

Notes

THE INTENTION THEORY IN PARTNERSHIP LIABILITY IN MISSOURI

In the case of *Strickland Printing and Stationery Co. v. Chenot*,¹ one Dodson had purchased stationery supplies from the plaintiff, and in default of payment therefor, the plaintiff brought suit on account against the defendants as partners *inter sese*. He produced a contract between the various defendants reciting that Dodson, as principal, desired to share profits with his salesmen as associates. The contract allocated the various units of profits among the principal and the associates; it provided also for an advisory board which would concern itself with the policies of the business and the possible sales commissions. The contract further provided for the establishment of a sinking fund to be set apart from the net or overriding commissions against which the losses of the enterprise were to be charged. The court held for the defendants, denying the existence of a partnership on the ground that from a consideration of the whole contract, there was no intention to share losses or to form a partnership. Apart from this holding, which will be the subject of later discussion, the case reiterates what is now a general and well-established doctrine, namely, that a sharing of profits is only presumptive evidence of the existence of a partnership and is no longer the determinative test.²

In 1775 the English case of *Grace v. Smith*³ announced as a positive rule that all those persons who shared the profits of a business were liable as partners in that business, regardless of whether as between themselves a partnership was contracted for, or even regardless of whether the creditors of the enterprise had relied upon an apparent partnership relation. As stated in *Waugh v. Carver*⁴ eighteen years later, the basis for the decision was the belief that by taking a part of the profits, one takes from the creditors a part of that fund which is the security for the payment of their debts. That this reasoning is utterly unwarranted is very positively brought out in *Eastman v. Clark*,⁵

¹ (Mo. 1932) 45 S. W. (2d) 937.

² *Philips v. Samuels* (1882) 76 Mo. 657; *In re Whitlaw's Estate* (1914) 184 Mo. App. 229, 167 S. W. 463; *Meehan v. Valentine* (1891) 145 U. S. 611, 12 S. Ct. 972; Bates, *PARTNERSHIP* (1888) secs. 15, 23, 47; Uniform Partnership Act, sec. 7, subd. 4.

³ 2 W. Bl. 998, 96 Eng. Repr. 587.

⁴ (1793) 2 H. Bl. 235, 126 Eng. Repr. 525.

⁵ (1872) 53 N. H. 276. For a cogent display of the power of this opinion see, 1 Rowley, *PARTNERSHIP* (1916) sec. 57.

which has become a leading case by reason of its condemnation of the profit-sharing test as the conclusive determinant of the existence of a partnership. The primary basis for the rule in *Waugh v. Carver* was the desire to retain intact the profits of the business in order to secure more fully to the creditors the payment of the debts owed to them, relying on the assumption that creditors normally expect payment from the profits. This assumption cannot be justified, for the profits consist of capital remaining after liabilities are paid and not before. The sharing of profits presupposes the prior satisfaction of creditors. The fund to which a creditor looks for satisfaction lies rather in the assets of a business and its capital, and it is upon these assets that the solidity of a business depends. Quite often a business realizes no profits; in such a situation the creditors would look to a non-existent fund for payment. Nevertheless, the rule in these cases was followed to a considerable extent by American courts,⁶ and until 1860 this was the one test almost universally applied for the purpose of determining the existence of a partnership.

In 1860, however, the English case of *Cox v. Hickman*⁷ repudiated the test of profit-sharing as conclusive evidence of a partnership, and placed liability on the ground of mutual agency—"but the real ground of liability is that the trade has been carried on by persons acting in his behalf." In the United States, the case of *Cox v. Hickman* has been quite generally followed, so far as it repudiates the profit-sharing test.⁸ And sharing in profits is now most generally recognized as establishing only a prima facie case, that is, it is presumptive evidence of the existence of a partnership,⁹ which may however be rebutted by the absence of various other elements which are yet to be considered.

In at least one state, however, the sharing of profits except as payment for services, is conclusive evidence of partnership.¹⁰

⁶ Mechem, PARTNERSHIP (1920) 79; Oppenheimer v. Clemmons (1883) 18 F. 886; Parker v. Caufield (1870) 37 Conn. 250, 9 Am. Rep. 320; Hubbell v. Woolf (1860) 15 Ind. 204; Pratt v. Langdon (1867) 97 Mass. 97, 93 Am. Dec. 61; Dob v. Halsey (N. Y. 1819) 16 Johns. 34, 8 Am. Dec. 293.

⁷ 8 H. L. Cas. 268, 11 Eng. Repr. 431. For affirmation of this doctrine see, Bullen v. Sharp (1865) L. R. 1 C. P. 86, 144 Eng. Repr. 583; (1923) 36 HARV. L. REV. 1016.

⁸ Berthold v. Goldsmith (1861) 24 How. 536; Cadahy Packing Co. v. Hibon (1908) 92 Miss. 234, 46 So. 73, 18 L. R. A. (N. S.) 975; Wade v. Hornaday (1914) 92 Kans. 293, 140 Pac. 870; (1888) 2 HARV. L. REV. 180 (sharing of profits is only evidence, as any other evidence, that the transaction is to be judged as a whole). Jones v. Bruce (Mo. App. 1919) 211 S. W. 692; Whittling v. Schreiber (Mo. App. 1918) 202 S. W. 418.

⁹ See authorities cited in n. 2 above.

¹⁰ Dilley v. Albright (1898) 19 Tex. Civ. App. 487, 48 S. W. 548.

It has been said that the Texas case of *Thompson v. Schmitt*¹¹ "marks a recrudescence at a very late day of the old discredited profit-sharing test of the existence of a partnership."¹² The court selects the test of profit-sharing in accord with a policy which insists either upon liability, or association in accordance with statutory regulation, and on this ground practically refuses to recognize the business trust as a method of attaining limited liability.

With the practical abolition of this so-called partnership as to third persons, the field of partnership became quite generally divided into two great types, first, the partnership *inter sese*, the true and real partnership, and, second, the partnership by estoppel, which is not in fact a partnership, but a liability enforced under the doctrine of estoppel for the sake of those who, in their dealings with the members associated together, relied on the appearance of a partnership. The latter is a class with which this paper is not particularly concerned; the tests by which the former, the real partnership, is established are however to be considered.

Partnership in this sense is the result of an agreement, expressed or implied, to join in a common enterprise; it is a voluntary association of persons, and it is this volitional element in the formation of the contract of association which leads the courts to a consideration of intention as the controlling factor. It is perhaps unfortunate that it has not always been stated that the consideration of intention in finding a partnership is merely a corollary to the principles governing the construction of agreements as was done in *Polk v. Buchanan*.¹³ It is the legal intention as displayed by the contract, or in the absence of an express agreement, as displayed by the surrounding facts and circumstances, rather than the expressed or actual intention that governs. This is founded upon the rule of construction that the parties intend the legal consequences of their voluntary acts. "Greater effect may be given, however, to the expressed intentions of the parties when the question arises between themselves only, than where third persons are concerned."¹⁴ But the legal effect of the contract is the controlling factor.¹⁵ The name which the partners apply to themselves, the title which they af-

¹¹ (1925) 115 Tex. 53, 274 S. W. 554.

¹² (1925) 39 HARV. L. REV. 276.

¹³ (Tenn. 1857) 5 Sneed 721.

¹⁴ Mechem, *op. cit.* 65.

¹⁵ *Illinois Malleable Iron Co. v. Reed* (1897) 102 Iowa 538, 71 N. W. 423; *Bradley v. Ely* (1900) 24 Ind. App. 2, 56 N. E. 44; *Wade v. Hornaday* (1914) 92 Kans. 293, 140 Pac. 870; *Magovern v. Robertson* (1889) 111 N. Y. 61, 22 N. E. 398; *Stewart v. Stovall* (1921) 191 Ky. 508, 230 S. W. 929.

fix is not conclusive, and an express agreement that they should not be partners is inoperative if the contract in law constitutes a partnership.¹⁶ Likewise, although the parties especially term themselves partners, if the contract in law does not create a partnership relationship, they are not partners.¹⁷ But, having found the existence of a contract, and the meaning of its terms, the courts must then employ certain tell-tale sign-posts which point either to or from a partnership status. The question is, what constitutes a given relationship a partnership *inter sese* in law? In answer to it there are several criteria which are generally applied.

One of the foremost of these is the profit-sharing element discussed above. But as was suggested, it is only evidence, and at the most presumptive evidence that a partnership was contracted for; the profits must be received as profits,¹⁸ not as compensation for services,¹⁹ nor as rental,²⁰ nor as interest on a loan.²¹

A case in Iowa²² held the sharing of losses to be indispensable. There is variation among the states as to the necessity of a loss-sharing provision. Missouri is among those states which hold that an agreement for the sharing of both profits and losses does not necessarily constitute a partnership.²³ It is generally held that the sharing of profits implies an agreement to share losses in the absence of any express stipulation.²⁴ Even though the parties do stipulate against losses, a partnership may nevertheless exist, if other elements are present, although as between the parties the stipulation against the sharing of losses may be enforced.²⁵

Another very important test or criterion has been termed the mutual-agency test. As stated by Justice Cooley in *Beecher v. Bush*,²⁶ the elements are, "community of interest in some lawful

¹⁶ *Beecher v. Bush* (1881) 45 Mich. 188, 7 N. W. 785, 40 Am. Rep. 465; *Martin v. Peyton* (1927) 220 N. Y. S. 29 and comment thereon (1927) 2 ALA. L. J. 193.

¹⁷ *Sailors v. Nixon-Jones Co.* (1886) 20 Ill. App. 509; *Oliver v. Gray* (1842) 4 Ark. 425.

¹⁸ *Wagner v. Buttles* (1913) 151 Wis. 668, 139 N. W. 425.

¹⁹ *Cassidy v. Hall* (1884) 97 N. Y. 159.

²⁰ *Weiland v. Sell* (1910) 83 Kan. 229, 109 Pac. 771.

²¹ *Foley v. McKinley* (1911) 114 Minn. 271, 131 N. W. 316. See also U. P. A. sec. 7, subd. 4, for exceptions to the rule which raises a presumption of the existence of a partnership upon a sharing of the profits.

²² *Haswell v. Standring* (1911) 152 Iowa 291, 132 N. W. 417.

²³ *Ellis v. Brand* (1913) 176 Mo. App. 383, 158 S. W. 705.

²⁴ *Whitley v. Bradley* (1910) 13 Col. App. 720, 110 Pac. 596. See statute to same effect in Alabama, Ala. Civ. Code (1923) sec. 9372.

²⁵ *Mechem, op. cit.* 73.

²⁶ (1881) 45 Mich. 188, 7 N. W. 783.

commerce or business, for the conduct of which, the parties are mutually principals of and agents for each other, with general powers within the scope of business, which powers, however, by agreement between the parties themselves, may be restricted at option to the extent even of making one the sole agent of the others and of the business." This was assigned as the ground for liability in *Cox v. Hickman*, and accepted and re-enforced in a leading Ohio case, *Harvey v. Childs*²⁷; therefore the true test of partnership is left to be that of the relation of the parties as principal and agent. This test, however, has, it seems, obvious logical defects. Partnership is not the creature of mutual agency, rather it is the creator. Mutual agency follows from the establishment of a partnership as an incident thereof. It is not the cause for the existence of a partnership status; it is a result. "Such a test seems to give a synonym rather than a definition; another name for the conclusion, rather than a statement of the premises from which the conclusion is to be drawn."²⁸ "Mutual agency is not a test of partnership, because the existence of such a relation is the very question in issue."²⁹ Besides, mutual agency is not conclusive from the existence of a partnership, since it does not always result, nor does a partnership always result from a mutual agency, for mutual agencies are not necessarily partnerships.

Another consideration which may become important in the quest for the legal intention is common ownership of property. Such ownership is a normal incident of the partnership set-up, and hence evidence of the existence of one; but it is not entitled to any decisive weight since both co-tenancy and joint tenancy do not depend necessarily upon consent and inter-party contract, and hence the necessary and essential voluntary element in an association as partners might be absent, and thus preclude the presence of the partnership condition. Where, however, co-owners of property use such property in carrying on a joint business, they become partners.³⁰ The endeavor must be an enterprise, a business, not merely an agreement to do a piece of work, or a single, independent act.³¹

Thus, it is seen that no one of the tests referred to is, nor can be, conclusive in itself. It is merely persuasive as evidence of the legal intention to form a partnership relation which is in its essence a joining as co-owners, or principals, in carrying on a business for profit. At least these elements are contained in

²⁷ (1876) 28 Ohio St. 319, 22 Am. Rep. 387.

²⁸ *Meehan v. Valentine* (1892) 145 U. S. 611, 12 S. Ct. 972.

²⁹ *Boreing v. Wilson* (1908) 128 Ky. 14, 108 S. W. 914.

³⁰ Gilmore, PARTNERSHIP (1911) sec. 13.

³¹ *Ibid.* sec. 14.

every workable definition,³² and they are entirely compatible with the test defined by the Uniform Partnership Act.³³

An interesting theory which Mr. Douglas in his article, *Vicarious Liability and Administration of Risk*,³⁴ favors as most capable of reconciling the multitude of varying decisions, is called the entrepreneur theory of liability or co-enterpriser's partnership liability. This theory has not been articulated by the courts, but a short review of it might prove profitable. It is founded on the idea that losses or liabilities are merely cost items in the conduct of a business, and consequently the consumer of the product should and would ultimately pay them. In any case, therefore, where the consumer would bear the brunt of these cost-items, there exists an enterprise, managed and owned by enterprisers. If there are co-enterprisers engaged in the business, they are partners. The test in establishing whether the parties are enterprisers is fourfold: (1) Control—or the ability to make and execute decisions governing the functions of the business; (2) Ownership—legal or equitable title to property used in the production process; (3) Profit-sharing—in the net income of the business; (4) Losses—the money or property staked in the enterprise. Now, there must be a voluntary agreement entered into by the parties which allocates these four factors. If the parties to the agreement each possess the majority of the four ear-marks, there is a partnership, for they are then co-enterprisers. If but two of these qualities are present, the party bearing the burden of proof fails to establish his case, and there is no partnership. Mr. Douglas emphasizes the necessity of the control and profit-sharing ear-marks, claiming that without either of these, the capacity to distribute losses among the consumers cannot exist.³⁵

From this summary consideration of the tests before referred to, it is clear that the various factors are only collectively determinative. And the legal intention of the parties is important only insofar as these factors are present or absent. References to intention must be understood to mean the legal effect of the contract and conduct of the parties, in other words, a mere juristic extension of the volitional element necessary in associating parties together as partners.

It is at this point that the principal case, *Strickland Co. v. Chenot*, diverges from the well-accepted doctrines, at least in

³² Mechem. *op. cit.* sec. 1, Gilmore, *op. cit.* sec. 1 and footnotes.

³³ U. P. A. sec. 6. "A partnership is an association of two or more persons to carry on as co-owners a business for profit."

³⁴ Douglas, *Vicarious Liability and Administration of Risk* II (1929) 38 YALE L. J. 720. *Malvern Natl. Bank v. Halliday* (1923) 195 Iowa 734, 192 N. W. 843.

³⁵ *Ibid.* See also (1929) 38 YALE L. J. 1152.

phraseology. Missouri cases have in the past relied on the intention test as an important one, and have constantly laid stress on its efficacy as a controlling factor, intention, nevertheless, being limited to legal effect, and not to the actual state of mind of the parties.³⁶ But in 1922, the case of *National Bank of Commerce v. Francis*³⁷ was decided. That case was an action by a national bank on the notes of a construction company, organized by the first mortgage bondholders of a railroad company. These bondholders had agreed to foreclose, and had purchased the railroad property at the foreclosure sale through a reorganization committee which they appointed. The plaintiff proceeded on the theory that the construction company was a dummy corporation acting as the agent of the bondholders as partners *inter sese*. The reorganization agreement gave the committee power to borrow money for specified purposes, and stipulated that the bondholders were not partners, and that liability was limited to the assets of the business, that is, the subscribers were to be liable only to the extent of their shares. The subscribers were to receive the profits through the committee. The committee was empowered to sell the property for certain purposes subject to the approval of the majority of the subscribers, and further, a majority of the subscribers might change the powers of the committee. The notes which were sued upon were, however, specially limited to the securities pledged for payment thereof. The court held that there was no partnership, saying that although there was an agreement to share profits, the parties must also have agreed and intended to share losses and become partners. And because there is no "single syllable" in the document contemplating that the defendants were to be liable for the losses, or intended to become partners, they cannot be partners. It seems evident from the authorities cited by the court, that it believed its decision to be in entire accord with the general law. It is submitted that this decision is out of line with the precepts hereinbefore established insofar as partnership law is concerned. The result reached is entirely justifiable on the ground that the powers of contract are wide, and by invoking this contractual power, parties may limit their liability to a particular fund; so, a stipulation in the particular notes, specially limiting payment to particular property may be effective and enforceable. But the dicta in reference to partnership, and the unnecessary decision

³⁶ *Hindeman v. Secoy* (Mo. App. 1920) 218 S. W. 416; *Ellis v. Brand* (1913) 176 Mo. App. 383, 158 S. W. 705; *Graf Distilling Co. v. Wilson* (1913) 172 Mo. App. 612, 156 S. W. 23; *Sawyer v. Burris* (1909) 141 Mo. App. 318, 121 S. W. 321; *Allen v. Coglizer* (Mo. App. 1919) 208 S. W. 102; *In Re Whitlow's Estate* (1914) 184 Mo. App. 229, 167 S. W. 463; *Jones v. Bruce* (Mo. App. 1919) 211 S. W. 692.

³⁷ 296 Mo. 169, 246 S. W. 326.

that there was no partnership here is not justifiable. There was here a sharing of profits, establishing a prima facie case, and from the spirit of the contract it is clear that the subscribers were to receive the profits, not as creditors, but as owners and operators; there was a co-ownership of property which is persuasive; there was an element of control in the subscribers which would normally be sufficient to prevent the formation of a business trust.³⁸ There was, however, an express agreement negating the loss-sharing element, and an express refusal to become liable as partners. As has been seen above, unwillingness to share losses is of no consequence as against third persons, if the other elements of a partnership are present. Sharing of losses is more of an incident of partnership than a test for its existence. Few people would willingly contract to be individually liable in so huge an undertaking. Nor is it necessary under the prevailing law that the parties consciously intend to become parties; if the result and effect of the contract is to make them partners, partners they are,³⁹ for parties intend the legal-consequences of their voluntary acts, and if the legal consequences unite in assuming the shape of a partnership status, the parties are partners. Here, then, there was an adoption, probably unaware, of a doctrine that is not justifiable in law. It is unfortunate that it has been repeated since by the Missouri court.

In *Darling v. Buddy*,⁴⁰ suit was brought for an accounting and contribution by the defendants as partners for judgments paid by the plaintiff. Under an agreement, the entire capital stock of a railway was to be vested in five syndicate managers who were to hold title, borrow money, manage the business in their sound discretion, and in general, to have complete control; the subscribers were to share in the profits according to the amount of their contributions, and in the losses in proportion to their subscriptions. There was expressed an intention not to be partners. The court held that they were not partners, applying the test of *National Bank of Commerce v. Francis*, saying that there must be, besides an agreement to share profits, an agreement to share losses and become partners, thus repudiating the general course of decisions to the effect that the test is a sharing of profits as co-owners or principals, in order to foster the illegitimate infant-child of the *Francis* case.

Here again, the application of the loss-sharing and expressed intention test was superfluous. The subscribers had no voice

³⁸ *Hoadley v. City Commissioners of Boston* (1870) 105 Mass. 519.

³⁹ "Partnership is a status, and may exist by reason of the terms of the agreement, although the parties thereto incorporate therein a declaration to the contrary," (1927) 2 ALA. L. J. 193. *Green v. Whaley* (1917) 271 Mo. 136, 197 S. W. 355.

⁴⁰ (1927) 318 Mo. 784, 1 S. W. (2d) 163.

whatsoever, in the management of the enterprise. All title to the property, and all control, were centered in the five managers. The subscribers merely shared in the profits. This set-up comprises a clear business trust. A case in Arkansas⁴¹ with similar facts, held outright that this situation presented a common-law business trust, with the trustees liable fully, but the *cestuis* liable only to the extent of their subscriptions.

In a 1928 Missouri case,⁴² a man and a woman who were betrothed pooled a portion of their resources, and bought and sold stocks for their common benefit, apparently in order to raise money to buy a home. The court held that the parties did not contemplate a partnership, and none existed; that there must be an intention to enter into a contract of partnership, and that this situation did not indicate a contract, but was merely an adventure in buying and selling stocks. Although the decision can be justified on the latter ground, that is, the activity was not a business enterprise, but a mere joint adventure, the case lays alarming stress on the absence of a clear intention to enter into a contract of partnership. A recurrence to the *Francis* test is found in a later case, *Taussig v. Poindexter*,⁴³ properly held to be a clear business trust, the court saying, "To constitute a partnership, there must be an agreement that each shall share in the profits, and be personally liable for his share of the losses."

In the principal case, the intention dogma as introduced in 1922 indicated its cumulative potency. There was in the contract involved a power to remove any associate, and a provision for unequal voting power, which are not usually present in a partnership, and the court was no doubt influenced by these considerations. But the court held that the mere labelling of Dodson as principal, and of other defendants, formerly salesmen, as associates, indicated that the erstwhile salesmen were mere employees, and further, that the establishment of a sinking fund without mention of contribution to the losses excluded any intention to contribute, and therefore there did not exist the necessary intention to share losses and form a partnership. It is difficult to understand why a failure to stipulate for individual liability excludes the intention to form a partnership, when an express refusal to be liable is of no avail, especially if the status which is provided for comprises a partnership. Furthermore, the sinking fund was to be derived from the net or overriding commission which each one of the associates earned and shared,

⁴¹ *Betts v. Hackathorn* (1923) 159 Ark. 621. See also *Thompson v. Schmitt* (1925) 115 Tex. 53, 274 S. W. 554, practically denying the validity of business trusts, and holding all individually liable as partners, with the ultimate test being profit-sharing.

⁴² *Furlong v. Druke* (Mo. App. 1928) 2 S. W. (2d) 162.

⁴³ (1930) 224 Mo. App. 580, 30 S. W. (2d) 635.

so that there was actually contribution to the losses by each of the associates, ergo, also an intention to contribute, although the contribution was to be made in a specified way and manner. There was here a community of interest in the business as such, a sharing in the profits, and a measure of control in each party to the contract. To this extent they were all principals who shared in the profits, and they should have been held to be partners. The net result of this case is a recognition of an anomalous type of enterprise, not quite a principal-agent relationship, not quite a partnership, but a principal-associate status hitherto unknown, with no reason to recommend its adoption as another means of attaining limited liability without complying with prescribed statutory regulation.

In cases of this type, it would seem to be the policy of the Missouri courts to recognize and favor a liability limited to particular property. There is no objection to allowing a limited liability where there is such a provision contained in the independent contracts with third parties, but there is some question as to the wisdom of a policy which in effect allows parties contracting *inter sese*, by such contracts to limit liability as to third persons, not the contracting parties. And although some argument might be made in its favor in large group action, there are statutory means of protection against full liability which should be employed for that purpose.

If the intention doctrine which Missouri has articulated since 1922 is an unconscious divergence from the prevailing view, then it is submitted that a conscious revision by the courts, or at least a disclosure of the policy intended to be served would be fitting. If, however, the adoption of the expressed intention and loss-sharing criteria as determinative in the formation of a partnership status is conscious and purposive, it is clear that the Missouri courts are clinging to a doctrine foreign to the prevailing view of Anglo-American partnership law.

STANLEY MORTON RICHMAN, '33.

THE MAIN PURPOSE RULE AND THE STATUTE OF FRAUDS AS APPLIED TO PROMISES TO ANSWER FOR THE PRE-EXISTING DEBT OF ANOTHER

Where a statute passed to prevent frauds and perjuries is actually used to enable a person to acquire a benefit and then prevent any inquiry as to whether he promised to pay for this benefit, there is an inevitable tendency of the courts to try to discover some way by which such a person can be forced to perform