Elements, Tests and Proofs of a General Partnership

Paul Dias
Santa Clara University School of Law

Follow this and additional works at: http://digitalcommons.law.scu.edu/stutheses
Part of the Partnerships Commons

Automated Citation
"THE ELEMENTS, TESTS AND PROOFS OF A GENERAL PARTNERSHIP"
A. M. D. G.

THIS THESIS IS RESPECTFULLY SUBMITTED
TO THE FACULTY
OF THE
UNIVERSITY OF SANTA CLARA,
for the degree of
Bachelor of Laws,
by
PAUL DIAS.
TABLE OF CONTENTS.

1: Partnership inter se.

2: Partnership the result of intention.
   a. Legal intention controls.
   b. Partnership by operation of law.

3: Tests of intention.
   a. Profit sharing.
   b. Intention.
   c. Sharing of losses.
   d. Mutual Agency.
   e. Common ownership of property.

4: Joint Enterprise or Business.
   a. Distinguished from partnership.

5: Partnership by estoppel.

6: Existence of a Partnership.
   b. Burden of Proof.
This thesis, dealing with the above mentioned elements, tests and proofs of a general partnership, the author will endeavor to show the relation of these component elements in the formation of such partnerships.
1: Partnership inter se.

a. Elements.

In regard to the requisites of a partnership, the rule has often been quoted as being that such requisites are that the parties must have joined together to carry on a trade or adventure for their common benefit, each contributing property or services and having a community of interest in the profits. (145 U. S. 611). In California, the Civil Code at Section 2335 states that "a partnership is the association of two or more persons, for the purpose of carrying on business together, and dividing its profits between them". How far the sharing in profits of an organization will make one a partner has been a subject of much discussion, and the modern doctrine seems to be that the simple sharing of profits is not sufficient to make one a partner. For instance, merely receiving compensation for services or labor, estimated by a certain proportion of the profits does not render one liable as a partner. He must share in those profits as a principal. (Loomis v. Marshall, 12 Conn. 69.) Likewise, where one has loaned money to an enterprise, and who is to receive a certain percentage of the profits in addition to a stipulated amount of interest, does not necessarily make him a partner in that business. So it seems that in the requisites as cited above that there is one very important element lacking. As stated by mod-
ern authorities, in order to have a true partnership, the relation of principal and agent must exist. The partner embraces the character both of principal and agent. So far as he acts for himself and his own interest in the common concerns of the partnership, he may be deemed a principal, and so far as he acts for his partner, he may be deemed an agent. The principal distinction between him and a mere agent is that he has a community of interest with the other partners in the whole property, business and responsibilities of the partnership, whereas a simple agent has no such interest.

Justice Story in a summary in his Commentaries on Partnership concludes that "a participation in the profits will ordinarily establish the existence of a partnership between the parties in favor of third persons, in the absence of all other opposing circumstances", but that it is not to be regarded as anything more than mere presumptive proof thereof, and therefore liable to be repelled and overcome by other circumstances, and not as of itself overcoming or repelling them", and that therefore if the participation in the profits can already be shown to be in the character of agent, then the presumption of a partnership is repelled.

And so it has been held that an agent or servant, whose compensation is measured by a certain proportion of the profits of the partnership business, is not thereby made a partner. (Perrine V. Haukinson, 11 N. J. L. 215.) And likewise an agreement whereby the lessor of a hotel
shall receive a certain portion of the profits by way of rent, does not make him a partner with the lessee. (Beecher & Bush, 45 Mich. 189.)

It is now equally as well settled that the receiving of part of the profits of a commercial enterprise in lieu of or in addition to interest, by way of compensation for a loan of money does not make the lender a partner. From the decisions of all cases cited, there must be the relation of principal and agent, where each partner is both principal and agent.

2: Partnership the result of intention.

a. Legal intention controls.

b. Partnership by operation of law.

Another element which enters into the formation of a partnership is the intent of the parties. Persons cannot be made to assume the relation of partners as between themselves, when their purpose is that no partnership shall exist. There is no reason why they may not enter into an agreement whereby one of them shall participate in the profits arising in the management of particular property without his becoming a partner with the others. Such was held in the case of London Assurance Co. vs. Drennan, 116 U. S. 461. And so in 20 Cal. Juris at page 461 it is held that an intention to form a partnership is necessary as between the parties themselves, but not as between them and third parties.

As to those who have had dealings with the alleged partners, the question as to the existence of a partner-
ship is to be determined with a view to the facts as were known to them, unaffected by any secret agreement between the persons who are sought to be held liable as partners.

The intent of the parties does not necessarily depend on their intentions but whether legally there was an intent. It is possible for parties to intend no partnership and yet form one. If they agree on an arrangement which is a partnership in fact, it is of no importance that they call it something else, or that they are not partners. The law must declare what is the legal import of their agreements, and names go for nothing when the substance of the arrangement shows them to be inapplicable. (Busher vs. Bush, 40 Am. Rep. 465.)

Mr. Bates, in 17 American and English Encyclopedia of Law, 328, gives the following definition of a partnership: "A partnership is the contract relation subsisting between persons who have combined their labor, property and skill in an enterprise or business as principals for the purpose of joint profit. In addition he states that although a partnership is called a contract, it is the result of a contract, the relations which subsist between persons who have agreed to share the profits of some business, rather than the agreement to share such profits. Hence, it is not essential to the existence of a partnership that it be so denominated in the contract of the parties, nor is it necessarily fatal thereto if the parties
declare in such contract that they do not intend to be partners. The real inquiry is, have the parties by their contract combined their property, labor or skill in an enterprise or business, as principals for the purpose of joint profit? If they have done so, they are partners in that enterprise or business, no matter how earnestly they may protest they are not, or how far distant the formation of a partnership was from their minds. The terms of their contract given, the law steps in and declares what their relations are to the enterprise or business, and to each other. (Spaulding vs. Stubbins, 39 Am. St. Rep. 888).

In the case of Chapman vs. Hughes, 104 Cal. 302, three men created an association for the purpose of carrying on together the business of selling lands, and dividing the profits between them. They contemplated united action in advertising and otherwise in promoting sales and a joint expense to be incurred thereby, and further expressly provided for the payment to the syndicate of commissions on sales of other lands than those put into the syndicate. This was sufficient to constitute the relationship of partnership. Whether the parties knew that they were partners or not, they certainly intended and contracted to do all that in law is necessary to create a partnership. The relation of partnership may be established although the parties may not expressly intend to create such relationship.

In the case of Farnum vs. Patch, 49 Am. Rep. 313, a number of unincorporated persons taking numbers of
"shares" "for the purpose of starting a grocery store" are partners between themselves, although they called themselves "stockholders" and their opinion was that there was no liability for losses beyond the amount paid for the shares. The reason for the holding was that the organization resembled a partnership in every manner. The profits were not to be set aside and kept as a separate fund with a preserved identity, but they were to be mingled with and become part of the "stockholders'" capital. The stockholders were to be joint principals carrying on the business, and they were to share in the profits alike. The result is that such principals are partners.

Thus the intent of the parties seems to be the necessary element in a partnership. This intent which is deemed essential is an intent to do those things which constitute a partnership. Hence, if such an intent exists, notwithstanding that they did not purpose the liability attaching to partners, or even expressly stipulated in their agreement that they were not to be partners. It is the substance and not the name of the arrangement between them which determines their legal relation toward each other.

3: Tests of intention.

a. Profit sharing.
b. Intention.
c. Sharing of losses.
d. Mutual Agency.
e. Common ownership of property.
The tests of this intent vary considerably, but the foremost are the test of profit sharing, sharing of losses, intention to form a partnership, mutual agency, and community of interest.

The first test, the test of profit sharing which was recognized by American courts came to us through the case of Waugh vs. Carver, an English case. From this case, the early American courts established the rule that if a person partakes of the profits of any branch or trade or business, he is answerable as a partner for his losses. The reason for this was that if he took a part of the profits, he took from the creditors a part of the fund which was the proper security for the payment of his debts. The only qualification which they had to the rule was when a person stipulated to receive a sum of money in proportion to a given quantity of the profits as a reward for his services, he was not chargeable as a partner.

Respective states differ on the question, many states still holding to this doctrine, but other following the modified doctrine as laid down in Cox vs. Hickman. In this case was where two merchants and copartners becoming embarrassed in their circumstances, assigned all their property to trustees, empowering them to carry on the business, and to divide the net income ratably among their creditors, and to pay any residue to the debtors, the majority of the creditors being authorized to make rules for conducting the business or to put an end to
it altogether. The House of Lords held that the creditors were not liable as partners for debts incurred by the trustees in carrying on the business under the assignment. The decision was put upon the ground that the liability of one partner for the acts of his copartner is in truth the liability of a principle for the acts of his agent; that a right to participate in the profits, though cogent, is not conclusive evidence that the business is carried on or in part for the person receiving them, and that the test of his ability as a partner is whether he has authorized the managers of a business to carry it on in his behalf. The creditors in this case proved that the business was only being run until such time as the business affairs could be wound up, and the managers only had power to carry on the business to such ends. The creditors were not held to be partners in the firm.

Possibly the leading case in opposition to the net profit test is the case of Eastman vs. Clark, 53 N. H. 276. This case holds that Waugher vs. Carver is based on a false assumption, namely, that a man who takes part of the profits, takes part of that fund on which the creditor of the trader relies for his payment. The fallacy lies in that creditors cannot, nor do rely on net profit for payment. Net profits do not exist until creditors are paid. The fact that net profits are realized, presupposes that the creditors of the firm are satisfied, or that the partnership assets are sufficient to satisfy their claims.
A sound argument in favor of the net profit test is that if one stipulates for an interest in the profits of a business which would give him a specific lien or a preference in payment over other creditors, giving him the full benefit of the increased profits without any corresponding risk in case of loss, it would operate unjustly as to other creditors. This is disposed of by Mr. Story as follows: "The creditors to whom he is preferred are only the separate creditors of the actual partner; he has no preference over the creditors, for there are no profits until they are paid, and it is only out of the profits that his remuneration is to come. And though a partner is entitled to an account, yet a person may be entitled to an account and still not be a partner. If he is to share a sum equal to a share of the profits, by the great weight of authority, clearly no partner, yet how can he secure the payment of the compensation agreed upon unless he has an account?

A third argument is that the sharer of the net profits will otherwise receive usurious interest without risk. But usury is punishable by law, and it is not customary to punish usury by compelling parties to perform contracts which they never made.

A fourth argument is that the net profit rule is necessary to protect third persons against the frauds which might be practiced if secret agreements were allowed to be binding on third persons. It is conceded by
the supporters of this doctrine that so far as this agree-
ment is known it is to be binding on all who have knowledge
of it. It is also conceded by the opposition as in the
case of Eastman vs. Clark, that although it is nearly
impossible for one to gain access to the net profits, that
if perchance he should obtain a part of the gross returns,
he must of course refund them if needed to pay debts; for
his own agreement does not authorize him to receive any
dividend until all the debts are paid.

The argument that one who shares in the profits might
not bear his burden of the losses as a fallacy. If he has
paid nothing for his right, there is no consideration, and
therefore we must presume that he pays something, and does
bear a burden in that he runs the risk of losing what
he puts in. His claim is not enforceable until all the
creditors of the firm are satisfied. Also, it is held
that an agreement to share profits without being liable for
its debts is not in its nature against the policy of the law.

It seems to follow that though the profit sharing test
is evidence of a partnership, it is only that and nothing
more.

The second test or the test of intention, seems to be
much more controlling than the former. This was followed
in both Beecher vs. Bush and Eastman vs. Clark. The conclu-
sion in Beecher vs. Bush was that the test of partnership
must be found in the intent of the parties themselves. They
may say they intend mone when their contract plainly shows
the contrary and in that case the intent shall control the
contradictory statement. In this case, there was no agency of either to act for the other or for both, no participation of profits, no sharing of losses, and no common property. They intended no partnership, and there can be no such thing as a partnership as to third persons when as between the parties themselves there is no partnership, and the third persons have not been misled by concealment of facts or by deceptive appearances.

The case of Yatsuyanaji vs. Shimamms, 59 Wash 24 held that: "The essential test in determining the existence of a partnership is whether the parties intended to establish such a relation, and as between themselves the intention must be determined by their express agreement or inferred from their acts." Participation in the profits of a business is a mere circumstance to show the relation between persons taking the profits and those carrying on the business, the test of partnership between the parties being a question of actual intent, either expressed in the contract or implied from the acts of the parties and the circumstances surrounding their relationship. (Roach vs. Rector. 93 Ark. 521.

Where there is no proof of actual agreement, the rule of sharing profits raising a presumption of partnership is applicable. But where there is such an agreement, the question of partnership must be determined from it. The court will look to the entire transaction in order to find the intention of the parties, and this intention when discovered will determine the existence or non-existence of
the alleged partnership. (In re Hirth 189 Fed. 926.)

The third test, the test of sharing losses, is always coupled with the sharing of profits. It is the presumption that where one shares profits he will also share losses, but this is not conclusive. As has been formerly stated, one may share profits without losses, but when the two are done together, it is strong evidence of a partnership.

It has been sometimes held that the sharing of gross returns makes the participants partners, and seems more feasible than the net profit test, in that if in the latter case, the one who shares in the net profits, takes from the creditors part of the fund on which they rely, for payment, much more does he who shares in gross returns. But the rule is and has been that an agreement to share gross returns, does not create a partnership. The Uniform Partnership Act provides; "The receipt of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or any interest in the property from which the profits are derived."

The next and probably most important test is the mutual agency test. The formation of a partnership makes the members thereof mutual agents in the conduct of the partnership business, and in many cases this mutual agency is made the test to determine the existence of a partnership.

Cox vs. Hickman seems to hold that one should not be held liable as a dormant or sleeping partner where the trade
might not be fairly said to have been carried on for him, and when, therefore, he would stand in the relation of principal toward the ostensible members of the firm as his agents, Lord Wensleydale says, "A man who allows another to carry on trade, whether in his own name or not to buy and sell, and to pay over all the profits to him, is undoubtedly the principal, and the person so employed is his agent, and the principal is liable for the agent's contracts in the course of his employment. So if two or more agree that they should carry on a trade, and share the profits of it, each is a principal, and each is an agent for the other; and each is bound by the other's contract in carrying on the trade, as much as a single principal would be by the act of an agent who is to give all of the profits to the employer."

Therefore, on principle the true test of a partnership at last, is left to be that of the relation of the parties as principal and agent. (Harvey vs. Childs, 22 Am. Rep 387.)

But even though mutual agency may be a useful test in many instances, it is not strictly logical nor entirely satisfactory, and it has been pointed out that the agency results from the partnership and not the partnership from the agency. In other words, agency is one of the attributes of a partnership.

It makes no difference what arrangements have been made between the parties for conducting their business, for as between themselves, if no partnership were intended, then there is none as between themselves. So it is held that whether a party who furnishes money to another under an
agreement where he shall receive instead of interest, half the profits of the business which the other conducts, as a partner in the business or whether he merely loaned the money depends on the intention of the parties. (Willoughby vs. Hildredth, 182 Mo. App. 80.)

That intention does not necessarily refer to the conscious working of the mind, but to the legal intention which the law deduces from the acts of the parties, and, if they intend to do a thing which in law constitutes a partnership, they are partners though their purpose was to avoid the creation of such a relation. (Breinig vs. Sparrow, 39 Ind. App. 455.)

All the facts surrounding the transaction must be taken into consideration. Among these facts is whether or not the alleged partner acquired by the contract any property in or control over, or specific lien to the profits before their division, in preference to other creditors. The intent of a partnership relation in respect to partnership liability to third persons is determined by the contract as a whole considered together with the conduct of the parties to the contract and dealings as to the world. (Westcott vs. Gilman, 150 Pac. 777.)

Still another test of intention seems to be the common ownership of property. But it has been held in the cases of Butler Savings Bank vs. Osborne, 159 Pa. 10, and Noyes vs. Cushman, 25 Vt. 320, that tenants in common engaged in the development or improvement of the common property will be
presumed in the absence of proof of a contract of partnership, to hold the same relation to each other during such improvement or development as before it began. As to third persons, they may subject themselves to liability as partners by a course of dealing, or by their acts and deductions, but as to each other their relation depends on their title, until by an agreement with each other they change it.

The English rule which the American Courts have followed is that when tenants in common agree to carry on mining operations upon their land each contributing to the expenses in proportion to his respective interest in the land, they will be considered, both to themselves and third persons as the ordinary owners of land, working their respective shares, subject to no laws of partnership whatever.

A mere community of interest in real or personal estate does not constitute a partnership. But where a purchase of that character is made, and the premises are rebuilt or repaired for the purpose of prosecuting some joint enterprise or adventure, and under an agreement to share in the profits and losses of the undertaking, the contract then becomes one constituting a partnership, and each member is liable thereof as a partner, and they are liable jointly for services performed in perfecting their joint undertaking. (Noyes vs. Cushman, 25 Vt. 390.)

Summing up the various and conflicting decisions upon the test of partnership, it is safe to say that insofar as any actual partnership is concerned, intention is the usual test, that is, as between the partners themselves. As regards
partnership liability to third persons, there is a considerable diversity of opinion. The test usually applied is the sharing of profits and losses together with the mutual agency doctrine. There is, however, a tendency of the American courts to look to the so-called tests more as presumptive than conclusive tests, and to take all the matter of the transaction into consideration in arriving at a decision.

4: Joint Enterprise or Business.

a. Distinguished from partnership.

It is not necessary that there should be a series of transactions nor that the relationship between the parties should continue a long time to constitute a partnership. It may exist for a single venture or undertaking. (Jones vs. Davies, 72 Am. St. Rep. 354.) This was a case where three persons joined together and purchased land for the purpose of sale and profit only. The property was purchased in the name of one of the parties. It was held that it is immaterial in whose name the purchase is made, or the title taken, as in such case the property is to be deemed to be partnership property, and the parties are entitled to the rights and subject to the liabilities of partners. An added fact in the case was that the parties were engaged in this single transaction only, and it was held that a partnership might exist for a single venture, or single venture, or single transaction such as the purchase of land for speculation.

A transaction such as the latter is sometimes termed a joint adventure, and although it is also known as a
partnership, still there is a difference in the meaning of the terms. A partnership is formed for transacting a general business of some kind, while a joint adventure is formed for a single transaction.

5: Partnership by estoppel.

It seems unnecessary to speak of estoppel as a test of partnership, as the very meaning of the word raised the implication that the acts of the party estopped, prevent him from setting up the real facts of no such relation. It is based upon the principle that if a person holds himself out either actively or passibly, or permits himself to be held out as a member of a partnership, and so, perhaps, induces third parties to deal with the firm and extend credit upon the belief that the party estopped was a member thereof, and upon the credit of this party, when otherwise they would not have so dealt, he should not then be allowed to deny his apparent connection with the partnership and to escape the liability to the detriment of the creditors who relied upon his acts or representations. (Morris vs. Brosn, 177 Ala. 389.)

When a holding out as partners has once been established, the parties are liable to one induced thereby to give credit. The ground of such liability is not upon the direct representations between the parties, to prevent fraud. The only means by which persons between whom there is no actual partnership can be held liable as partners is by making out a case of estoppel against them, and all the elements of estoppel must be proved.
In order to hold one a member of a partnership by estoppel, it must appear that the person dealing with the firm believed, and had a reasonable right to believe, that the party he seeks to hold as a partner was a member of the firm, and that credit was to some extent induced by this belief, and it must also appear that the holding out was by the party sought to be charged, or by his authority or with his knowledge or assent. This where it is not the direct act of the party, may be inferred from the circumstances, such as from advertisements, shop-bills, signs, or cards, or from various other acts, from which it is reasonably inferred that the holding out was with his authority, knowledge or assent, and whether a party has so held himself out is in every case a question of fact and not of law.

It was also held that a jury may infer that a person was held out to the public as partner with knowledge and consent from the fact that he knew that his name was signed with that of other persons to an advertisement calling attention to their business and soliciting from the public a continuance of confidence and business, and did not insert in a newspaper in which such advertisements were published any denial of the partnership, and evidence of this fact is admissible though the party dealing with the supposed firm never saw the advertisements, where it has been shown that he had trusted the firm in good faith and upon good grounds. (FletcherPullen. 14 Am. St. Rep.355.)
6: Existence of a Partnership.


b. Burden of Proof.

After enumerating the various elements and tests of a partnership, we have arrived at the final analysis, namely, the burden of proof under certain conditions and relations.

Generally speaking, the burden of proving a partnership is on the plaintiff. The law never presumes the existence of a partnership, but requires those who assert its existence, especially as between themselves, to prove such existence by the clearest and most positive evidence. (Chapin vs. Cherry, 147 S.W.1084.) Where a plaintiff declared against a defendant individually but sought to charge him as a partner, the burden was held to be on the plaintiff to show the partnership, but it is held that when the evidence prima facie establishes a partnership, or when it is such that a partnership may reasonably be inferred, the burden is cast upon the defendant to show an incorporation where it was sought to avoid individual liability, on the ground that the company was incorporated. (Henshaw vs. Root, 60 Inc.220.) Where the action is between partners as for accounting or dissolution, the burden is on the plaintiff to prove the existence of a partnership.

Courts recognize the fact that no absolute rule can be given either as to the amount or kind of proof sufficient to establish the relation of partnership among the persons
sought to be charged. It is apparent that the proof must be sufficient to bring the parties within the comprehension of the definitions previously given. That is, the evidence must be sufficient to show some arrangement or agreement between the persons sought to be charged as partners, to contribute money, goods, skill or labor to some business or enterprise, to the end that the profits derived therefrom may be divided between them; or generally an agreement to the effect that they share in the profits and losses. It has also been shown sufficient in respect to third parties, to prove that one of the persons sought to be charged, shall have permitted the others to use his creditor to hold him out as jointly liable with themselves.

To establish the fact of partnership between themselves much stricter proof is necessary than in cases between partners and third persons. The reason for this is that it is within the powers of the partners to give evidence on the subject of the partnership than a third person could ordinarily produce. (Walker vs. Mathews, 58 Ill. 196.)

The question as to what constitutes a partnership is one of law, but whether or not one exists is a question of fact to be determined by the evidence surrounding the case.