Hayes*,[66] brushing aside any formalistic notion, observed: argument is made that the defendants (directors-shareholders) are not partners even if there was no corporation; but if they were actively cooperating in a business enterprise, and in connection therewith committed the tort in question, they are liable thereon whatever the title of their combination: partners, co-adventurers, joint-fortfeasors or what."

bb. Deviations from ordinary partnership norms and the tax code concept of association.—

In the preceding discussion, the attempt is made to show how the implications of an ordinary partnership relation become involved in such forms of business association other than the corporate device, *de jure* or *de facto*. Limited liability, transferrability of shares, centralized management and continuity of organizational existence have, to achieve certain objectives, become appealing corporate features. Business men would consider them desirable and necessary in the conduct of some particular business.

The investors, however, in so far as they choose to adopt the limited partnership device, the joint stock company or the trust arrangement, in order to attain such ends would be doing so under positive statutory sanctions. And in so far as the same general results are sought through the private agreements of parties admittedly bound under the conventional partnership relations, such attempts would have to face the court's inclination toward adhering to the broad proposition that only the legislative can confer the corporate entity features.

The above situation, almost a sort of a dilemna, becomes even more complicated when the tax economy problem, involved in the various methods of doing business, is considered. Such problem often crucially bears upon the success or failure of certain enterprises, particularly the small unincorporated organizations.

It is generally assumed that the over-all load can be reduced by conducting the business through the partnership.[67] It is not impro-

[65] Baker v. Bates-Shirt Street Co. (CCA 1st 1915), 6 Fed. 2nd 280.

[66] 201 Pac. 677 (1921 Colorado). See Mandeville v. Courtright (1905), 142 Fed. 97, Corporation organized to engage in the business of dentistry was declared illegal—all the defendants who were officers or directors and stockholders were held liable for a tort committed by the defective corporation.

[67] See generally: Fuller, *Partnership Agreements for the Continuance of an Enterprise after the Death of Partner,* (1940), 50 Yale L. J. 202—"Unmistakable signs of expanded use of the partnership device have recently made their appearance in the field

bable that on account of such alleged tax advantage even existing corporations would be dissolved and the partnership device adopted to obtain the resultant tax savings.[68] In attempting to accomplish such objective, it often happens that, by organizing and operating the association along the corporate pattern while at the same ostensibly remaining as partnership for tax purposes, the investors would be caught in that traditional struggle which is between the tax gatherer and the tax payer.

The scheme employed is probably ingenious and sound business practice were it not for the apparently innocuous clauses contained in the definition provisions of the Internal Revenue Code. The code provides, among others, that: "the term *corporation* includes association, joint stock companies and insurance companies."[69] The term *partnership* on the other hand includes an *unincorporated organization* through or by means of which business, financial operation, or venture is carried on, and which is not by virtue of the same definition provisions, a *trust or estate* or a *corporation*.[70] In addition, the pertinent tax regulations would make any business organization come within the purview of the term *association*, and in that respect, taxable as a corporation, when such features as continuity, centralized management and transferrability of interests are present.[71] It is therefore possible that what may be a partnership pursuant to the provisions of the partnership statute may be treated as a corporation for federal tax purposes. Similarly, these practices which are intended to keep down the firm's tax expenses may simply result in a weakening of the business structure without the slightest reduction in tax liability by reason of the aforementioned tax code concept, which, as one court has held, is designed "to impose a fair share of the whole burden of taxation upon business organizations which although not operating under a corporate form, nevertheless are en-

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of small enterprise. This renewal interest is clearly attributable to the fact that the cost of doing business frequently are less where this time-honored business units is used in place of the heretofore popular corporation. In recent years, the latter has been a favorite source of revenue for constantly mounting costs of government. And as corporate taxes rose without corresponding increases being levied against those using the partnership, the time came when the incentive was strong to re-evaluate the comparative advantages of the two business institutions."

[68] See note 32, *supra*. *"Tax Problems in the Elimination of One-Man Corporation and Closely Held Corporations,"* 30 Geo. L.J. 458. See also: No. 4—Practicing Law Institute: Addenda to the Monographs on Fundamental Federal Taxation, (1947).

[69] Internal Revenue Code, section 19.3797 (a) (3) [Reference is made to the Federal Internal Revenue Code of the United States.]

[70] Internal Revenue Code, section 19.3797 (a) (2).

[71] Internal Revenue Code, section 19.3797-4: "If an organization is not interrupted by the death of a member or by a change in the ownership of participating interest during the general period of its existence, and its management is centralized in one or more persons in their representative capacities, such organization is an association, taxable as a corporation." Section 19.3797-5 refers to limited partnership. Section 19.3797-6 to such associations authorized under such statute as that of Pennsylvania—Penn. Stat. Ann. (perm. ed.) title 59, c. 3.

gaged in making profits in much the same way that corporations carry on business activity."[72]

As far as the strictly partnership set-up is concerned, some difficulty may arise as to what deviations from the conventional norms would automatically turn a partnership into a corporation.[73] Merten writes: "It is very difficult to draw satisfactorily the dividing line * * * The line cannot be drawn upon the basis of the law of any particular states nor can it be drawn upon the basis of the provisions as to dissolution and admission of new members. The basic test is whether an organization which may be thought to be a partnership conducts business in the general form and manner of a corporation: if it does, it will be taxed as a corporation." [74]

However, apart from such features as centralized management, continuity of existence and transferrability of interests, which courts, in interpreting the tax provisions, seemed to have stressed particularly in the trust and joint stock company cases,[75] other factors have been considered in determining whether or not a particular business organization more clearly resembles a corporation than it does the ordinary partnership method. This may properly be inferred in the following broad language of one federal court: "In determining whether the entity is a partnership or an association, there shall be a balancing of *resemblances and contrasts,* since Congress evidently intended to tax as a corporation only partnerships conducting business by the corporate methods and forms." [76]

In that broad context, therefore, an attempt to limit liability even among the members of the group themselves may well create the impression that the partnership is within the tax code concept of association. In the comparatively recent case of *Poplar Bluff Printing Company* v. *Commissioners,*[77] a corporation was dissolved and in its stead a partnership was formed to take over the business. The partnership was composed of the original stockholders each of whom took a certificate of participation corresponding to what each

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The validity of such provisions has been sustained, and it makes no difference how state laws call a particular business organization. See: Burk-Waggoner Oil Association v. Hopkins (1925), 269 U.S. 110. Poplar Bluff Printing Co. v. Commissioner (CCA 8th 1945), where the taxpayer, considered to be an association, had previously been held by the state court as a partnership. Tyrell vs. Commissioner (CCA 5th 1937), 91 F. 2nd 500, certiorari denied in (1937), 302 U.S. 747.

[72] Equitable Trust v. Magruder (D.C. 1941), 37 F. Supp. 711.

[73] See generally: Rubin, *Association: Partnership Taxable as Corporation* (1948), La. L. Rev. 313-324. Compare: Levy, *The Incorporation of Partnerships* (1947), 25 Taxes 43. Schiller, *The Lawyers Dilemna* (1946), 24 Taxes 837. Paul, Partnerships in Tax Avoidance (1945) 13 Geo. Law Rev. 121.

[74] Mertens, *Law of Federal Taxation,* section 43.30.

[75] For example, Burk-Waggoner Association v. Hopkins (1925), 269 U.S. 110. Herbert v. Malley (1924), 265 U.S. 144—where a Massachusetts trust was held taxable as a corporation.

[76] Commissioner v. Brouillard (CCA 10th 1934), 70 F. 2nd 154 certiorari denied in (1934) 293 U.S. 672. Bert v. Helvering (1937) D.C. 340, 92 F. 2nd 491. Glendsder Textile Co. v. Commissioner (1942) 46 B.T.A. 176.

[77] (CCA 8th 1945) 149 F. 2nd 1016.

held in the dissolved corporation. By virtue of the partnership agreement, management was vested exclusively in one of the members. The certificate of shares was made negotiable although subject to the typical pre-emption option clause as embodied in the partnership articles. It was also provided that the partners shall not be liable for the obligations of the association until all its property shall have been liquidated and applied for that purpose. In holding that this particular partnership organization was within the category of *association*, the court pointed out that the limited liability provision though not legally binding as far as third persons are concerned, is inconsistent with the ordinary partnership incident.[78]

In the final analysis, it seems certain to say that in making a choice as to which form a business unit will be employed, all the tax advantages of partnership cannot be had while at the same time conduct the business along the corporate pattern. An enterprise which wants to be taxed as a partnership should bear a reasonable relationship in its methods of doing business to a normal partnership. And for that purpose, if the partnership device is employed, it would be necessary for the partners to give more attention to their organizational set-up and business methods, a problem which at the outset calls for a careful draftsmanship of the articles of association, in order to maintain an efficient unit which can genuinely pass the tax-gatherer's eagle eye for corporate resemblances.[79]

c. *Problems relating to the existence of a partnership relation: doctrinal tests.*—

In an ordinary situation, a partnership relation arises from the voluntary contract of two or more individuals who place their money, effect, labor and skill, or some or all of these, in lawful commerce or business, and share in the profits and losses in such proportions as may be agreed upon.[80] It is assumed that each member places his stakes in the enterprise primarily on account of the total qualities which make up the personal integrity of the other

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[78] Other criteria which have been considered. Holding out as an association or corporation, or not indicating that it is either—Lisoner v. United States (Ct. of Cl. 1931) 52 F. 2nd 1058, dissolving a corporation and turning its assets to partnership but continuing to conduct in the same way as before and not making efforts to make known such change—Jackson-Wermick Trust v. Commissioner (1931), 24 B.T.A. 150; such matters as keeping new books, changing advertising signs in the establishment as well as that appearing on company's vehicles—Seattle Benton Lumber v. U.S. 133 F 2nd 989.

[79] Smith, *Association Classified as Corporations Under the Internal Revenue Code* (1946), 34 Calif. L.Rev. 461—where the author states that for an organization to fall within the tax code concept of association taxable as corporation: "associates in a joint enterprise for a business purpose, with a reasonable degree of continuity, centralized management and transferrability." See also: *Taxability of Unincorporatd Corporate Equivalents* (1941), 92 Univ. of Pa. L. Rev. 296.

[80] Powell v. Powell (1947), 184 P. 2nd 373, 181 Or. 675. Greenstone v. Klar (1947), 69 N.Y.S. 2nd 548, *appeal denied in* 74 N.Y.S. 2nd 405, 272 App. Div. 1004.

members. For this reason, the relationship is a personal one, with the entrepreneurial element remaining as its dominant feature.[81] Consequently, there is a greater probability for the members to make such private agreements as would in a legitimate way accomplish the partnership objective and fix their respective participation in the conduct of the business, with due regard to such factors as the nature of the business, their number, their relative ability and willingness to participate in the management and the extent of their capital contributions. From the functional standpoint, it will depend almost upon the partners themselves on how well they could take advantage of their combined resources and skill on the basis of such arrangements, formal or informal, which they may make regarding the conduct of the business, and thus enable the firm to meet various local needs in the community in which it resides. In sum, the partnership relation is essentially contractual; and if they have put into written form how they will stand with respect to the firm, define their respective rights and obligations, there would probably be less difficulty in ascertaining in what particular capacity they are bound as to each other on the one side, and one the other, their exact relations as far as third persons are concerned.[82]

Often times, however, the agreement entered into between individuals ostensibly engaged in a common business enterprise and which agreement is thought to create a partnership relation, may be vague and ambiguous. Cases are thus numerous in which those who might be connected in one way or another in an enterprise, whatever their motives might be, do not make any written expression of their exact relationship. The informal character of the partnership probably accounts for such omission.

In a situation where the agreement is vague, let alone where no written agreement is made at all, courts encounter considerable difficulty in spelling out the proper criteria in ascertaining the existence or non-existence of a partnership relation; and in using different tests or a combination of them, simply would arrive at varying conclusions. And in making reference to such factual elements, as individual sharing in the profits, an undertaking to bear part of the future losses, the ownership rights which the party concerned has in the assets of the firm, the control which the investor has in the affairs of the firm or the extent of his actual participation in the management as well as in the formulation of policies, courts, intentionally or unintentionally, often would attach greater significance in one or some of such factual circumstances than in others in the attempt to give a general definition of a partnership

[81] Moore v. Du Bard (1947) 29 N.W. 2nd 94, 318 Mich. 578. Further, see the following discussions: Strauss, *The Entrepreneur; The Firm* (1944), 52 Jour. of Pol. Econ. 112. Compare: Cole, *"Entrepreneurship as an Area of Research"* in the Task of Economic History—supplement to the Dec. issue of the Journal of Economic History (N.Y. 1942), 118-126. Knight, *Profit and Entrepreneurial Function, id.* 132-142. Evans, *A Theory of Entrepreneurship, id.* 142-146.

[82] Trenbath v. Platt (1940), 20 N.Y.S. 2nd 244, *appeal denied in* 35 N.Y.S. 2nd 211, 264 App. Div. 755. Reed v. Montgomery (1947), 175 P. 2nd 986, 180 Or. 196.

relation as distinguished from other juridical relation.[83] As far therefore as the basic problem is concerned, namely, whether or not a particular association is a partnership, one can readily venture the statement that the jurisprudence is so confusing—even decisions on quite similar facts give conflicting reasons—that it is almost impossible to make a single generalization that this or that test is determinative of a partnership relation.

The apparent lack of uniformity in the rules for determining the existence or non-existence of partnership may well be due to the attempt of most courts to find a technical definition which may be applicable in each particular situation, irrespective of the particular issues involved, instead of adapting the definition required for the decision of the case on the specific issues raised. Many of the apparently inconsistent cases might be reconcilable if the problem is posed not as one single problem of law generally to define partnership as distinguished from other relations, but as more or less independent questions in reference to the facts and circumstances of each case.

An approach which stresses on locating who the parties are, what claims or issues they raise, whether the party is a creditor seeking to enforce a claim against individual members irrespective of who among the latter he dealt with on the assumption that the defendants are co-partners or whether the controversy is one between individuals who supposedly have some interests in the same enterprise in all of which the determination of the existence or non-existence of a co-partnership relation is the decisive issue—would be more useful in the way of achieving a fair degree of uniformity than the usual efforts employed in resolving the issue by means of intricate legal distinctions. What is controlling in the last analysis would be the fact involved in any particular controversy.[84]

Or probably a partnership relation can be ascribed to a set of facts only by a process of elimination from a series of other conventional legal relations. Thus: "the decision as to whether a par-

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[83] Thus, *Crane writes:* "The judicial process of determining that a particular association is or is not a partnership consists in a finding of the factual elements of the association and a decision that those elements do or do not include those which are necessary for what is legally designated as partnership. Legislatures, textwriters and judges have attempted frequently to formulate a definition of partnership which will indicate what are the necessary elements. It has been cited that it is impossible to formulate an exact and precise definition of a partnership, any attempt to reconcile conflicting cases in this particular is futile." *supra,* 21.

[84] See Sec. 4 (3) Uniform Partnership Act makes the law of agency applicable. This is said to be necessary in determining whether a partnership relation exists in the various situations where the question may be raised. Such provision confirms the statement that courts through over-emphasis on technical distinctions may ascribe an unintended legal relation to a particular set of facts.

Section 7, *id.,* prescribes the rules for determining the existence of a partnership. Included therein are other legal relations—a situation which clearly indicates what might well be the sources of confusion in the treatment of the question. See: Cook v. Lenten (1948), 80 N.E. 2nd 280, 325 Ill. App. 92. Brown v. Miller (1943), 141 P. 2nd 682; 111 Colo. 327. Block v. Schmidt (1941) 296 N.W. 698; 296 Mich. 610.

ticular form of business association is a partnership or not is often a necessary step to determining the appropriate rule of law to apply to a business situation, whether a rule of law peculiar to a partnership, or one peculiar to a principal and agent, landlord and tenant, debtor and creditor or some other form of association or relation. * * * There are situations in which the existence of the partnership relation is in issue * * [and] determining the issue of partnership or not, as the form of association existing in a particular situation is but a process of elimination." [85]

However, once the legal nature of a contract has been established to be one of partnership, certain consequences or incidents follow as a matter of law irrespective of any actual understanding as between the partners. Among such usual incidents as provided for under partnership statute are: partners' sharing in the profits and losses;[86] sharing in the management and conduct of the partnership affairs; [87] that every partner is an agent of the firm and entitled to bind the partners by his acts for the purpose of its business; [88] a fiduciary relation exists between the partners; [89] all property brought into the partnership stock is partnership property; [90] and that on dissolution the partnership is not terminated but continues, until the winding up of the partnership affairs is completed.[91]

A most common method employed by courts as a starting point in the process of ascertaining whether the partnership relation could be ascribed to a particular set of facts is the so-called profit-sharing doctrine. Until the *Cox v. Hickman* case, noted before, early decisions treated profit-sharing arrangement as conclusive criterion in determining the question whether a partnership relation existed or

[85] *Crane, supra:* 17-18. For cases: Melosevich v. Cichy (1948) 193 P. 2nd 342. Rouse v. Pollard (1941) 18A. 2nd 5, 129 N.J. Eq. 47 affirmed in 27 A. 2nd 801. Commercial Casualty Insurance Company v. North (1943) 50 N.E. 2nd 434, 320 Ill. App. 221. A partnership is a contract of mutual agency, each partner acting as a principal on his own behalf and as agent for his co-partners.

Witness the following statement of *Lewis:* "In preparing the draft the writer was obliged to discard the idea that the partners were co-principals with the partnership in all partnership transactions. The whole idea leading to the adoption of the theory of partnership is that the partnership, not the partners, is carrying on the business. If the partners must still be regarded as co-principals it may well be asked: Are not the problems of partnership sufficiently complicated without creating another person who must be regarded as participating in all partnership acts, and be made with the partners as party in all actions arising out of partnership transactions? It was also impracticable to regard the partners as merely sureties in all partnership contracts, declaring their liability with the partnership to be joint and several, or to regard the partners as guarantors, because either these solutions left the liability of partners for partnership torts still to be provided for." *supra.* 165.

[86] Section 18(a), *Uniform Partnership Act.*

[87] Section 18(e), *id.*

[88] Section 9(1), *id.*

[89] Section 15 and section 21, *id.*

[90] Section 8, *id.*

[91] Section 30, *id.*

not, both in situations where the rights of third persons were involved and where only those of the partners *inter se* were the subject of litigation.[92] The reasoning of these decisions is that the profits of the business create a fund which all who contract with the firm had the right to look for payment, and that it is fraud on those who dealt with it to abstract that fund and at the same time escape responsibility from such contracts by which the fund is created.[93] The courts' view on the matter gradually changed, and in time, the orthodox profit-sharing doctrine became and is now subject to a number of qualifications which, in themselves, are complicated, and pose varied problems as they are applied in actual cases. Among such qualifications are: when the party concerned received the profits not as principal;[94] where the so-called profits are received as compensation for services rendered;[95] in payment of rent,[96] or of a loan or interest thereon, or as annuity to a widow or legal representative of deceased partner or when said profits are given as consideration for the sale of the business or other property in installment or otherwise.[97]

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[92] For example, Sheridan, v. Medara, 10 N. J. Eq. 469. Culley v. Edwards, 51 Am. Rep, 614. Webster v. Clark, 24 Fla. 637. Price v. Alexander, 52 Am. Dec. 526. Boston & C. Smelting Co. v. Smith, 13 R. I. 27. Hallstead v. Coleman 143 Pa. 352. Burnett v. Snyder 81 N. Y. 550.

[93] See note 38, *supra.*

[94] Compare: Crane, *supra* at 188 and see: Meehan v. Valentine, 145 U. S. 611—the liability of one partner for the acts of his co-partner is placed on the ground that as regards each other they are principal and agents and that the right to participate in the profits was treated merely as evidence that the person so participating has authorized the managers to conduct the business in his behalf. Berthold v. Goldsmith, 24 How (U. S.) 536, 16 L. ed. 762. Section 7 (4) Uniform Partnership Act. Peterson v. Eppler, (1946) 67 N.Y. S. 2nd 110 where agreement named the plaintiff as a junior partner but expressly provided for a fixed monthly payment as salary in addition to a fixed percentage of the net profits and definitely stating that plaintiff shall have no other financial interest in the firm and no authority to participate in management—mere employee and not a co-partner.

[95] Section 7 (4) id. e. g., Taylor v. King Cole Theaters, (1944) 31 S. R. 2nd 260, 183 Va. 117—lease of ground floor of building for use of a theatre company created landlord and tenant relationship rather than a partnership in the absence of agreement to share in the profits or losses, although the contract provided for a payment of 25 percent of the gross receipts of each performance as rental and for the installation of certain equipment. Compare: Roberts vs. Roberts, (1945) 155 P. 2nd. 155, 133 Colo. 128—farming on share basis. Preslin v. Haxton Canning Co., (1948) 80 N. Y. 2nd 869, 274 App. Div. 144.

[96] See: Gilmore, *Cases on Partnership,* (2nd ed) 42. In most of the cases the courts will not hold the mere investors liable as a partner absent other elements such as the power of control and management. Jacobs v. Escott (1943) 37 N. Y. 2nd. 789. Kirshon v. Friedman (1944) 36 A. 2nd. 647, 349 Pa. 171.

[97] Section 7 (4), *Uniform Partnership Act.* Holcombe v. Long, 245 Mass. (1933)—arrangement for the payment of the profits to the representative of a deceased partner. Thompson v. Batchelder, 134 App. Div. 506, 119 N.Y.S. 577—royalty paid for transfer of perfumery business. Hammond Oil Co. v. Standard Oil Co. of New Jersey 259 N.Y. 312, 181 N.E. 583 (1932)—assignment of oil concessions in consideration of a share in the productions.

The accepted modern view is that the sharing of profits, as well as the sharing of losses for that matter, is not of itself a conclusive test to establish the existence or non-existence of a partnership and that the party concerned may just as well be standing in some other relation as indicated above. At most, as stated in one recent case, *Quier* v. *Rickley*,[98] profit-sharing is merely *prima facie* evidence tending to show that the recipient might probably be a partner in the light of the total circumstances involved.

Along side with the profit-sharing formula, other basic tests have been developed in determining whether a partnership exists or not. For a time the mutual agency criterion, which stemmed from the rather broad language of the *Cox v. Hickman* decision, had been used extensively. Reference to it is in fact being made though in a somewhat modified context. This method of approach has been criticized as tautologous and question-begging for it simply furnishes an "effect rather than a test." [99] Crane criticizes this as misleading since a minority partner cannot by revocation terminate power of a co-partner to so bind him unless he seeks the dissolution of the enterprise.[100] In *Meehan v. Valentine*,[101] the United States Supreme Court observed that such a criterion offers nothing but a synonym rather than a definition and indicated further that agency results from a partnership relation rather than the converse in so far as the question on hand is involved.

Still another way by which courts attempt to support their conclusions on the question whether a given set of facts constitutes a partnership or not is the so-called intention of the parties test, another broad and probably undefinable notion. *Smith v. Smith*, decided in 1947, is a typical illustration of how courts formulate the rule without one getting a feel of its contextual reference. Says the decision: "The particular test as to the existence of a partnership relation, which is applicable especially as between the parties themselves, is that partnership exists only when it is the intention of the parties that they be partners." [102]

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[98] (1947) 177 P. 2nd. 549, 116 Colo. 5 Devereux v. Cockerline (1946) 170 P. 2nd 727, 179 Or. 229—where the liability policy protected wrestling promoter and the city, leasing municipal auditorium to promoter but did not protect the general public or patrons of the exhibition, the fact that the premium rate was based on gross receipts from the wrestling matches did not make the insurer a partner of the promoter and hence alleged injuries to a patron resulting from the wilful assault of a wrestler could not be based on a partnership relation between insurer and promoter. Weisman v. City of Long Beach (1941), 106 P. 2nd 45, 41 Cal. App. 2nd 8. The receipt of profits from business, not as interest on a loan, is *prima facie* evidence that recipient is a partner in such business, and without more, the *prima facie* case thus proved precludes dismissal of recipient's action to recover amount invested in the partnership. Hanson v. Namestead (1942), 3 N.W. 2nd 498, 212 Minn. 325.

[99] Mechem, *Elements of Partnership*, (2nd ed) 1920 section 96.

[100] Crane, *supra*, note 21.

[101] 145 U. S. 611.

[102] Smith v. Smith (1947), 53 A. 2nd 15. For similar statements: Calvin v. West Coast Power Company, D.C. Or. (1942) 44 F. supp. 783; Cohen v. Orlove (1948) 57 A. 2nd. 810. Collier vs. Collier 32 A. 2nd 469, 182 Md. 82. Zuback v. Bak-

Indeed, the intention-of-the-parties doctrine simply offers a convenient and spacious area for judicial manipulation of a set of factual circumstances, without either party being able to get the slightest hint just what inference would be drawn from the pro-offered facts and which of them will be given any significance. If what the parties actually did constitute a partnership, it would surely be a run-about technique to say that it is so because that has been the intention of the parties.[103] On the other hand, courts would often say that the partners cannot by using the word *partnership* create such relationship as when, for instance, the contract between them clearly provides that there was no community of interest in the business as such and no right to participate in the management of the business.[104] Thus, in *Fenwick v. Unemployment Compensation Commission*,[105] decided in 1944, in finding that the agreement between the parties was one of partnership—the business was a service enterprise, a beauty parlor, and the plaintiff as receptionist, would receive under the agreement certain percentage of the net profits—the court made the statement that in determining whether the relation created by the integrated agreement of the two persons was one of partnership or employment merely, the parties' own characterization of the relation was not conclusive. As a general proposition, therefore, much may be gained on behalf of clarity if the evaluation would proceed on the basis of the facts on hand rather than the employment of the seemingly definited intention-technique.[106]

It should be recalled that a partnership relation by statutory definition presupposes an association of two or more individuals acting as co-owners of a business for profit.[107] Lewis writes: "Ownership involves control. It is impossible to state that this or that power makes the man who possesses it an owner or co-owner of a business." [108] The definition, it has been suggested, while it is intended merely as an accurate statement of the pre-existing law, does have the distinct advantage in that by the use of the word *co-owners*, it serves more clearly than other forms of expression to differentiate partners from other persons who are connected in some way

maz (1943) 29 A 2nd 473, 346 Pa. 279 Powell (1947) 184 P. 2nd. 363, 181 Or. 675.

[103] Compare: Giles v. Vitte, loc. cit. at note 41, In re Marcus (1922) F. 928 Aff'd in 262 U.S. 553 "The Uniform Partnership Act manifests a definite purpose of making permanent the contractual intent of the parties to the agreement as a test for fixing a general partnership liability rather than as often theretofore, by way of penalization for participation in partnership profits, or doing other things which held partners to general partnership liability when general partnership was not contemplated or intended, and was not in fact effective as between themselves."

[104] For example, Peterson v. Eppler, (1946) 67 N.Y.S. 2nd. 498 and see note.

[105] (1944) 38 a. 2nd. 849, 132, 132 N.J.L. 185.

[106] The proposition is well stressed in: Ramos v. Pacheco, (1944) 148 P. 2nd. 704, 64 Cal. App. 2nd 304, California Stabilization Commission v. Walters (1944) 149 P. 2nd, 17, 64 Cal. App. 2nd 554.

[107] Section 6, Uniform Partnership Act.

[108] Lewis, *supra*.

with the carrying on of a business.[109] In that context, courts therefore would say that in order to constitute a partnership there must be such ownership interest as empowers each party to make contracts, incur liabilities, and manage the whole business.[110] Proceeding thus from the underlying assumption of ownership, courts would sustain an assertion or denial of general partnership liability on the basis of what is thought to be a more concrete and probably less conceptualistic notion, namely, the extent of control which a party exercises with respect to the affairs of the firm. The reasoning is that business reverses should be shouldered by the entrepreneurs in whom ordinarily resides the power to control and allocate the risks attendant in the conduct of any profit-making venture. Hence, there are decisions in which the courts avowedly regard the presence or absence of control as the decisive factor in imposing upon a party the full accountability of a co-partner.

Regarding the control factor, Justice Douglas, writing years ago, advanced a modified entrepreneurial concept[111] for the purpose of determining whether or not the incidents of partnership should attach in any particular situation. The author pointed out that the basic incident of business ownership is the ability to meet losses resulting from its operation; that the extent in which such losses should be suffered primarily depends upon the ability to distribute the cost items of the enterprise as well as the capacity to manipulate the profit differential for the goods or services which the organization offers to the community.[112] In that respect, those persons who are in a position to determine these particular phases in the management of the business may well act as the administrator of any and all resultant risks having reference to the enterprise affairs. Under this theory, the individuals who hold both these two prerogatives, namely, the determination of the cost item and the right to formulate the price policies should be made to answer for the obligations of the partnership. In connection, however, with the profit-sharing formula, Douglas gives the following remark: "Profit-sharing would not be essential. That is not to say that sharing of profits as such would never be a *sine qua non*. If the right to determine the cost item did not include the liability in question a cost item, and to get reimbursement from the assets, profit sharing in

[109] Dodd, *supra*.

[110] For example, Smith v. Grove (1942) 118 P. 2nd. 324, 47 Cal. Appl. 2nd. 456. Intimate business associates of long standing, each of whom owned one-half of the stock in a bakery corporation, by virtue of written contract providing for indefinite continuance of such equality of ownership, benefits and control and giving the survivor an option to purchase stock of deceased stockholder and the manner of operation under such agreement, stood in the relation of co-partners as respects standard of conduct required in their mutual dealings. Fewell v. Tappan, (1947) N.W. 2nd, 648, 223. Minn. 483.

[111] *Douglas, Vicarious Liability and Administration of Risks II,* (1929) 38 Yale Law Journal 720. Compare: Rowley, *The Influence of Control in the Determination of Partnership Liability,* (1928) 26 Mich. L. Rev. 290.

[112] Douglas, supra, at 720-739.

the strict sense would be a *sine qua non.* For it would provide the channel for reimbursement." [113]

Justice Douglas' theory finds illustration in the case of *Southern Can Co. of Baltimore City v. Hartlove.*[114] In that case, the owners of a canning establishment entered into an agreement with the defendant Hartlove granting the latter the exclusive sales agency of the products of the firm. All the products of the firm were to bear the label of defendant. Pursuant to the agreement, defendant was to make cash advances to the firm for the purpose of purchasing raw materials, cans, cases and labels, and also to advance funds from time to time to pay the company's pay-roll. Both parties were required under the agreement to make their respective accounts of all transactions made and which accounts shall be open to the inspection of either party at any time. In addition to the commission and discounts granted to the defendants Hartlove, he received an extra compensation of one-half of the net profits and that in figuring the net profits, all advances made by the defendant shall be charged as expenses for operating the establishment. Furthermore, the defendant was given the right to determine the salary and wages to be paid in the cannery, and that no additional advances were supposed to be made under the agreement unless the wage scale should meet with the approval of defendant. It was stipulated, however, that the owners of the firm shall have the exclusive control and management and would not permit anything of any nature to interfere in such management. In holding that the defendant was a copartner in the business and therefore liable as such, the court pointed out:

> "Under the agreement of the alleged partners [the owners of the canning establishment] had to a large extent the control of the manufacture, although even in this respect Hartlove had what in the ultimate analysis *real control* under the terms of paragraph 6 of the agreement which authorized and empowered him to fix the wages of the employees at the cannery, and, if not satisfactory, to refuse the furnishing of any further capital, and had complete and unhampered control of the disposition of those products; it being stored in his own name as soon as packed, labelled as his goods. We think that the facts are sufficient to show that Hartlove had a proprietary interest in the partnership and its assets. He furnished all the money necessary for the conduct of the business, had partial control of the manufacturing operation, full control of the sale of its output,

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[113] Id. at 735.

[114] (1927) 152 Md. 303, 136 A. 624. See, Gilmore, *Cases on Partnership,* (1949 3rd ed.): "Care must be taken therefore to discriminate between the cases of an alleged loan, with a share of profits by way of an interest, and a real partnership disguised as a loan, for it appears that the transaction is mere device to obtain the advantages of a partnership, without the responsibilities, it will be held a partnership whatever the parties may have called it. The interest is usually to be found in the power of control of the alleged lender. Has he any voice or part in controlling the management of the business as a principal therein? Has he by virtue of the arrangement such an interest in the business that he can be regarded both as principal and agent for the others?" at 70.

was entitled to one-half of the net profits, and must be under these conditions held to be partner in spite of the fact that the agreement stipulated that one-half of the profits which Hartlove was to receive should be an extra compensation." [115]

It would seem that the control factor as a basis of determining whether general partnership liability should be imposed or not in itself varies in degree such that it cannot cover the entire factual elements supposedly involved in the relationship, let alone serve as a single definitive test.[116] Court decisions which make reference to this technique are indeed not altogether clear as to the extent in which one who would invest in an enterprise may participate in the conduct of firm affairs without being later held unlimitedly liable as a co-partner. Conceivably, certain degree of supervision and control may be accorded to those who have been invited to invest in an enterprise without intending that they should be liable beyond their original contributions. Yet it is not unusual that such arrangements would simply be nothing but some overly protected investments and that the investors are in fact co-enterprisers. Similarly, while much can be said in favor of the cost-and-price theory for the purpose of determining whether an individual connected in some way with the business exercises such effective control as to make him liable as a co-partner, the theory may simply be interpreted to cover only a portion of the complex process involved in the term *control*. To be sure, so many factors are equally involved in the management of the affairs of a business enterprise, however limited its field, such that the control test, as above expounded, may just as well be another esoteric concept. If anything, it is an important factual element of the partnership relation, which, as well said by a California court "cannot be determined by dissecting (it) into broken parts and members, and studying each dejoined fragment as though it were a complex whole." [117] (*To be continued next issue*)

[115] But compare: Martin v. Peyton, 246 N.Y. 213, 158 N.E. 77 where the lenders of certain securities, as a protection for their interests, where given the right to receive fifty per cent of the net profits of the borrower-firm and were given full information of the firm affairs and could veto any transaction considered speculative or unsound. The court refused to hold the lenders liable as partners since the *control* vested was insufficient for that purpose. See Crane, *supra*, 63.

[116] Rowley, *supra*, *loc. cit.* at note 111.

[117] Wescott v. Gilman, 170 Cal. 568, 150 Pac. 77. San Joaquin Light and Power Corp. v. Cantaloupes, 96 Cal. App. 3222—in holding T. a partner in the defendant-firm, it was held: "The dominant characteristics of the contract was to carry on the business and every provision of the contract was to this purpose. That it was carried on jointly is likewise clear. In the business venture there were two branches, as is necessarily true in like undertakings, namely, manufacture and sale. In each of these branches, the association and control of T. was provided for. The selling end was exclusively under his control and discretion, and the manufacturing end was under the control of the Cantaloupes and the representative of T., which representative was to be paid a salary greater than the proportionate salary of either of the others * * * If the transaction were as claimed, merely a naked loan, why do we not find some provision in the contract concerning the re-payment thereof, or the rate of interest chargeable thereon."