THE AMERICAN LAW REGISTER

FOUNDED 1852.

UNIVERSITY OF PENNSYLVANIA

DEPARTMENT OF LAW

VOL. { 50 O. S. / 41 N. S. } APRIL, 1902. No. 4.

FIRM CREDITORS' PRIORITY ON PARTNERSHIP PROPERTY.

INTRODUCTION.

One of the chief advantages of the common law over a code is its flexibility. By reason of this it is possible, not only in courts of law, but—if they fail—in the chancery, to so modify rules of law that they may meet the needs of changed conditions in the world of affairs. It is for this reason that the study of English law in a historical light has a special importance. One who reads the current decisions is as a rule observing the fine flower—so to speak—of a doctrine which has, perhaps, taken centuries to mature. If he look at it from a twentieth century point of view it may not appear to him of special excellence. But if he take the trouble to pursue the records of its growth as contained in the reports of past decisions—to find the germ from which it sprang—he will probably come to the same conclusion that Lord Coke did when he said that the common law—being the product of many minds working amidst various conditions—far surpassed the possible wisdom of any one man or group of men, endeavoring to create a system of law out of hand. Accordingly the study of ancient decisions has a special value in connection with the modern law. It is interesting to see how, when the courts of law had crystalized their decisions into inflexible rules whose strict operation led to results unsatisfactory to the community, the chancellor would introduce some *modus vivendi* which would in effect repeal the law while expressing the greatest respect for it. Frequently this was done by processes which from a strictly logical point of view were like the proverbial hair-splitting. The *result,* however, was the main consideration, and as the means employed were often of an unsatisfactory nature it was difficult for some decisions to weather the storm of hostile criticism. Then the dangerous but useful expedient of distinguishing between cases to the naked eye as like as possible was invoked. Hence the confusion of some branches of the law and two or more "lines" of cases descending from a common ancestor.

Bearing in mind, however, that the law is above all else practical, and that where necessity takes the direction logic must step aside, we are prepared to look tolerantly upon the "elaborate structures of split hairs" raised by the common lawyers. It sometimes happens also that the scaffolding—to carry out the figure—used in erecting the "structure" is never wholly removed, resulting in a disfigurement of the edifice.

With this general introduction we may take up a consideration of a certain important branch of the law which has given rise to endless ingenious discussion—namely, what are the true principles upon which firm creditors may claim priority upon partnership property in case of a contest between them and separate creditors of the partners.

Difficulty of the Subject.—The adventurous student who sets forth on a voyage of discovery over the apparently trackless ocean of decisions on the subject of priorities of partnership creditors, over separate creditors of the partners (as to firm property) soon finds himself in angry seas and driven hither and thither at the mercy of contrary currents of decision.[1] If he look about him he will find as

[1] See opinion of Henderson, J., 42 Ark. at p. 450 (1883) and T. Parsons, P. S. p. 327.

his only aid the bright star of Eldon's genius which points a way of safety to the haven of understanding where he fain would be. The following essay is an attempt to chart a course over this apparently pathless sea.

Any one who, like the author, has examined the two hundred or more cases on this subject to be found in the books, will be impressed with the great diversity of decisions in the state courts. Not only do the cases conflict among themselves, but many of them differ internally. Various courts have taken almost every conceivable view of the subject. Many of the reasons adduced are, it is believed, unsound. In some cases several reasons are given as the *bases* of the same decision, notwithstanding that upon close examination they appear to be inconsistent.[2] It seems that the reason for this unsatisfactory state of the law is due to the conflict of interests which necessarily arises in cases of this sort. There are two main points of view from which the subject may be regarded; that of the purchaser of a partner's *unascertained* share and that of the firm creditor. The corollaries of these respectively are those of the separate creditor and of the partner himself. These last two give a slightly different outlook. Consequently where there is so much uncertainty as to what the law ought to be and, by reason of its involved nature, as to what it really is, courts of different predilections have arrived at different results.

It is believed that in the present state of the law *no* theory however comprehensive can have at *all* its points the authority of even a preponderance of decisions—unanimity is not to be thought of. The following thesis is, then, a tentative effort to develop a coherent theory which will be adequate to the needs of the subject.

Probable Historical Growth.—Certainly at common law a partner might sell out his *unascertained* share or interest in a partnership and it might also be sold out on

[2] Consequently in the preparation of this article the English decisions —which are, admittedly or not, the source of the entire law on this subject—have been principally looked to. In order to prevent "overloading" the notes only the decisions in point have been cited, and elementary propositions are stated without citations.

execution by his separate creditor.[3] The result seems to have been that the separate creditor took the entire *proceeds* of the sale; the vendee took as tenant in common with the remaining partner,[4] free however from any liability to the joint creditor, who thereby lost his right to come upon the entire partnership estate and could only have execution upon the moiety of the remaining partner.[5] Apparently this state of affairs was deemed intolerable, since about the middle or early part of the eighteenth century the Chancellor would in many cases relieve the joint creditor,[6] not, however, for his own merit, but in aid of the remaining partner.[7] Subsequently the relief was also allowed at law by Lord Mansfield, though later this remedy was restored to the court of chancery. It is impossible to give a more particular statement of the historical growth of the joint creditor's priority.[8] Even Lord Eldon, nearly a century ago, confesses that "How it originally became law I do not know."[9]

It may readily be imagined that it was thought expedient that firm credit additional to that existing by the old law as to partnerships should be given by allowing a firm creditor a preference over an individual creditor.[10] It will be remembered that the beginning of the eighteenth century was a time when England's commerce was growing vigorously and such favoring of firm transactions would be only another manifestation of the growing consideration of the

[3] *Pope* v. *Haman*, Comberbach, p. 217 (1694), see also Watson, Partnership, chap. v.

[4] This is true now in some states, *e. g., Knight* v. *Ogden*, 2 Tenn. Ch., pp. 473 to 477 (1875); *Andrews* v. *Keith*, 34 Ala. 722 (1859); *semble, Hirschfield* v. *Claflin*, 52 Cal. 617 (1878). It is believed that the cases in notes 58-68 inclusive are inexplicable on any other view.

[5] Theophilus Parsons, Partnership, chap. x; see also note on p. 106, 16 Johns. (N. Y.) (1819) and *Morrison* v. *Blodgett*, 8 N. H. 244 (1836). Cf. *Craven* v. *Widdowes*, 2 Cas. Ch. 139 (1682).

[6] See *Taylor* v. *Fields*, 4 Ves. 396 (1799).

[7] Cf. *Fox* v. *Hanbury*, Cowper at p. 445 (1755).

[8] See, however, *Jacky* v. *Butler*, 2 Ld. Raym. at p. 871 (1701) and authorities there cited.

[9] *Barker* v. *Goodair*, 11 Ves. p. 78 (1805).

[10] But see remarks of Gibson, C. J., in *Doner* v. *Stauffer*, 1 P. & W. 198 (1829).

common law for the convenience of merchants. The (probably nearly contemporaneous) statute III and IV Anne (making promissory notes negotiable) is also an example of this tendency, as is Lord Mansfield's later recognition of the customs of merchants in insurance cases.

However this may have been the courts having once laid down the rule that firm creditors might have priority seemed to feel the necessity of some more conclusive reason than the vague (and in this case disputed) one of "public policy."

Nature of Joint Creditor's Priority.—Accordingly it was early laid down[11] and has been followed in a myriad of cases[12] that the priority of the joint creditor depended upon the equity of the partner to have the firm property applied to the payments of the firm debts.[13]

The strict logical operation of this principle, however, appeared to some judges[14] and writers to lead to harsh and inequitable results. In consequence the principle was either neglected in certain cases or a new principle, namely, that the joint creditor had in his own right a sort of a lien upon the *corpus* of the firm estate was advanced. Among the text writers James Parsons, it seems,[15] was the most vigorous champion of this theory. He says:[16] "The firm creditor enjoys a priority on the firm fund, not by reason of any difference between his contract with the parties and that of a separate creditor, but by reason of an independent and

[11] Story, Partnership, p. 558.

[12] S. Bates, P. S., vol. ii, § 824 and authorities in note 2.

[13] Kent, Com. iii,* p. 65.

[14] *E. g.* in *Tenney* v. *Johnson,* 43 N. H. 144 (1861).

[15] I say "it seems" advisedly since, notwithstanding the apparently explicit statement in his book, he agrees with the tremendous weight of authority that the right of the firm creditor to priority is dependent upon the partner's "equity." But Mr. J. Parsons goes on to contend that the partner's equity is an inalienable, indestructible interest. Consequently if the foundation consisting of the partner's equity is indestructible the superstructure of the joint creditor's priority would also be indestructible. This then in effect amounts to a vested interest in the firm creditor. It is obvious that the objections made by Lord Eldon apply with equal force in both cases.

[16] Partnership, 2d ed., p. 453; see also p. 474.

vested right which he has acquired in the firm stock in consequence of its destination to his use by means of the joint tenancy of the partners."

The inconvenience of the practical operation of this view and its effect, if carried out, to destroy the very end—commercial convenience—which it sought to serve, was long ago pointed out by Lord Eldon in *ex. p. Ruffin.*[17] Carried to its logical conclusion it would result in the intolerable inconvenience that no firm could ever give a clear title to a purchaser of its property as long as there were creditors of the firm.

Let us revert to the other view sanctioned by authority and grounded in reason.[18]

"Partner's Equity."—Assuming then that the firm creditor's priority is dependent upon the so-called "partner's equity" (which is also enforced at law), which enables the partner to have the joint property applied to the payment of the firm debts, it becomes important to consider (*a*) the nature of the "partner's equity" and (*b*) the grounds upon which it is based.

(*a*) *Its Elements.*—As to the nature of the partner's equity it has been suggested that it consists of four elements: (1) to have the partnership assets applied to the payment of the partnership debts; (2) the corresponding right to demand contribution in case of a deficiency of assets; (3) a right to a moiety of any surplus remaining;[19] and, (4) for the purpose of enforcing all the preceding rights, an independent right to an accounting. It has been ingeniously contended that when a partner sells out or has sold out on execution "all his right, title and interest" in the firm only the last two rights pass to the sheriff's or partner's vendee (since the vendee is not liable for the firm

[17] 6 Ves. 119 (1801). "To say this seems to me a monstrous proposition; that which at any time during the partnership has been part of the partnership effects, shall remain [so] notwithstanding a *bona fide* act. . . . If it were held [so] . . . commercial transactions could not go on at all." Quoted with approval by Church, C. J., in *Allen* v. *Co.*, 21 Conn. 130 to 137 (1851).

[18] *Jones* v. *Fletcher,* 42 Ark., at pp. 450-51-52 (1883).

[19] By Lord Eldon in *ex parte* Williams, 11 Ves. p. 3 (1805).

debts, and therefore has no need to acquire the first two rights); and the rights first mentioned still remain in the partner. It is conceived that while the first right[20] above mentioned may not pass to the vendee yet it is, unless specially reserved,[21] lost to the retiring partner,[22] which as far as the joint creditor is concerned amounts to the same thing as if it had passed to the vendee. Even in the few jurisdictions which insist that the first part of the equity is unassignable by the retiring partner it is admitted that it is a right which may be waived.[23] In any event it is difficult to see how a partner can sell out *all* his "right, title and interest" and at the same time reserve a part of it by *implication.*

(*b*) *Its Nature and Foundations.*—As to the grounds on which the partner's equity is based: A very recent view enunciated by the Chief Justice of Maryland[24] is that, "Partnership creditors have no lien on partnership assets, but the partners themselves have a right to insist upon the appropriation of the joint property to the payment of joint debts, upon the principle that as the joint debts were contracted in making the purchases of the joint assets the latter ought primarily to be charged with the burden of paying the former.[25] The right of the partners to have the joint debts

[20] As to the right to demand pro rata contribution from the remaining partners this, it seems in all cases, remains to the retiring partner. So far as I am aware no case has ever decided the point, probably for the reason that in the cases where it might have arisen, it would have been impossible to recover anything of value.

[21] As was the case in *Buck Co.* v. *Johnson,* 7 Lea (Tenn.), 282 (1881); *Rogers* v. *Nichols,* 20 Tex. 719 (1858); *Darden* v. *Crosby,* 30 Tex. 150 (1867), and *Wildes* v. *Chapman,* 4 Edw. Ch. 669 (1846).

[22] *Tracy* v. *Walker,* 1 Flip. (Circuit Court of U. S. for O.) 41 to 44 (1861).

[23] Cf. Baker's Ap. 21 Pa. p. 76 (1853), and *Young* v. *Clapp,* 32 N. E. 187 to 191 (1892), first col., and *Howe v. Lawrence,* 9 Cush. 553 to 558 (1852). Likewise where all partners agree to apply firm property to satisfaction of separate debt of a partner.

[24] *Franklin Sugar Ref. Co.* v. *Henderson,* 86 Md. 452 (1897).

[25] This "principle" seems rather curious. It has a certain speciousness about it, but on examination it appears to be merely a hollow phrase. Clearly the "debts" have no rights. Nor is there any duty on the part of the assets to surrender *themselves* in satisfaction of the firm obligations. The debts are personal to the partners, and it would seem clear

paid out of the joint assets in preference to the right of the separate creditors to be paid out of the same assets, gives rise to the derivative equity of the joint creditors to have payment of their claims out of the proceeds of the co-partnership property before any of those proceeds can be devoted either to the separate use or appropriated to the payment of the separate debts, of any of the members of the firm."

It has also been said that the partner's equity is an incident of his ownership in the firm business, in which case it would seem to be dependent upon one of the terms of the partnership agreement, express or implied,[26] or upon some arbitrary rule of law. That is to say that the right of a partner to compel the appropriation of firm property to the satisfaction of firm debts is a *chose in action* springing from the contract of partnership, or a property right of a peculiar nature. In considering the first point the remarks of Gibson, C. J.,[27] seem to leave nothing to be desired. "That a contract which enables the parties to keep a class of their creditors at bay and yet retain the *indicia* of ownership, should not have been deemed within the statutes of [13] Elizabeth [Chap. V, *infra*] is attributable exclusively to the disposition universally manifested by courts of justice to encourage trade." But it is believed that such an agreement would be inherently unenforcable. The fact that the courts allowed a preference to joint creditors would therefore indicate that they proceed upon some principle *ab extra* and in nowise arising from the partner's contract.[28]

The second point, that the right of the partner to have the firm property applied to the payment of the firm debts, is a sort of property right presents less difficulty. If we regard it as property (in the nature of a lien) and yet, as

that the personal status of the partners should be the basis of rights and duties. But see Kent, Com. iii,* p. 65, note 1 by Holmes, now C. J. of Massachuse[illegible] and Bates, P. S., vol. ii, § 820, and *Tenney* v. *Johnson*, 43 N. H. 1[illegible] [illegible]61) in this connection.

[26] See *Lin[illegible]*, P. S. 6th ed. p. 338.

[27] [illegible] v. [illegible]*auffer*, 1 P. & W. 198 (1829).

[28] See on [illegible] point J. Parsons' acute—if involved and obscure—criticism [illegible] C. J. Gibson's view.

does James Parsons, inalienable and only extinguished upon payment of the firm obligations, we are presented with the unusual phenomenon of an untransferable right of property. But this is no unknown conception in the common law.[29] If, however, we regard it as property which is untransferable, yet we would admit that it might be capable of surrender and we would probably go further, and say that it always was surrendered—unless stipulated otherwise—so as to pass an unencumbered title.

Still another view is that it springs from the partner's unlimited liability for the reason that if one partner did not have his "equity" another partner might appropriate the firm assets to the payment of his private debts, whereupon the other partner would have to make good the deficiency as to the firm creditors, thus virtually, in case of insolvency by the first partner, having to pay the debts of the bankrupt as well as the firm obligations.[30]

It is submitted that these last two reasons are correct and that with them in mind it is possible to work out a rational theory of the law in harmony with decided cases.

Practical Application of the Theory. When the Partner's Equity is Gone, Joint Creditor's Priority is Gone—not Before.—We have seen above the four elements of the partner's equity and two reasons which may be said to be its foundation, and now proceed to a consideration of all possible cases in which the doctrine can operate as to firm creditors.

Since in the last analysis, then, the joint creditor's priority is a derivative right, it is *a right in rem* or quasi-lien[31] *operative only* through the medium of a personal right belonging to a partner.[32]

Consequently when the partner's personal right is lost the derivative right of the firm creditor is lost also.

[29] Bl. bk. ii, ch. ii,* p. 35. The "spendthrift" trust would be another illustration.

[30] Cf. 1 Bates, Partnership, § 540.

[31] See T. Parsons, Partnership, p. 331, note. Evidently it is not a true lien, since it is not on any *specific* property. v. *Young* v. *Clapp*, 32 N. E. 187 to 190 1st col. (1892).

[32] Cf. J. Parsons; Partnership, 2d ed., pp. 508-11-12.

No doubt there exists, as long as all the original partners remain in the firm, a series of *mutual* equities among the parties.[33]

True it is that these equities are latent and only arise *ex proprio vigore,* in such sort as to give rise to the derivative right of the joint creditor, upon a dissolution of the partnership[34] or in case of bankruptcy.[35] In the language of Lord Eldon,[36] "While they remain solvent and the partnership is going on the joint creditor has no equity against the effects of the partnership."

Suppose A., B. and C. partners. Obviously A. has equities against B. and C. B. has equities against A. and C. C. has equities against A. and B. Consider a simple case: C. sells to X. "all his right, title and interest" in the firm. What is the legal situation? The firm is dissolved. C. having sold out his interest has no further standing[37] in respect to the firm property. But says Sharswood,[38] C.'s rights are not extinguished. He still remains liable indefinitely for the firm debts. Therefore his liability remaining his equity remains and all X. gets is a right to the balance which would have been due C. on an accounting among the partners. The reason however, it is submitted, is not because of C.'s merit, but because the rights of the *other* partners are conserved by their equities. Apparently this preservation of the equities of the remaining partners

[33] "Among partners clear equities subsist, amounting to something like a lien. They have equities to discharge *each of them* from liability and then to divide the surplus according to their properties; or if there is a deficiency to call upon *each other* to make up that deficiency according to their properties." Lord Eldon, *ex parte* Williams, 11 Ves. p. 3 (1805). Cited with approval by Lords Cairns, Hatherly and O'Hagan in *Kendall* v. *Hamilton,* 4 Ap. Cas. pp. 517, 521 and 536 (1879); Story, Partnership, 7th ed., p. 556, note 2.

[34] *Howe* v. *Lawrence,* 9 Cush. 553 to 558 (1852).

[35] Story, P. S., 7th ed., § 361, p. 557; Bates, P. S., vol. i, § 540, *Com. Bank* v. *Wilkins,* 9 Me. 38 (1832); Lindley, P. S., 6th ed., p. 343.

[36] 11 Ves., p. 3 (1805). See Story, P. S., § 358.

[37] *Ex. p.* Fell, 10 Ves. jr. 347 (1805); *Vosper* v. *Krames,* 31 N. J. Eq. 420 (1879); *Jones* v. *Fletcher,* 42 Ark. at p. 449 (1883); *Bivens* v. *Croone,* 2 Head (Tenn.), 339 (1859); *Howe* v. *Lawrence,* 9 Cush. 553 to 558 (1852); *Rogers* v. *Nichols,* 20 Tex. 719, 724 (1858); Bates, P. S., vol. i, § 550.

[38] ... quoted by James Parsons, P. S., 2d ed ...

was not so at the ancient common law as we have seen.[39] Moreover the liability theory depends upon the deeper reason that if the firm debts be not paid out of the firm assets C. will be damaged in his own estate. *But C. has already received an indemnity against loss in this particular.*[40] It is not for him to say if it turn out that he will actually lose by the transaction that he has not been indemnified enough. He has made the bargain and must stand by it.[41] But says James Parsons,[42] "the (partner's) equity [*i. e.*, that portion of it which compels the application of the firm assets to the payment of the firm debts]. . . is not a vendable commodity. No one is interested in buying exemption from a liability to which he is not exposed." Certainly not, but may not a man having a claim release it? That is, in effect, what the retiring partner does. He does not sell it, if you like, but he releases it and it is gone as to him.

As to the joint creditors, they may still work out their priority at any event through A.'s and B.'s equities. There seems, however, to be in the minds of some judges a very different way of looking at the situation. In such a case[43] as the one under consideration, it was held per Sharswood, J., that the joint creditors could indeed have preference—not through A.'s or B.'s rights, but through C.'s right which in the mind of the judge was inextinguishable! It is submitted that the result reached by the decision was right, though for a wrong reason.

And so by a parity of reasoning the joint creditor's priority will be conserved as long as any two of the original partners remain in the firm or as long as one partner remains if there be a separate vendee of the retired partner's interest also. Obviously the vendee is subrogated to the retired partner so far forth[44] and the equities as between the vendee

[39] *Pope* v. *Haman*, Comberbach, p. 217 (1694).

[40] See cases cited T. Parsons, P. S., p. 332, note.

[41] See Story, P. S., § 359 and authorities in note 1.

[42] James Parsons, P. S., pp. 457-58, 2d ed.

[43] *Brenton* v. *Thompson*, 20 L. I., p. 133 (1863), Dist. Court Philadelphia. *Accord, Hobbs* v. *Wilson*, 1 W. Va. 50 (1865), where, however, the preference was put on the basis of an implied promise (!) by the remaining partners to pay firm debts.

[44] An assignee, vendee or mortgagee of the retiring partner's interest

and the remaining partner still exist.[45] What Gibson, C. J., calls "The curious question . . . whether separate purchasers of the shares respectively would stand in the relation of partners, so as to enable the joint creditors to follow the goods,"[46] will be considered later.

It has been suggested, however, that where a partner sells out his interest to two or more remaining partners, what takes place is that the first firm sells out *its* property to the second firm.[47] This it *could* do since the retiring partner is so far agent of the first firm that he may pass a good title to the firm property. If the transaction be really between two firms and *bona fide,* then the *res* of the first firm is no longer subject as such to the lien of the creditors of the first firm. While this is a perfectly possible legal way of looking at the matter, it is submitted that it is highly artificial. The only difference it makes in the rights of all the parties is to exclude the creditors of the first firm and prefer those of the second. The fallacy, however, in this reasoning appears when we consider the status of the partnership after the withdrawal of a member. Either the partnership is dissolved or it is not. If it be dissolved the equities of the remaining partners spring into being instantly and through them the firm creditors can claim priority. Obviously there can be no settlement of the partnership affairs until the firm creditors have been notified of the partner's withdrawal and have had a reasonable time to prove their claims.[48] The

can of his own right maintain a bill for an accounting against the other partners. *Nichol* v. *Stewart,* 36 Ark. 612 (1880); *Miller* v. *Brigham,* 50 Cal., p. 615 (1875); *Fellows* v. *Greenleaf,* 43 N. H. 421 (1862); *Marx* v. *Goodenough,* 16 Ore., 26 S. C., 16 Pac. 918 (1887); *Stimess* v. *Pierce,* 13 R. I. 452 (1881); *Driggs* v. *Morely,* 2 Pinn. (Wis.) 403, S. C. 2 Chand. 59 (1850); *Donaldson* v. *Bank of Cape Fear,* 1 Dev. Eq. (N. C.) 103, 18 Am. Dec. 577 (1827); *4th Natl. Bank* v. *Carrolton R. R .Co.,* 11 Wall. 624 (1870); *Redmayne* v. *Forster,* L. R. 2 Eq. 467 (1866); *Fawcett* v. *Whitehouse,* 1 R. & M. 132 (1829).

[45] "The purchaser would get merely the legal estate of the individual debtor in the particular goods sold, *subject to the rights of the other partners and creditors of the firm,*" per Peters, J., *Fogg* v. *Lawry,* 68 Me. 78 (1878). The italics are mine. See also *Atkins* v. *Saxton,* 77 N. Y. 195 to 199 (1879).

[46] *Doner* v. *Stauffer,* 1 P. & W. (Pa.) p. 198 (1829).

[47] Cf. Story, P. S., 7th ed., chap. xv, pp. 551-52.

[48] Per Brewer, J., in *Birks* v. *French,* 21 Kan. 238 to 242 (1878).

only way in which the firm creditors can instantly lose their priority is that indicated below, where all the partners sell out or where one partner purchases the interests of all the others. If the firm be not dissolved, then the transfer is only a form of words and the firm creditors will still retain priority over all other creditors in caseof a bankruptcy of the firm.

It must be admitted, however, that the distinction contended for in the text, that whether, when a partner sells out to remaining partners, the priority of the creditors of the original firm over the creditors of "the new firm"—to use a convenient form of expression—will be allowed or not, is dependent on what Lord Eldon calls "effluxion of time," is not distinctly made, so far as we are aware, in any of the cases. The cases are decided flatly one way or another, that the priority of the creditors of the old firm are to be preferred or not. The numerical weight of authority inclines to the latter view. But it is submitted that were the point to be established, it would make a convenient touchstone for the solution of this vexatious question. It seems obviously unjust to spirit away the *res* from the creditors of the original firm without their having any chance (as they have when their rights are likely to be lost on sale of all the partners' interests at the instance of separate creditors) to get hold of them. On the other hand it must be said that from a "business" point of view it is probably desirable to permit the "new" firm to deal with the *res* as being unencumbered by anything in the nature of a lien. It is not clear from Lord Eldon's opinions how far the flight of time enters into his decisions in *ex p. Ruffin* and *ex. p. Williams*. In both those cases more than a year from dissolution had elapsed before the contest between the two sets of creditors arose. It seems likely then that the first set of crditors may have been taken to have given up their priority on the partnership property in *specie* and to have looked—if they may be thought to have anticipated loss—to the separate estate of the partners. In this light nice questions would of course arise as to the same creditors of both firms, *i. e.*, those who had dealt with the first firm and who had continued to deal with the second "firm" as if there had been no change. It is believed that the logical view is the one indicated above.

Under any circumstances, where two or more partners remain, the separate creditors would come in last of all, since even as to the first set of firm creditors the equities of the remaining partners would operate to preserve the property for the latter.

Perhaps, since on the firm to firm hypothesis the proceeds of the sale *must* belong to the original firm subject to distribution among the original partners, the joint creditors would still have their "quasi-lien" on the proceeds. As a matter of fact the proceeds never do belong in such a case to the old firm. They go, and it is understood by all parties to be the fact that they go, to the retiring partner. Consequently it has been held that such a transfer is void as to the creditor of the first firm.[49] The court said in effect they would look to the real nature of the transaction and would not allow a mere form of words to do injustice to the creditors of the first firm. It is submitted that the transaction even if *bona fide* might well be in despite of the statute 13 Eliz., Chap V,[50] though nevertheless regarded as a sale by one firm to another.

So far the working of the general theory here propounded is comparatively simple. We have seen that a partner's equity is either dependent upon his interest in the business or upon his unlimited liability. In either case it vanishes *as to him* on a sale by him of his interest, since in the first case his interest is all gone and in the second case he must be taken to have released his claim because he is indemnified so as to cut the reason from beneath his equity. This is tacitly recognized to be the case by conveyancers who, in negotiating a sale of a partner's interest to the remaining partner or partners, frequently require a bond of indemnity to save the retiring partner harmless from the firm debts.[51] The retiring

[49] *Franklin Sugar Ref. Co.* v. *Henderson,* 86 Md. 452 (1897).

[50] "Be it therefore declared . . . that all and every . . . grant, alienation . . . of lands . . . goods and chattels . . . shall be from henceforth deemed and taken (only as against that person or persons . . . whose actions, suits, debts . . . are, shall or might be in any wise disturbed, hindered, delayed or defrauded) to be clearly and utterly void. . . ." Repealed in England, 1865, but in force in Pa. in 1808. See report of Justices, Roberts' Dig. Brit. Stats.

[51] *Ex p. Ruffin,* 6 Ves., p. 119 (1801); *Wilson* v. *Soper,* 13 B. Mon. (Ky.) at p. 414 (1852); Lindley, P. S., 6th ed., p. 345.

partner's equity being gone the joint creditor cannot hope to work out his priority through it. If he retain his preference it is only because another partner, not uniting in himself the entire right to the firm property, remains. As tending to show the soundness of the general conclusions here advanced it may be remarked in passing that it has been held[52] that where there is a "partnership by estoppel," the fact that only one of the associates was an owner of the business will prevent any preference in favor of the creditors of the supposed partnership. Likewise, where by reason of a community of goods no account could be taken, since under the agreement each member could take all he wanted, it was held there being no equity in either partner no derivative right of firm creditors could be said to exist.[52a]

Thus far, it is believed there has been no rational criticism of the actual *results* obtained from the operation of the theory which forms the subject of our thesis.

Consider now the case of a single partner remaining with the entire firm property vested in him.[53] A., B. and C. are partners. A. and B. sell out "all their right, title and interest" to C. The retiring partners having lost their equities the joint ceditor's priority is lost with them. What was once the firm property is now the separate property of C.; that is to say the right *in rem* against the *corpus*, even if it may be said to exist as a metaphysical abstraction, is no longer available to the joint creditors since the personal right to enforce it is lost to the partners. C., therefore, is absolute owner and free to alienate the property in any honest way. An interesting speculation arises here whether in view of the fact that C. is still liable for all the firm debts he may not be said to have a lien on the *corpus* himself and consequently the joint creditors to have their "quasi-lien." In addition to the legal impossibility of a man having a claim as a

[52] *York Co. Banks' Ap.*, 32 Pa. 446 (1859); *Bixler* v. *Kresge*, 169 Pa. 405 (1895).

[52a] *Rice* v. *Barnard*, 20 Vt. 479. (1848).

[53] *Ex p. Ruffin*, 6 Ves. 119 (1801); *Wilson* v. *Soper*, 13 B. Mon. (Ky.) at p. 414 (1852); *Geombel* v. *Arnett*, 100 Ill. 34 (1881); *Trentman* v. *Swartzell*, 85 Ind. 443 (1882); *Bullitt* v. *Chartered Fund*, 26 Pa. 108 (1856).

partner against himself individually,[54] the argument used before becomes pertinent. Namely, that when the only remaining partner sells what was the firm property he is indemnified as to his still remaining liability. However, if the joint creditors be diligent and proceed at once against C. they can attach the *res* in his hands and get execution on it and satisfaction of their entire demand.

Consider now the only other possible case[55] in which the partner's equity and with it the derivative priority of the joint creditors can be lost. This occurs when the interests of all the partners are alienated and it may happen (*a*) when the firm alone is solvent, or (*b*) when some of the partners are insolvent and the firm is solvent, or (*c*) when some of the partners are insolvent and the firm is insolvent, or (*d*) when both partners and firm are solvent.

(*a*) Take the first case. The interests of A., B. and C. are sold out by the sheriff on judgments by separate creditors. We have seen that in C. J. Holt's time the vendees became tenants in common. What becomes of the "equities?" By our hypothesis they become extinguished, since the personal rights upon which they were dependent are lost. This, it is believed, is and has been the common law for more than two centuries. The joint creditors have lost their *preference* and consequently the separate creditors who have been more diligent in getting judgment and execu-

[54] *Falkner* v. *Lowe,* 2 Ex. 595 (1848); *Gorham's Admir.* v. *Meacham's Admr.,* 63 Vt., 231 (1891); *Eastman* v. *Wright,* 6 Pick. (Mass.) 316 (1828).

[55] The case of joint creditors of the partners being able, by virtue of the doctrine here indicated, to retain priority over certain other joint creditors of the *business* of the partners where a prior execution has been issued by the former, is really no exception to the rule. *Hall* v. *Richardson* (N. H.) 20 Atl. 978 (1890); *Saunders* v. *Reilly,* 105 N. Y. 12, s. c. 12 N. E. 170 (1887); *Davis* v. *D. & H. Canal Co.,* 109 N. Y. 47 s. c. 15 N. E. 873 (1888); (*semble*) *Snodgrass Ap.* 13 Pa. 471 (1850); (*semble*) *Hoare* v. *Bank,* 2 Ap. Cas. 589 (1877). Same effect *Couchman* v. *Maupin,* 78 Ky. 33 (1879); *Cits. Bank* v. *Williams,* 128 N. Y. 77, s. c. 28 N. E. 33 (1891); *contra, Bank* v. *Mitchell,* 58 Cal. 42 (1881). What happens is that among several creditors of the partnership the one getting prior execution retains the first lien on *res.* The result is attained thus: the doctrine of firm creditors' priority is for the benefit of a solvent partner. But where there is a contest between creditors of

tion take the proceeds.[56] Nor as between the vendees at sheriff's sale and the joint creditors are the latter in any better position. It cannot be said that they had a lien on the firm property, since in that event no firm could ever give a clear title to a vendee of its property as long as there were creditors of the firm. The result is that, because the partners are bankrupt the firm creditors can recover only what may be had in a scramble for the separate estates of the partners. This is the rule in the United States courts,[57] in Pennsylvania,[58] in Alabama,[59] in Arkansas,[60] in Illinois,[61] in Indiana,[62] in Maryland,[63] in Tennessee,[64] in Kentucky,[65]

the partners as joint obligors and creditors of the partners in respect to firm transactions the reason for the doctrine fails. That is, since the solvent partner is no worse off by reason of the diversion of the *res* from the payment of the partnership debts as such, to the payment of the joint obligation, the priority of the creditor of the firm business will not be allowed. This seems proper, since it is possible for a man to be a partner in more than one enterprise at the same time. Consequently where he is associated with the *same* partner or partners in several distinct ventures the real state of affairs is that the original partnership has been enlarged to include the new venture. Then what happens when a joint obligee gets execution on firm property is that one partnership creditor has secured precedence over another. Ordinarily he will not be disturbed. Very probably, however, this rule would be controlled in bankruptcy. See Bates, P. S., vol. ii § 829, where the subject is regarded from another point of view, but with a similar result.

If on the other hand the joint obligation be regarded as the several obligation of each partner, it would follow as in the case of *Coover's Appeal* that the entire right of each individually having been sold out, the derivative right of the firm creditor would also be lost.

[56] *Doner* v. *Stauffer*, 1 P. & W. 198 (1829); *Coover's Ap.* 29 Pa., p. 9 (1857).

[57] *Case* v. *Beauregard*, 99 U. S. 119 (1878); *Huiskamp* v. *Wagon Co.*, 121 U. S., p. 324 (1886).

[58] *Coover's Ap.* 29 Pa., p. 9 (1857).

[59] *Goldsmith* v. *Eichold*, 94 Ala. 116 (1891).

[60] *Jones* v. *Fletcher*, 42 Ark., p. 450 (1883).

[61] *Goembel* v. *Arnett*, 100 Ill., p. 34 (1881).

[62] *Trentman* v. *Swartzell*, 85 Ind. 443 (1882).

[63] *Griffith* v. *Buck*, 13 Md. 102 and pp. 114-15 (1858).

[64] *Croone* v. *Bivens*, 2 Head, 339 (1859).

[65] *Wilson* v. *Soper*, 13 B. Mon. at p. 414 (1852).

and in England.[66] It is observed, however, that even in so unusual a case as that above the joint creditors are *no worse* off than the separate creditors. Had the former gotten in their execution first they would have had priority.[67]

"The[68] injustice, and it may be said the absurdities, which result from such a view, lead to an inquiry into its correctness. A firm may be perfectly solvent though the members are individually insolvent, yet in such a case the doctrine that the property of the firm is diverted and the equities of the partners and partnership creditors are extinguished, by separate transfers of the individual interests of all the partners' might result not only in an appropriation of all the properties of the firm to the payment of the individual debts, to the entire exclusion of the firm creditors, but to a most unjustifiable sacrifice and waste of such properties. For example, suppose a firm to consist of three members, each having an equal interest and to be possessed of assets to the amount of $300,000, and to owe debts to half that amount, the interest of each partner, supposing their accounts between (*sic*) themselves to be even, is $50,000. The members of the firm are individually indebted. One of them sells his share and receives for it $50,000, which is its actual value. The share of another of the partners is sold out under execution and brings its full value $50,000. Thus far one partner remains and he has an equity to have the firm debts paid. . . . The purchasers of the separate interests are entitled to the surplus only; the joint creditors still have their recourse against the partnership property and the right to levy on such of it as is subject to sale on execution. But before any levy the remaining partner sells out his individual interest, or it is sold out on execution. According to the doctrine applied in the present case and maintained in the case of *Coover's Appeal* (*supra*) the firm property is, by

[66] *Ex p. Ruffin*, 6 Ves. 119 (1801). *Contra Menagh* v. *Whitwell*, 52 N. Y., p. 156 (1873), and *Ross* v. *Henderson*, 77 N. C. 170 (1877). But the authority of this first case must be considered as impaired since the decision of *Davis* v. *D. & H. Canal Co.*, 109 N. Y. 47, S. C. 15 N. E. 873 (1888).

[67] *Ex p. Williams*, 11 Ves. 3 (1805).

[68] Per Rapallo, J., *Menagh* v. *Whitwell*, *supra*.

this last sale, relieved from the partnership debts; the two shares first sold are at once changed from interests in the surplus to shares in the *corpus* of the property, free from the debts, their value is doubled and the fund which should have gone to pay the joint debts is without any consideration (?) appropriated by the transferees of the individual interests of partners."

This last objection as to the wasting of the patners' estate seems hardly to go to the root of the matter. By the very hypothesis the partners are individually bankrupt and as to the $50,000 they *might* have diverted to the payment of firm debts they are no worse off than before. A man who is bankrupt is not damaged by having an additional $50,000 of debts thrown upon him, since he can always take advantage of the bankrupt law and become discharged. In any event he can have an accounting *before sale* on execution.[69] By so doing the only thing to be sold will be the *ascertained* share of the partner against whom execution is issued. This is a very different thing from selling "all his right, title and interest," as in the case put. As has been pointed out the tangle into which the law on this subject has gotten is due to the fact that at common law a partner's *unascertained* interest might be seized and sold. It is unfortunate that this relic has survived.

(*b*) Considering now the second case where the firm is solvent and one or more of the partners is solvent. The solvent partner sells out and the interests of the remaining partners are sold out. As to the joint creditors the result is as before. But how about the "unjustifiable sacrifice" of the solvent partner's interest? He it is true is damaged by becoming liable for the entire firm debt. That being so can he protect himself? Clearly he can by demanding an accounting in the first place instead of selling out. It may be that he is in instant need of the money. He can, of course, mortgage his interest. If he does sell it and subsequently loses by the transaction, as in the case put, how does the matter stand? He has simply sacrificed his property for the

[69] *Nixon* v. *Nash*, 12 O. State, 647, at p. 651 (1861); *Hubbard* v. *Curtis*, 8 Ia. 14 (1859).

sake of ready cash—a thing which happens every day in business; and against which the law cannot relieve.

(*c*) The third case is where some of the partners are solvent and the firm is insolvent. It is conceived that this case is much the same as the foregoing. There is indeed no more reason for seeking to preserve the solvent partner's equity, since he will be liable to some degree in any event. The joint creditor moreover is not quite so badly off.

(*d*) The last case—where the partners and the firm are solvent—is comparatively simple and has already been incidentally discussed. Obviously the loss of the joint creditor's priority is no hardship to him, since he can always get full satisfaction from the partners.

Consider now in the above four cases the position of the vendee of the partner's "right, title and interest." Since the common law permitted the sale of a partner's unascertained share the vendee is *in any event* buying what James Parsons[70] picturesquely calls "a pig in a poke." Whether the fact that "the pig"—to carry out the figure—may double in size over-night is a drawback to the propriety of the sale is not at all obvious.[71] It might very well redound to the advantage of the partner whose share was sold, since the prospect of a purchase becoming more valuable might encourage a vendee to pay a higher price than otherwise.

The body of principles described above is, if not ideally perfect, nevertheless of great practical value.—In the last analysis, therefore, it is seen that the only difficulty found by its critics with Lord Eldon's theory is that it denies the firm creditor *priority*—NOT an equal chance with the separate creditors—only when all the partners' interests have been sold or where one partner has bought all the others' interests. This, it is to be observed, is important only in case of the insolvency of the partners themselves. It is hinted in some of the cases that the above results would give opportunity for fraud in disposing of the partnership assets. But if fraud *were* committed, the whole transaction could be set aside. The fact that fraud *might* be committed is no

[70] James Parsons, Principles of Partnership, 1st ed., p. 288.

[71] See Story, P. S., 7th ed. 261, p. 405.

reason at all. No system of jurisprudence will ever be devised which will eliminate all *possibility* of fraud. As to another matter—the power to prefer creditors under cloak of the doctrine here enounced—it must be borne in mind that until the passage of the National Bankruptcy Act preferences were allowed in the great majority of the United States, as they now are in England.

To sum up then the objections to what Theophilus Parsons[72] calls "Lord Eldon's theory of the quasi-lien of the firm creditors," we find that in two unusual cases the joint creditor is deprived of his priority. We are by no means sure that this is an undesirable result. As C. J. Gibson says,[73] "a preference in favor of joint creditors (is) founded on no merits of their own." *Non constat* that it is to be to the public advantage to have the joint creditors preferred *in any case*. However, they can always protect themselves by getting in an execution first.

It has been shown that the only other possible theory—short of a mere rule of thumb, that joint creditors are to be preferred in all cases—on which firm creditors are to have priority, is absolutely untenable and would bring about confusion worse confounded than that it seeks to avoid.

Conclusion.

One last word, assuming that the statement of the common law given above is correct, in reference to the significance of the historical growth and logical application of the doctrine as a whole.

While it may very well be that if we were preparing a brand new code we would provide that firm creditors should have as against separate creditors a lien upon partnership property, it is difficult to see why this should be done, as they seem adequately protected under the existing law. True it is that if they sleep on their claims they may in two instances lose their priority. But though it may be troublesome they may in those cases secure themselves.

In short, it seems that after much travail the courts have

[72] T. Parsons, P. S., 4th ed., p. 331, note.

[73] *Doner* v. *Stauffer*, 1 P. & W. (Pa.) 198 (1829).

brought forth in response to a demand by the community a doctrine, perhaps not "without speck or blemish," but which answers its purpose *without deranging the rest of the law of partnership.*

The growth of the principles here discussed seems a most instructive example of the manner in which the common law is moulded and shows with what ingenuity courts will labor toward a desired end.

Edmund Bayly Seymour, Jr.