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ARE LIMITED PARTNERSHIPS NECESSARY?

The Return of the Commenda

By Judson A. Crane*

As trade employs capital, a need arises for a form of association under which one can invest funds in an enterprise, sharing profits, but without responsibility for management and without risk of loss or liability beyond the amount invested. The institution which met this need during the middle ages was called the commenda. The commendator loaned money to the commendatarius or tractator to employ in trade. The commendator received the major portion of the profits and had no claim for loss not caused by the fault of the commendatarius. This institution was recognized as the Société en Commandite by an ordinance of Louis XIV in 1673, and by the French Commercial Code of 1807. This was the basis of the limited partnership acts adopted in the United States in the early eighteenth century.

The general partnership, known as societas, the members being socii, was functioning during the middle ages in continental

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1 Holdsworth, History of English Law 195; Mitchell, Early Forms of Partnership, 3 Select Essays, Anglo-American Legal History 183.

2 Secs. 23-28. Sec. 23 defines the association, “La société en commandite se contracte entre un ou plusieurs associés responsables et solidaires, et un ou plusieurs associés simples bailleurs de fonds, que l'on nomme commanditaires ou associés en commandite.” No provision is made for personal liability of the commanditaires except in event of participation in management.

3 Kent, Commentaries, 33-36 notes that this was the first instance of an American state deriving its statutory law from a country other than England. Limited partnership acts were adopted in New York 1822; in Connecticut, 1922; Pennsylvania, 1836. All the states except Arizona and Florida have some form of limited partnership act. Nineteen have adopted the uniform limited partnership act.
Europe and in England especially among the foreign merchants. The commenda appears to have been known in England as well as on the continent. But as the common law courts gradually took jurisdiction over mercantile causes formerly dealt with in mercantile courts, only the general partnership with joint liability of all its members was recognized. Holdsworth attributes the rejection of the commenda to several causes, the insularity of the common law after it absorbed the law merchant, the exclusiveness of the trades controlled by regulated companies, the emergence and popularity of joint stock companies, and legislative opinion hostile to limited liability save by grant or franchise, as in the corporation.

There are numerous references to socii in the early commercial cases collected and translated in the Selden Society collection of Select Cases on the Law Merchant. The Fair Court of St. Ives, (1293) 23 Selden Society 59; St. Ives, (1300) 23 Selden Society 77; St. Ives, (1287) 23 Selden Society 25; St. Ives, (1317) 23 Selden Society 105; King's Council, (1273) 46 Selden Society 12; Assize at Lincoln, (1278) 46 Selden Society 18; King's Council, (1284) 46 Selden Society 39; Itinerant Justices (1288) 46 Selden Society 45; Court of the Mayor of London on King's Writ, (1299) 49 Selden Society 14.

The first Usury Ordinance of the City of London (1363) imposed liability for usury on "partners in the said bargains," Riley, Liber Albus 320. The later ordinance of 1391 also refers to transactions by partners, Riley, Liber Albus 346.

Holdsworth also infers a recognition of commenda in the London Usury Ordinance (1391) Riley, Liber Albus 344, defining usury, "if any person shall lend or put into the hands of any person gold or silver, to receive gain thereby, or a promise for certain without risk . . . ." Holdsworth, History of English Law 104. Compare American Law Institute Contracts Restatement section 527.

"In many parts of Europe limited partnerships are admitted, provided they be entered on a register; but the law of England is otherwise, the rule being, that if a partner shares in advantages, he also shares in all disadvantages." Lord Loughborough in Coope v. Eyre, (1788) 1 H. Bl. 37, 48. See also Pollock, Essays in jurisprudence and Ethics 95, 101.


Holdsworth, History of English Law 196.

The Law Merchant is a source of the common law of partnership, especially the doctrine of non-survivorship of joint property on death of a partner and the duty of the survivor to account. Hammond v. Jethro, (1611) 2 Brownl. 97, 99; Jeffereys v. Small, (1683) 1 Vernon 217; Lane v. Williams, (1692) 2 Vernon 277, 292; Devaynes v. Noble, (1816) 1 Mer. 529, 564, 524; 1 Coke's Lit., sec. 282; Burdick. What is the Law Merchant, (1902) 2 Col. L. Rev. 470, 483, 3 Select Essays, Anglo-American Legal History 34.

Compare the Texas views of business trusts as expressed in Thompson
Along with the growth of the common law of partnership there developed in England, starting with *Grace v. Smith* and *Waugh v. Carver,* the doctrine of partnership liability to third persons of anyone who shared the profits of a trade, including lenders of capital who received a share of profits in lieu of interest. It was recognized that not all such persons were partners inter se, that is, not partners in fact, but for reasons of policy and expediency it was deemed necessary to impose on them liabilities for trade debts as if they were partners. This doctrine has had a wide following in this country. In England a reaction began with *Cox v. Hickman,* and it became the law that while profit sharing is a prima facie indicium of partnership it is not conclusive, and one may receive a share of profits, as payment of a debt, or in lieu of or in addition to interest, without becoming a partner in fact or liable as though a partner to third persons. The line of English cases to this effect came too late to prevent the adoption in many

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v. Schmitt, (1925) 115 Tex. 53, 274 S. W. 554; and cases on the liability of members of unlicensed foreign corporations, as Cunyngham v. Shelby, (1916) 136 Tenn. 176, 188 S. W. 1147.

10 (1775) 2 H. Bl. 998, De Gray, J., “Every man who has a share in the profits of a trade ought also to bear his share of the loss.”

11 (1793) 2 H. Bl. 235, Eyre, C. J., “It is plain upon the construction of the agreement, if it be construed only between the Carvers and Geisler, that they were not, nor ever meant to be partners. . . . But the question is, whether they have not by parts of their agreement, constituted themselves partners in respect to other persons.”


American states of the partnership as to third persons doctrine, but it has in some cases had a counteracting effect.\(^4\)

Legislative relief against this doctrine of liability as partner on the part of the investor, which was sometimes found to be economically undesirable and resting on precedent only,\(^5\) took two forms. In England what was known as Lord Bovill's Act was adopted in 1865.\(^6\) This provided for a loan of money to a trader under a written agreement with profit sharing by the lender and without liability beyond the amount invested. In several cases the Act was held to be no protection to the lender because powers of control vested in the lender under the agreement made him a partner in fact.\(^7\)

Similar legislation was adopted in Pennsylvania in 1870, and several cases of unsuccessful attempts to comply with the act occurred.\(^8\)


A distinction has been made between sharing profits and receiving compensation for services equal to a share of profits, which was approved by Story, Partnership, sec. 52, but criticized by various courts. See Miller v. Bartlett, (1827) 15 Serg. & R. (Pa.) 137; Buzard v. First National Bank, (1886) 67 Tex. 83, 2 S. W. 54.


\(^{1628}\) & 29 Vic. ch. 86. The act commences with the statement, "Whereas it is expedient to amend the law relating to partnership." The Act was occasionally referred to erroneously as a Limited Partnership Act. See Pollock, Essays on Jurisprudence and Ethics 104.

It not only provided for the creditor-debtor relation by written agreement but provided that no partnership liability should result from compensating a servant or agent by a share of profits, or from paying a widow or child of a deceased partner an annuity out of profits of the one continuing the trade, or from paying one a portion of profits as consideration for the sale of the good will of a business. These latter provisions were included in the English Partnership Act, 1896, 53-54 Vict. ch. 39, as part of the rules for determining the existence of a partnership, and were reproduced in the Uniform Partnership Act, sec. 7 (4).


The other form of legislative relief from the partnership as to third persons doctrine as applied to investors was the adoption of limited partnership acts beginning in 1822. Under these acts if certain conditions were complied with the investor, called a limited partner, could risk his investment in return for a share in profits without further liability. But by express provision of the acts liability as general partners was imposed on all the associates for various defects in compliance with the statutes, as false statements in the certificate filed, failure to file the certificate at all, failure to record it in a county in which a branch was established or to which the principal office was removed. Aside from express statutory liability the view generally taken in the courts was that the limited partner was essentially a general partner with the privilege of limited liability on condition that all the requirements of the act were satisfied, and failure to satisfy any of them left him in the status of a general partner as regards liabilities to third persons. The New York courts, however, showed a tendency in later decisions to impose liability only where the statutes expressly required it. In a few other cases of fail-

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The acts now in force other than the uniform limited partnership act are collected in the appendix to 8 Uniform Laws Annotated, Limited Partnership.

Under statutory provisions that "all the persons interested in such partnership shall be liable for all the engagements thereon as general partners." Andrews v. Schott, (1848) 10 Pa. St. 47; Richardson v. Hogg, (1861) 38 Pa. St. 153. As to who are persons interested, see Crehan v. Megargel, (1922) 234 N. Y. 67, 136 N. E. 296, discussed in Warren, Corporate Advantages without Incorporation 311 et seq.

Another form of statute provided that the result of false statements is that "the partnership shall be deemed general." Smith v. Areall, (1844) 6 Hill (N.Y.) 479; Van Ingen v. Whitman, (1875) 62 N. Y. 513.

Henkel v. Heyman, (1878) 91 Ill. 96, certificate taken to office but removed before it was recorded. See contra, Manhattan Co. v. Leimbear, (1888) 108 N. Y. 578, 15 N. E. 712.


Riner v. Poppenhausen, (1870) 43 N. Y. 68.

"The question, therefore is, have the members of the firm complied with the terms prescribed by the statute? For, unless the conditions of the act are substantially observed, all the defendants are general partners." Rogers J. in Andrews v. Schott, (1848) 10 Pa. St. 47; Madison County Bank v. Gould, (1843) 5 Hill (N.Y.) 309; Richardson v. Hogg, (1891) 38 Pa. St. 153.

Buck v. Alley, (1895) 145 N. Y. 488, 40 N. E. 236; Buckle v. Iler,
ture to comply with the statutes the status of general partner for all purposes was not imposed.

Neither Lord Bovill's Act\(^{26}\) nor the limited partnership acts prior to the uniform limited partnership act have proved to be adequate protection to the investor because of the risk of liability in event of non-compliance with the technical statutory requirements. Relief appears now to be afforded along two lines, expressed in the two uniform acts. The uniform partnership act follows the doctrine of the group of cases headed by Cox v. Hickey\(^{27}\) in providing in section 7 containing "Rules for Determining the Existence of a Partnership. (1) Except as provided by section 16, persons who are not partners as to each other are not partners as to third persons."\(^{28}\) and further,—"(4) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:

. . . (a) As a debt by installments or otherwise,
. . . (d) As interest on a loan, though the amount of payment vary with the profits of the business."

Under these rules it appears that a status similar to that of limited partner can be created without compliance with any statutory forms, and that one may invest money subject to the risks of the business sharing profits without liability for losses provided there is no participation in the management. The uniform limited partnership act provides for the consequences of defective organization in section 11:


\(^{26}\) An estoppel to enforce personal liability of the limited partner has been maintained against creditors who have dealt with the association as a limited partnership, Tracy v. Tuffy, (1890) 134 U. S. 206, 10 Sup. Ct. 527, 33 L. Ed. 879; Allegheny National Bank v. Bailey, (1892) 147 Pa. St. 111, 23 Atl. 439. Compare California, Civ. Code, sec. 2503 and see Warren, Corporate Advantages without Incorporation 309.

As between the parties themselves there is no objection to carrying out their terms of association as regards their mutual obligations and rights. In re Allen's Estate, (1889) 41 Minn. 430, 43 N. W. 382 semble.

The intended limited partner is not liable for torts, but only for contractual debts of the associates, McKnight v. Ratchiff, (1863) 44 Pa. St. 156. The intended limited partner is not liable as partner by estoppel after failure to give notice of withdrawal. Tilge v. Brooks, (1889) 124 Pa. St. 178, 16 Atl. 746.

\(^{27}\) See notes 13 and 14.

\(^{28}\) This clause in a section entitled "Rules for Determining the Existence of a Partnership" seems somewhat out of place, since it deals with liabilities of persons as between whom a partnership relation does not exist.

Section 16 deals with partner by estoppel.
"Status of Person Erroneously Believing Himself a Limited Partner. A person who has contributed to the capital of a business conducted by a person or partnership, erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership; provided, that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income."

Each of these means of defense was held effective in the case of *Giles v. Vette.*

Marcuse and Morris proposed to form a limited partnership to take over the business of a former partnership engaged in the brokerage business in which Marcuse was a partner. They intended to have several limited partners, but finding that the rules of the New York Exchange prohibited member firms having more than two, decided to associate with Hecht and Finn as limited partners, who in turn were trustees for various other contributors. An agreement was executed and filed July 2, 1917, in Chicago. July 1, the new uniform limited partnership act became effective, superseding the former Illinois Act of 1874, under which the parties supposed they were organizing. The new uniform act did not authorize limited partnerships for the stock brokerage business, and the agreement was not in the form nor filed at the office required by the new act. The partnership became bankrupt, and the limited partners, in attempted compliance with section 11 of the Uniform Limited Partnership Act, paid into court the profits which they had received. The district court adjudicated as bankrupt, along with the general partners, the limited partners and their beneficiaries. On petition to review and revise, the circuit court of appeals, seventh circuit, eliminated from the order of adjudication all except Marcuse and Morris. This decision was affirmed by the Supreme Court. In the circuit court of appeals, Anschuler, J., with whom Page, J. concurred, held that the limited partners were entitled to the benefit of section 11 of the Uniform Limited Partnership Act, holding it applicable to a partnership which by reason of its purposes could not have been formed under that Act. It was also

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held that the petitioners, if not entitled to any protection under the later Act, were not general partners, not being co-owners of the business within the definition and rules contained in the uniform partnership act, and not being partners in fact could not be partners as to third persons so as to be subject to adjudication as partners.

The bankruptcy act provides that "A partnership, during the continuance of the partnership business, or after its dissolution and before final settlement thereof, may be adjudicated a bankrupt." 31 In this case the petitions of creditors had alleged the two limited partners and their beneficiaries to be general partners. Prior to this case it had been often stated in the lower federal courts that only partners in fact can be adjudicated bankrupt in a petition against the partnership. 32 Partners by estoppel were not so adjudicated. 33 It has been held that one who is liable as a partner to third persons by reason of profit sharing cannot be included as partner in bankruptcy proceedings against the real owner of the business. 34 There was, however, some authority to the effect that the limited partner in a defective limited partnership, being liable to creditors, could be included in partnership proceedings in bankruptcy. 35

The determining issue was stated by Anschuler, J., to be "whether under the above stated facts petitioners are liable as general partners with Marcuse and Morris." 36 Mr. Justice Butler in the Supreme Court stated that "The question for decision is whether any of the persons named, other than Marcuse and Morris, are liable as general partners." 37 In both courts, the petitioners were held not subject to adjudication not merely because

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34 In re Kenney, (D.C. N.Y. 1899) 97 Fed. 554.
36 (C.C.A. 7th Cir. 1922) 281 Fed. 928, 932.
37 (1924) 263 U. S. 553, 554, 44 Sup. Ct. 158, 68 L. Ed. 444.
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they were not partners in fact but because they were not liable as partners to creditors. The case is therefore authority for the non-liability to third persons of one who enters into an intended limited partnership as a limited partner. The result of the case appears to be the virtual adoption of the commenda as an informal common law institution, by reason of the abolishment of the doctrine of liability to creditors of persons not partners in fact save in the case of estoppel. There are other cases which have reached a similar result under the uniform partnership act and on the authority of this case. It should not be understood that the decision in Giles v. Vette as to the non-liability of an investor is a radical advance upon previous decisions, some of which have been cited heretofore. The provisions of the uniform partnership act relied upon in the opinion are merely declaratory of the common law of a majority of the jurisdictions. The unique feature of Giles v. Vette is that the parties intended to create inter se the relation of limited partnership under the former Illinois limited partnership act. The case is also important as a decision of the United States Supreme Court applying the uniform partnership act as an aid to interpretation of the bankruptcy act.

In Giles v. Vette the Supreme Court also approved the other ground for the decision of the circuit court of appeals, that the intended limited partners were entitled to the benefit of section 11 of the Uniform Limited Partnership Act. This section does away with the risk of personal liability being imposed on a person who has in good faith attempted to become a limited partner and

38 Petition of Williams, (C.C.A. 1st Cir. 1924) 297 Fed. 696. By written agreement Williams contributed capital to a firm, in which he was described as being a "silent or special" partner. He was to be inactive, have no share in ownership but to share profits in addition to interest. He was held not subject to adjudication as a partner.

In re Mission Farms Dairy, (C.C.A. 9th Cir. 1932) 56 F. (2d) 346. One King supplied the entire capital for a dairy business, operated by Hultgren and wife, who were to receive from income $150 monthly compensation, turning over to King the balance of earnings until he was repaid his investment. They held the property in trust for him. King was held not subject to adjudication as partner with the Hultgrens.

Martin v. Peyton, (1927) 246 N. Y. 213, 158 N. E. 77, lenders of securities to a stock brokerage firm, in return for a share of profits and with limited powers of supervision and control, held not to be partners in fact, and not to be liable for partnership debts. There being no partnership by estoppel.

39 See note 14.

is not responsible for the defective compliance with the statutory requirements. This provision was held to be broad enough in its scope to apply to a partnership which could not be organized under the Act, and which the associates did not intend to organize under the Act. In the circuit court of appeals, Evans, J., dissented as to both grounds of the decision.41

With this protection against liability of persons bona fide believing themselves to be limited partners, this form of organization is much safer than the limited partnership under the former acts.42 By other provisions of the uniform limited partnership act the limited partner is given certain rights, including the right to information43 and to force a dissolution and winding up,44 and limitations are placed on the general partners' powers.45 To attempt to give by contract, without compliance with the Act, all the rights given the limited partner under the Act might by some courts be held to constitute such control as to create a partnership in fact, in spite of the case of Giles v. Vette and those that follow it. It is likely, therefore, that in the interests of security and certainty associations will be organized under the Act, even though it be an unnecessary precaution as regards exemption from personal liability of the inactive investor.

41 (C.C.A. 7th Cir. 1922, 281 Fed. 928, 941.
42 See annotation by the Commissioners on Uniform State Laws to Uniform Limited Partnership Act, sec. 1; Lewis, The Uniform Limited Partnership Act, (1917) 65 U. of Pa. L. Rev. 715.
43 Sec. 10.
44 Sec. 16(4).
45 Sec. 9.