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CRITERIA OF PARTNERSHIP.

ALTHOUGH a distinguished writer discourages any attempt to determine questions of partnership by reference to common principles, yet it will hardly be denied that the tendency of recent adjudications lies unmistakably in that direction. The doctrine of *Grace v. Smith*, 2 W. Bl. 998, affirmed in *Waugh v. Carver*, 2 H. Bl. 235 and in many subsequent decisions, has been emphatically overruled, and the arbitrary notion that a mere participation in the profits of an undertaking or business created a partnership liability as to third persons, has been superseded by the adoption of a new criterion involving the principle of agency: *Cox v. Hickman*, 8 H. L. C. 268; *Bullen v. Sharp*, Law Rep. 1 C. P. 85.

Still, it may be doubted even now, whether these decisions furnish a rule of general application and utility. For if, as Lord WENSLEYDALE observed in *Cox v. Hickman*, "the maxim that he who takes the profits ought to bear the loss, is only the consequence and not the cause why a man is made liable as a partner," it might, at least, with some semblance of reason, be said that the mutual relation of principal and agent results from the fact of partnerships, which is first to be proved, but does not give existence to that fact. "I do not think it proper for us to inquire," said Mr. Justice BLACKBURN in *Bullen v. Sharp*, "whether this rule of law is more or less expedient than the rule laid down in *Waugh v. Carver*. That is a question for the legislature, who

may alter the law as to them seems best." And subsequently the statute 28 & 29 Vict. c. 86 was enacted, sanctioning the *ratio decidendi* of *Cox v. Hickman*, and defining specifically what conditions should be held not to constitute the liability of a partner.

The want of scientific certainty and uniformity in the older resolutions on this subject, is doubtless the result of misdirected inquiry as to the perception of profits, instead of seeking out the actual contract of the parties as the true foundation of their liability. For a contract either express or implied, is in fact the only just criterion, whether we regard the intentions or the legal liability of the parties, and unless the circumstances of the case are such as to warrant the presumption or to prove the fact of an agreement, there can be no obligation because there is really nothing to originate it. A contract being thus the proper subject of investigation, we have no other guidance than that which is furnished by the doctrines of the common law. For, in the language of Mr. Parsons, "as a very large part of commercial business consists in forming and executing contracts which must be governed by the law of contracts generally—and this is a part of the common law—many of the principles applicable to partnership are the same as those which regulate the common transactions of men; and so far the law of partnership may be said to be founded upon the common law."

But is it true that *any* other principles than those which govern contracts generally ought to be applied in seeking to fix upon a person suspected of being a partner, a liability which he has not expressly undertaken? For as early as 1795, in a case where the partners were *known* to the creditor, it was said that "notwithstanding where the person bringing the action has looked to the faith of several partners, who are in business together, and has relied upon their joint credit, though but one only of the partners acted, the proof of the act of one shall charge them all; *yet it must be made out in an action at common law that such debt or contract was joint, before the other partners shall be charged.* For in *assumpsit* against several a joint debt or contract must be proved; otherwise the proof would not correspond with the declaration:" Watson on Part. (ed. 1795), 59; Layfield's Case, 1 Salk. 292; 1 Esp. N. P. 267.

The cases in which the want of some definite and general test is most seriously felt, are those where there is no formal agree-

ment among the parties to be partners, but where they do in fact contract to share a joint or common benefit, and there is a question whether the agreement, such as it is, actually constitutes them partners *inter se*.

In cases of secret, silent, dormant or unknown partners, who agree in the common characteristic of secrecy or concealment in respect to creditors of the firm, the only inquiry is as to the person, and not whether he is a partner or not, for this he is already, *ex hypothesi*.

On the other hand, where a person so acts as to induce the belief that he is already jointly bound with those who seek and obtain the credit, as in the case of nominal, public or ostensible partners, it seems hardly necessary to call in aid the principle of agency in order to determine their liability. For example, if in the firm A., B. and C., A. and B. are acting partners, and C. a mere nominal partner, it would appear that C. is responsible to the partnership creditor, not because A. or B. may have contracted a debt as his agent, but because C., by appearing in the firm, addresses himself directly to the creditor who is thereupon authorized to clothe him with the full character of an original and immediate contractor. He is not a partner merely because A. or B. may subject him to a joint obligation with themselves, but because by knowingly permitting his name to appear in the firm, he thereby expressly constitutes himself a partner, or rather is estopped from denying that he is a partner, and thus *being* a partner any member of the firm may bind him as an agent. Here it is only necessary to prove that he was *knowingly* represented as a member of the firm, without reference to any agreement made with his copartners. But in the case of one suspected of being a partner, the proof is entirely different, and it is not only admissible but necessary to resort to the common law for the means of establishing the fact of partnership, which being done, the law-merchant comes in to supply the consequences of that relation.

Let us endeavor then to ascertain among the doctrines of the common law, the ultimate principle on which the joint liability of joint contractors is founded, and see if it may not be made serviceable in determining the partnership relation in respect to the creditor. For it must be remembered that we are now called upon to prove the fact of partnership, in the

absence of any express agreement to that effect, and perhaps in the face of a denial made under the solemn sanction of an oath. It is therefore requisite to prove a *joint* liability between the party sought to be charged and the party or parties already known to be liable for the debt. And this can be done only by showing that the relations of all the parties to the creditor are identical.

The common law enables us to ascertain this identity of relation by the application of its most familiar elementary principles.

And first there must be a contract.

It may be said generally that wherever the common law gives a remedy for enforcing the payment of money—except in actions *ex delicto*—the right to recover is predicated on the existence of a contract either express or implied. In actions of debt, covenant and assumpsit, it is absolutely indispensable to prove that the parties agreed together either in formal terms or by intendment of law, before the defendant shall be required to disprove the allegations of the plaintiff. And certainly because a man is supposed or charged to be a partner, there is no reason either in law or in justice to subject him to harder conditions than those which obtain in ordinary cases, so as to render him liable on a contract which as to him has no existence either actual or presumptive.

Having established the contract (supposing a consideration proven) the question next in importance is who are answerable for its fulfilment, or rather for damages, in default of its fulfilment, in other words, who are properly defendants to the action? And here it is manifest that no one ought to be made a defendant who was not a party to the contract either in person or by representation lawfully authorized. Where the contract is *express*, there is no difficulty in determining the question; but where it is implied, it is necessary to ascertain where the *legal liability* rests, for where this is found, then the presence of a contract is presumed. But no one can enforce this liability to whom it is not *directly* given, for “it is a general rule that no person can maintain this action (assumpsit) on an agreement to which he is not a party, for in such case there can be no contract express or implied,” 1 Str. 592. Nor is there any magic virtue in the *lex mercatoria*, which can convert a stranger into a party simply because he happens to be called a partner by those whose interest it is to prove that he is such.

The real question then is, did the supposed partner contract

with the partnership creditor? and in the absence of any express agreement, the law will infer a contract from certain facts and circumstances.

When A. at his request, either express or implied, obtains the goods of C. without agreeing as to the price or actually promising to pay it, the law imposes on him the obligation of a contract to pay so much as they are worth, and the ground of his liability is the benefit to himself and the corresponding detriment to C. The same is true if A. and B. obtain goods in a similar manner, each one at common law being liable for the whole debt, with the right of demanding contribution.

But the benefit must move *immediately* from C. to A. or to A. and B., and not through an intermediate interest or title, for otherwise the assumpsit cannot be implied, but must be expressly given. For instance, if A. assumes the responsibility of a debt contracted by B., for B.'s benefit, the law can raise no implied undertaking from A. to the creditor, whatever may be the consideration as between A. and B., but goes so far as to require that the promise shall be in writing. The liability of the guarantor is essentially different from that of the principal debtor, and depends upon a totally different principle. For here in fact are two contracts; the debtor's contract to pay for the goods, and the guarantor's undertaking to pay the debt in default of payment by the principal debtor. As to the contract *to pay for the goods*, there is no privity between the guarantor and the creditor, and the only effect of the statute 29 Car. II. c. 3 is that such collateral agreements are now required to be in writing, in order that the guarantee may be more readily proven, but it does not merge the two contracts into one.

So if A. purchases goods on credit and then gives or sells them to B., although the latter has the use and benefit of the property so obtained, yet the creditor cannot go around his immediate debtor and charge the debt upon a stranger, because here is an intermediate title or ownership, and there is *ex vi terminorum*, no privity and consequently no contract between the stranger and the creditor.

The ground of the implied contract is therefore the benefit drawn *directly* from the use of the goods or property purchased, which property has been received *immediately* from the creditor in such a manner as to create a privity of relationship between

the debtor and himself; and what is true of one, holds equally good of any number of debtors.

This general reasoning is applicable to all cases of supposed partnership, where an attempt is made to extend the liability beyond its ostensible limits. The problem with the defence is to fix the point at which the liability ceases, for it must cease when no contract can be legally presumed or proven to exist, and if it can be shown to fall short of the person sought to be charged by being intercepted in some intermediate party, it follows necessarily that the former cannot be affected by it.

A *community* of interest in the profits of a joint undertaking or business is said to be essential to the existence of a partnership; but this is true only so far as the manner in which the profits are taken serves to evidence and explain the contract between the parties. Profits being therefore the proper subject of partnership property, it is only requisite to inquire into the mode of participation, in order to determine whether the party interested is a partner or not. Suppose C. is suspected of being a partner with A. and B., by what proof is the fact established? A mere participation in the profits is not alone sufficient to charge him, for the *mode* of participation may be such as to prove directly the contrary. It must be shown that the supposed partner is in the same relation to the creditor that the known partners are; that is, they must all be immediate debtors to the partnership-creditor for a joint benefit conferred simultaneously and directly upon them by the creditor. A. and B. are liable because they have received a benefit directly from the use of the creditor's property; and inasmuch as it is a joint benefit derived from a joint use and disposition of that property, the law attaches to them the joint liability of partners which, *ex hypothesi*, they have expressly assumed. Hence if C. can be shown to have a similar interest in the profits and thereby to sustain a similar relation to the creditor, it follows, as a matter of course, that he is liable in the same manner and to the same extent as the other partners are, and is himself a partner. In other words, the supposed partner must have the same privity of relation to the creditor that all the other partners have. And hence instead of saying "that he who shares in profits indefinitely, is liable as a partner to creditors, *because he takes from that fund which is the proper security to them for the payment of their debts*;" it seems more accurate to say—*be-*

cause by having in the profits an interest similar in character to that of the other partner or partners, he has enjoyed a benefit conferred directly upon him by the creditor, and thereby through an implied contract, becomes as much his debtor, as the party or parties already known to be so indebted.

How, then, is this privity to be ascertained? We answer—by showing that the profits are derived from a joint benefit moving *immediately* from the creditor to all the parties to be charged; or what is the same thing, by proving that the interest of the party who ostensibly receives and the interest of the party who actually shares the benefit or profits, are homogeneous;* that is, subsisting in the same right and in the same subject-matter. Otherwise the contract cannot be presumed as between the supposed partner and the partnership-creditor.

The view here taken justifies the reasoning of Lord ELDON in *Ex parte Hamper*, 17 Ves. 404, where he makes a distinction between a stipulation for a proportion of the profits as a compensation for labor, skill or services, and an agreement to receive a sum of money equal to such a proportion of the profits and actually paid out of them; holding that the former constituted a partnership and the latter did not. And the distinction is obvious notwithstanding Mr. Justice BRAMWELL thought there was no "difference except in words, at least so far as creditors are concerned:" *Bullen v. Sharp, ubi sup.* 126. The real difference consists in the different legal consequences of the two contracts. Where the agreement is to receive a proportion of the profits in consideration of services, these latter are to be regarded as component parts of the partnership stock belonging to, and being under the control of the firm, and the party who contributes them is thereby made a partner, in the absence of any special restriction to the contrary. While he labors to produce profits for others, he is at the same time producing them for himself and thus he has the same interest in his own services, as if he contributed only *money* to the partnership stock and bore his share of the expense which the firm would have to incur if it employed

¹ The words *homogeneous* and *homogeneity* strike us as far more accurate and convenient expressions for indicating the interest of partners than the words *common* and *community*, which are usually employed for that purpose. This may have been the idea of Mr. Parsons when he said "the distinction taken is between different *kinds* of interests in or claims upon profits:" Pars. Part. 75, in note.

the labors of a hired servant, instead of his own. Moreover he derives his interest directly from the joint use of the partnership stock and is therefore an *immediate* debtor to the partnership creditor. But where it is expressly agreed that a sum of money *equal* to a proportion of the profits shall be paid as a *reward* for services, the very words forbid the supposition of a partnership and merely provide a contingent measurement for the compensation to be paid, the payee not sharing the direct use and control of the partnership property, but receiving his interest through an intermediate party in whom the *ownership* had previously vested. And here we have an illustration of Mr. Parsons' favorite criterion of "ownership in the profits before they are divided" deduced from a rule which he himself denies.

But our conclusion as to the necessity of *homogeneity* in the interests of the parties as above explained, in order to create the partnership relation as to third persons as well as *inter se*, is only the ultimate development of the reasoning upon which the case of *Cox v. Hickman* was decided. That case was substantially as follows: a manufacturing concern being heavily indebted conveyed all their property to trustees to carry on the business and out of the profits to pay off the debts. The trustees, in process of time, became involved, and *their* creditors attempted to fix a joint liability with the trustees upon the other creditors because they received the profits. But every consideration of common sense and common justice plainly urged the repudiation of a rule which led to so absurd a consequence, and the court realizing the necessity of finding some escape from its extravagant conclusions, boldly renounced and attacked the rule itself, holding that inasmuch as the trustees could not be regarded technically as the *agents* of the first creditors in contracting the subsequent liabilities, no partnership existed between them.

The necessity of founding the partnership liability upon a *direct and immediate contract* with the creditor, is thus distinctly recognised. The party to be charged *must* be shown to have made a contract, and if it does not appear that he contracted in person, the next inquiry naturally and logically is, did he make the contract through an agent? If neither, then he is not liable as a partner.

So there must be an *identity of relation* between the supposed partners in respect to the creditor, and hence the newly adopted

rule requires that the relation of principal and agent shall be *mutual*, so that the contract of one shall be the contract of both.

Whether the party actually contracting should be regarded as an agent *quoad hoc* is a question not more easily answered in many cases than the question of partnership itself, and herein, if anywhere, the insufficiency of the rule is exposed.

Reasoning upon the principles which we have contended for above, in their application to the case in question, it would appear that the relation of the *first* creditors and that of the trustees to the *subsequent* creditors were entirely different, and the difference is too obvious to be specifically pointed out. The legal title and actual ownership of the profits was in the trustees intervening between them and the first creditors, and so the legal ownership of the profits was likewise in the trustees, before they were actually paid over to the beneficiaries under the deed. There was no immediate relation or privity, and consequently no contract between the first and second creditors because the benefit conferred by the subsequent creditors did not move *directly* but *mediately* through the trustees, to the former creditors. The interest of the first creditors and that of the trustees not being homogeneous, the relation of partnership did not exist between them.

As a matter of course, many of the old adjudications will be found erroneous in the light of these later decisions, but it is useless to go into a consideration of them. Mr. Parsons, after citing numerous cases, admits the very manifest "difficulty, if not impossibility, of drawing from the decisions any definite principle, or rule applicable with certainty to the question, who are partners as to third persons?"

All the cases where there is no express contract of partnership among the parties, may be reduced to the following formula:—

A contract between A. and B., C., having a legal claim against A., assumes that B. is subject to the same liability by reason of his contract with A. :

In construing the agreement between A. and B., the real question is, whether or not it raises the presumption of a contract between B. and C. According to the rule of *Cox v. Hickman*, it must appear that A. was the agent of B. in contracting the debt to C., and the agency is sufficiently proven by showing that the trade carried on by A. was in fact carried on in behalf of A. and

B. We think the proposition is better stated thus:—A. being indebted to C. for a benefit moving directly and simultaneously from C. to A. and B., the same cause which makes A. a debtor necessarily makes B. a debtor also, and therefore they are partners.

In *Hesketh v. Blanchard*, 4 East 144, Lord ELLENBOROUGH held, in accordance with the prevailing doctrines on the subject, that a man might be a partner as to third persons, though so far from being a partner with his immediate contractor, that he might bring an action against him on their contract. This class of cases is thus disposed of by BRAMWELL, J., in *Bullen v. Sharp, ubi sup.* 124:—"Partnership means a certain relation between two parties. How, then, can it be correct to say that A. and B. are not in partnership as between themselves, they have not held themselves out as being so, and yet a third person has a right to say they are so as relates to him? But that must mean *inter se*, for partnership is a relation *inter se*, and the word cannot be used except to signify that relation." Now the "relation *inter se*" must always depend upon the contract *inter se*, and this must place the parties in the same relation to the creditor, for otherwise A.'s contract with C. cannot be B.'s contract with C.

There is a class of cases where the contract between A. and B. (adopting the foregoing formula) is one of bargain and sale, and the stipulation for profits is only intended to designate a mode of paying the price. The case of the bargain for a house* stated by Mr. Parsons is one of this kind, and shows to what extravagant lengths the rule of *Waugh v. Carver* may be carried. The idea of a partnership between A. and B. on such a contract as this, we venture to say, would never have entered any reasonable mind that was not misled and prejudiced by the unwarranted significance which the word *profits* gradually acquired on the authority of judicial interpretation.

The case of *Barry v. Nesham*, 6 C. B. 641, may be cited as

* If two men were bargaining for a house and the seller says your business is so prosperous, you can afford to pay me all I ask; and the buyer replies, you mistake, the profits of my business are not so large as you think; and the seller rejoins, well, I will, at all events, take one-fourth of your next year's profits for the house, and a written contract is executed on these terms, it would be simply absurd to contend that this sale of a house made the seller liable for all the business debts of the buyer: Pars. on Part. 71.

an illustration, and the following arrangement will simplify the meaning of the contract.

1. There was a sale of a newspaper by B. to A. for 1500*l.*, payable in seven annual instalments; 2. B. guaranteed A. a clear annual profit of 150*l.*; 3. A. agreed in consideration thereof to pay B. all the profits in excess of the 150*l.*, until they reached the sum of 500*l.*; 4. If the surplus profits should amount to 500*l.* during the seven years the instalments had to run, then A. agreed to pay in addition to what he had already promised, the existing liabilities of the paper, not exceeding 250*l.*; 5. B. should receive such surplus profits only until they amounted to 500*l.*; 6. A. might pay off all the purchase-money, assume all the liabilities of the paper, and become entitled to all the profits at any time; 7. B. might withdraw his guaranty of 150*l.* at any time.

The question was whether B. was liable as a partner for goods supplied to the newspaper on A.'s order, and the court held that he was, on the ground that he was still the *owner of the paper*, and *participated in the profits*, as stated in the opinion of MAULE, J.

Now, if B. continued to own the paper there can be no doubt of his liability for its debts; but whether as a partner or not, is another question. For if there was no sale, A. was in fact nothing more than a "salaried agent receiving a definite sum out of the profits as a compensation for services, and in this case he could have no interest in the surplus profits. But it seems that there *was* a sale, that all the subsequent stipulations had reference only to the mode of payment, and that the surplus profits did actually go to help pay what A. owed B. Nor was payment confined to profits alone, for A. might at any time have paid the whole price and become entitled to all the profits, or B. might have withdrawn the guarantee, and in either case there would have remained a simple undisguised contract of bargain and sale. It was not even a conditional sale, for B. retained no ownership in or claim upon the newspaper, nor was there a provision that he should take it back in any contingency.

If he was a partner then, it was because of the agreement that a third of the debt (500*l.*) might *possibly* be paid out of profits, and we say possibly, for this part of the agreement might have been rescinded. Was the mode of participation viewed in connection with all the circumstances, such as to constitute a partnership between A. and B.? We conclude that it was not,

and we do so with the less hesitation because the decision of this case was expressly founded on the principle of *Waugh v. Carver*. WIGHTMAN, J., in *Cox v. Hickman*, said: "I greatly doubt whether the creditor who merely obtains payment of a debt incurred in the business by being paid the exact amount of his debt and no more, out of the profits of the business, can be said to share the profits;" and the proposition that if one "limits his claim to be paid out of profits only, his limited right to payment creates an unlimited liability" was pronounced by POLLOCK, C. B., in another case, "unjust, absurd and at variance with natural equity." These *dicta* seem to settle the rule which governs such cases. Here B. was in fact a creditor, not of the supposed firm, but of A. individually; the debt was not even "incurred in," but was preliminary to, the business, and the application of profits being for the payment of an existing debt, there was not such a participation as to establish the relation of partners, between A. and B.

Applying our own reasoning to the case, it appears that the interests of the parties in the profits were not homogeneous, for all the profits belonged primarily and exclusively to A., as the fruit of his own capital and labor. B.'s interest in the profits—if he can be said to have an interest therein—was the result of a distinct and independent contract with A. and not of any implied contract with A.'s creditor. Under the existing agreement B. had no lien on the profits, but only a right of action against A. for so much as they were worth; consequently these interests did not subsist in the same right or necessarily in the same subject-matter, and therefore there was no partnership between them.

There is a class of cases where the contract between A. and B. is continuous on both sides and contains a provision for the continued payment of profits. Here, as in other cases, the relation of the parties must be gathered from the whole contract, and not postulated by mere force of the word *profits*.

In *Ex parte Langdale*, 18 Ves. 300 (in terms of the formula), it appears that A., the bankrupt, had kept a canteen, and that B. was a manufacturer of beer. The statements of the parties were conflicting: A. represented that half his shop-rent was paid by B. in consideration of A.'s paying him 17s. per barrel of beer out of the profits. B. stated that he paid half the shop-rent and A. in consideration thereof paid him 4l. 5s. per barrel for beer,