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Some Problems In Partnership
Restated

Prolegomena

Partnership has been termed "a commercial adventure." The elementary principles applying to this subject at common law are neither difficult of comprehension nor of application, provided there is maintained by the Courts a clear idea as to the nature of the adventure. It is obvious that the organization of individuals dealing as partners is not a corporation and yet the trend of much authority has been in the direction of accrediting to such an organization corporate attributes. To the earnest student groping his way through the decisions of the Courts and the Acts of the Legislature in the effort to glean principles of partnership law, a chief difficulty encountered is to determine through what theory the Courts or the Legislature are viewing the organization of partnership. Moreover, our Courts of Pennsylvania have not been consistent in their expressions on this subject and reconciliation of view is well nigh impossible.

Again as has been pointed out, the Uniform Partnership Act of 1915 is far from clear in its theory. This problem is concisely presented by Professor Edward H. Warren in his recent work "Corporate Advantages without Incorporation" where at page 301 he says:

"The law becomes blurred and confused unless Courts and Legislatures give a clear answer to this question: Are partnership rights and obligations the rights and obligations of the human beings who are
the partners or are they the rights and obligations of some other legal unit having its rights and obligations, which are distinct from their rights and liabilities?"

The accepted characteristics of partnership are (1) the ownership of the assets by the partners and (2) their unlimited liability for whatever debts are contracted in the joint venture. Despite these obvious characteristics much discussion has revolved around the nature of partnership, and our first problem will be a restatement of this matter.

**Nature of Partnership**

In an article published in Dickinson Law Review, March Number, 1916, the present writer stated the divergent views of the nature of partnership. They are three in number, viz: The association theory; the entity theory; and a third view offered by Professor James Parsons in his Principles of Partnership at page 97 and known as the status theory.

The prevailing view and the one followed at common law is the association theory. The entity view is well expressed by our Mr. Justice Williams in *Clark v. The Railroad Company*, 136 Pa. 413, 1890, wherein he uttered this dictum:

"The partnership when formed is a distinct person in law. It has its own name, its own property, and a right to contract, to sue and be sued, by its firm name."

This same view was expressed in 1829 by Chief Justice Gibson in the leading case *Doner v. Stauffer*, 1 P. & W. 198, when he declared:

"It is well settled by a train of decisions in the American as well as the British Courts, that the joint effects belong to the firm, and not to the partners."

These statements, coming from eminent authority, have contributed not a little to a confusion that exists in respect to the nature of partnership. They are misleading and inaccurate as correct legal principles. The firm as a
distinct entity or legal person has never been so recognized in Pennsylvania Law. On the contrary, in every case where the exact question was before the Courts, partners have been recognized as the co-owners of assets held in partnership and on the other hand they are made responsible personally for whatever obligations have been contracted in pursuance of the joint venture.

Quoting from the article already referred to, the remaining view of the nature of partnership is thus expressed:

“A third view of the nature of a firm has been offered by Professor Parsons in his Principles of Partnership. According to his views, partnership is a status and in support of this view he presents the following discussion:

“The sum of the rights and duties of the partners in the relation is called the status of partnership. The status may be created by contract, like marriage or sale. The contract is the occasion or door, and the consummation or conveyance established rights in rem.”

“Though partnership may be dissolved at will and the relation brought to a close through the act of the individual, yet the status, with all its attendant duties and prerogatives, subsists until it is terminated in a manner consistent with its original purpose.” “The elevation of partnership into a status is due to the presence of a firm estate.” “The partners, being merged as individuals, in the firm estate, are enabled to trade in a distinct capacity.” “The only qualification is that in acting as partners they bind their separate estates, and the firm creditor is not confined to the firm fund.” “It is the recognition by the law of the estate that severs the partner from himself as a man.”

The above author rejects the mercantile or fiction theory and queries:

“What is the polarity of mind of a lawyer who advocates making a partnership by turns a corporation and a number of individuals? If he comprehended the
elemental distinction of kind, he would not expose his confusion by making the suggestion, but he would disguise the proposition in the jargon of lawyers who speak of a man quo modo, a horse."

Referring to the first two theories Professor Warren in his work at page 2 says:

"There are two theories as to the proper basis for that law,—the entity theory and the aggregate theory. The advocates of the entity theory urge that the partners should be considered to be merged into a composite unit, the partnership, which unit has a continuing identity and acquires its rights and incurs its obligations. The advocates of the aggregate theory, on the other hand, urge that the partners should be considered as not merged into a composite unit, but as so many individuals who acquire their joint rights and incur their joint obligations."

To quote again from Professor Warren in explanation of these two theories he states the following at page 35 of his work:

"Under the aggregate theory, an obligation incurred in the conduct of the partnership business is the obligation of those persons who were partners at the time the obligation was incurred. The partners are liable, directly and primarily liable, and liable without limit.

The advocates of the entity theory say that an obligation incurred in the conduct of the partnership business is incurred by it, the partnership,—that the partnership is a legal unit and that the obligation is its obligation. They then add that they do not mean that the partners themselves should be protected from liability.

Their position is therefore that, without legislative sanction therefor, (1) the courts should treat a partnership as a legal unit; but then, (2) should provide in some affirmative way that the members of this legal unit shall not escape liability. . . . . . .
In what way do advocates of the entity theory propose that the partners should be reached? Three ways are thinkable:

a. The partners might be held to be under a liability to the partnership to supply it with funds sufficient to enable it to discharge its liabilities; this liability of the partners to the partnership would be one of its assets, which its creditors could reach. Under this conception, the creditors of the partnership will reach the partners via the partnership and therefore the liability of the partners, from the point of view of the creditors, is indirect and secondary.

b. The partners might be held to be liable as sureties for it, the partnership. Under this conception, the rights of the creditors will be directly against them, the partners, as well as against it, the partnership, but the liability of the partners to the creditors, although direct, will be secondary.

c. It might be said that both it, the partnership, and they, the partners, are liable. Under this conception, the rights of the creditors will be directly against the partners as well as against it, the partnership, and the liability of the partners to the creditors will be direct and primary. But the duty to pay will not rest solely upon them; the duty to pay will be shared by it."

As has already been stated the law of Pennsylvania has never recognized the entity theory as such although there does appear in many of the cases loose talk about the partnership, its rights and obligations and frequently the statement is made that the personal property belongs to the firm and the title thereto can be transferred in the firm name. On the other hand in treating of titles to real estate, at least prior to the passage of the Uniform Partnership Act, our cases have been uniform in holding that only the partners could hold the title to real estate used for partnership purposes and the reason assigned has always been that the firm had no legal recognition and could not per se be the grantee of a legal title. In reference to suits by and
against those acting as partners a practice has grown up in the Pennsylvania cases permitting these suits to be brought in the partnership name. An illustration of this will be found in Tonge v. Item Publishing Company, 244 Pa. 425, 1914, where it was stated that from the time of early decisions in Pennsylvania a suit might be maintained against the partnership in the firm name only and without naming the individual partners and that such a record would support a verdict, judgment, and execution against the partnership property as well as the individual property of any partner who was actually served with process. But such a judgment will not bind the individual estate of a partner not served with a summons and consequently no execution could issue against him. Other illustrations of suits permitted in the partnership name are found in O'Brien v. Saint Rita Oil Company, 4 D. & C. 640, 1924 and Frisby Lumber Company v. Kratzer, et al, 6 D. & C. 295, 1924. These cases, however, illustrate merely questions of procedure and do not affect the nature of the partnership relation. Moreover, it is generally recognized as better practice in actions by or against partners that they be so named on the record as individuals, followed by a description of them trading as partners. 30 Cyc. L. & Pr. 60.

The emphasis laid by our law upon the partners as individuals is well illustrated along these same lines in Walsh v. Kirby, 228 Pa. 194, 1916, wherein suit was brought against "F. M. Kirby and F. J. Weckesser, trading as F. M. Kirby & Company." The summons was served on Kirby alone. Elkin, J. said:

"We think it is clear on both reason and authority that service upon one or more members of a partnership in a suit instituted against the firm is a good service for the purpose of affecting the partnership with notice and in the event of recovery of binding the partnership property. Of course the personal and separate estate of a partner not served will not be bound by the judgment recovered against the partnership. If it is sought to hold not only the partnership property but the separate and personal estate of each individual partner then the
service must be made upon each partner. In other words, the individual and separate estate of a partner is not bound by a judgment against the partnership unless personal service of the writ is made upon the partner whose property is sought to be bound.”

Following these cases it is probably true in Pennsylvania that if suit is brought against and in the name of a partnership and the summons under the Service Act of July 9, 1901, P. L. 614, is served upon some agent or manager of the partnership at the partner’s place of business but service was not had upon any partner, a judgment obtained in the name of and against the partnership would not support an execution other than against the partnership property. Furthermore, it appears to some that these cases indicate a recognition of the entity of the firm by reason of the liability of the firm property for firm obligations.

The Uniform Act of March 26, 1915, P. L. 18, was drawn by Dr. William Draper Lewis, late Dean, and afterwards Professor in the Law Department of the University of Pennsylvania and now at the head of the American Law Institute. Quoting from the article in Dickinson Law Review for March, 1916, already referred to, it is said:

“Much space has been devoted in the magazine articles cited concerning the theory of partnership which has been adopted by the language of the Act. The learned draftsman and the Committee apparently are of the opinion that the common law theory has been adopted. To this assumption Mr. Judson A. Crane in his article in the June number, 1915, of Harvard Law Review takes serious exception and argues that the legal person theory or so called mercantile view should have been adopted and in fact has been unconsciously recognized in the very terms of the act.

It appears to the writer that the true version of the matter is that neither the aggregate or common law theory nor the legal person theory has actually been adopted but that without really giving credit the terms
of the act are only explicable by a reference to the status theory already referred to as advanced by Professor Parsons."

The comment of Professor Warren on this same point in his recent work at pages 300 and 301, is thus stated:

"The truth of the matter seems to us to be that the Uniform Partnership Law is based, partly upon the aggregate theory, and partly upon an entity theory, —Dr. Lewis' entity theory. The language of the Act reminds us of the language of some political platforms. There is some language which will please those who approve the aggregate theory. There is other language which will please those who approve the entity theory. . . . . The language is not clear because the thought is not clear. We all dislike to be technical or fussy over grammatical inaccuracies; we want to be broadminded, and to regard substance and not form. But if anyone says that the distinction is a mere technicality, a distinction of form and not of substance, a mere difference in the form of expression, he is mistaken."

To which may be added this thought, that the interpretation of the Act reminds one of the difficulties of those interpreting the synoptic gospels upon the theory that different parts were written at different times by different authors with different views and finally compiled by a third person without regard to the divergences.

The Century Dictionary thus defines generally the word partnership:

"The state or condition of being a partner; joint interest; participation with another."

Following this thought the English Partnership Act of 1890 declares that:

"Partnership is the relation which subsists between persons carrying on a business in common with a view of profit."
The American Uniform Partnership Act departs from this English precedent and ostensibly seeks to improve the definition as follows:

"Section 6. (1) A partnership is an association of two or more persons to carry on as co-owners a business for profit."

Despite the opinion of the learned author that this definition accords with the common law theory of partnership, it is submitted that the definition leads away from the aggregate theory and stresses the organization too much as such rather than as purely a relation of the partners which is the result of a contract entered into by them, and that many parts of the Act are wholly unintelligible from the common law theory standpoint unless we are furnished with some code of interpretation as to the meaning of the word "Partnership" as it appears throughout the Act, and this code is not furnished within the confines of the Act except as we may glean it from the definition as given.

If the draftsman had followed the English definition, the thought would be more clear but we can only attain that same clarity in the present definition by some transposition as the following:

"Partnership is \textit{the} association of two or more persons to carry on as co-owners a business for profit."

Thus no emphasis is laid on \textit{the} partnership but rather on the individuals in a relation or association in partnership.

To the definition should be added an explanation that wherever in the Act the word partnership appears it is to be construed as meaning either (a) the joint partners or (b) the aggregate of the property real and personal contributed or acquired by the joint partners and dedicated to partnership uses and known as the partnership Estate.

Following this suggested code for the interpretation of the Act, let us test it by reference to certain sections. The following section has been much criticised by Mr. Crane:
“Section 8. (Partnership Property.) (1) All property originally brought into the partnership stock or subsequently acquired, by purchase or otherwise, on account of the partnership is partnership property.

(2) Unless the contrary intention appears, property acquired with partnership funds is partnership property.

(3) Any estate in real property may be acquired in the partnership name. Title so acquired can be conveyed only in the partnership name.

(4) A conveyance to a partnership in the partnership name, though without words of inheritance, passes the entire estate of the grantor unless a contrary intent appears.”

Prior to the passage of the Uniform Act in Pennsylvania and following the theory of our cases already quoted, the courts declared repeatedly that the title to partnership personal property was in the firm and would pass by a transfer in the name of the firm. On the contrary, however, in the case of real estate it was distinctly held, following common law theory, that the legal title to real estate could not be taken in the impersonal name of a firm, i.e., Carlisle Land Company or Pittsburgh Oil Company. The reason assigned is that the law only permits the vesting of a real estate title in a legal person, i.e., a human being or a corporation, and as a partnership is not a legal person, such a deed of conveyance would constitute a legal futility because it lacked as an essential element a legally recognizable grantee to accept the title.

In Trexler v. Africa, 42 Pa. Super. Ct. 542, 1910, Morrison, J. said:

“It does not appear in the record that the American Stave & Lumber Company was a corporation. It must, therefore, have been a partnership name or a fictitious name, and under the above quoted authority, the conveyance by Fritch and wife by the deed of August 4, 1894, to the American Stave & Lumber Company did not vest the legal title to the land therein described in that company, because it had no such legal existence as would entitle it
to be a grantee in a deed of real estate.” See also 30 Cyc. 431.

Under the present section a title to real estate “may be acquired in the partnership name” and it is further stated that such “conveyance to a partnership in the partnership name, though without words of inheritance, passes the entire estate of the grantor unless a contrary intent appears.” In whom then is the title vested? A name cannot of itself be the recipient of a title, and if the name represents an inanimate object, i.e., the town clock or a cemetery lot, it is equally futile as an act of conveyancing. Can it be said that the title is vested in the partnership as an entity when under the hypothesis there is no entity?

It is stated in Section 4 (4) that the Act “shall be so interpreted and construed as to effect its general purpose to make uniform the law of those states which enact it.” Furthermore, it is a cardinal rule of construction that the general intent of a document must be obtained by a reading of the same in its entirety. By reference to Sections 24 and 25 it appears, therefore, reasonably apparent that when the draftsman speaks of a “conveyance to a partnership” he means a conveyance to the partners and not to an entity or legal person created by the act and known as a partnership. It is unfortunate as already suggested that the draftsman did not adhere strictly to phraseology which would emphasize the partners as individuals rather than the partnership as an organization. We join with Professor Warren in the expression as found at page 301 of his work: “Drafting the Uniform Partnership Act afforded a wonderful opportunity to give a clear and unambiguous answer to that question. We think that no such answer is given by the Act, and that this is a matter for profound regret.”

The writer in the quotation just made is referring to the distinction between the rights and obligations of the partners as human beings and the rights and obligations of some possible legal unit that may have been created.

Referring further to the Act, Section 9 states that every partner is “an agent of the partnership” and that his act within the limits of authority “binds the partnership.”
What is evidently meant is that each partner within certain limits is an agent of his co-partners and when he acts within these limits such act is binding upon all of the co-partners as an act done in the relation of partnership.

In Section 10 in treating of an unauthorized conveyance of real property held in partnership it is stated that "the partnership may recover such property" under certain conditions and further on in the section in paragraph 3 there is a reference to "the right of the partnership". Section 11 refers to "evidence against the partnership", and Section 12 refers to "knowledge of the partnership".

Section 13 in referring to a wrongful act or omission of any partner, states that under certain conditions "the partnership is liable" and Section 14 pursuing the same line of thought refers to the fact that the "partnership is bound" under certain conditions. Section 15 in treating of a partner's liabilities states (a) that under certain conditions partners are liable jointly and severally for everything "chargeable to the partnership" and (b) that as partners, are jointly liable for "all other debts and obligations of the partnership."

To quote again from Professor Warren's work at page 296:

"When we move about in Sections 13, 14 and 15 we feel that we must be in the wrong house. And as we go through other sections of the Act, the feeling that there must be some mistake increases."

Agreeing that these quotations from the Act and others of a similar nature found therein are unfortunate expressions in an act which is stated to be based upon the common law or aggregate theory of partnership, yet such incongruities fade away when the expressions are interpreted in the light of the code which has been suggested. That this is the view taken by a certain part at least of the Profession in Pennsylvania and also of certain County Courts and the Superior Court wherein partnership questions have been recently litigated appears in the following citations:
Property Rights of a Partner

This subject is presented in Sections 24, 25 and 26 of the Act. These Sections constitute the very heart of partnership and are clearer in expression and phraseology than any others. But, nevertheless, they likewise present certain problems which will now be discussed.

These sections appear to be strangely set in the midst of the Act. The reader of course, has been warned in the definition that the persons who have formed the partnership are "the co-owners of the business". Nevertheless there follows so much about the partnership, its rights and obligations, that the sections interlarded come somewhat as a surprise. Moreover, following these sections, the "partnership" thought is immediately continued. Howbeit, the draftsman declares:

"Section 24—(Extent of Property Rights of a Partner.)—The Property rights of a partner are (1) his rights in specific partnership property, (2) his interest in the partnership and (3) his rights to participate in the management".

By Section 25 a partner is designated as a co-owner with his partners of specific partnership property according to the tabulated incidents of a tenancy created by the statute as a tenancy in partnership.

The complement of these sections is found in the following:

"Section 26—(Nature of Partner's Interest in the Partnership)—A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property".

The comment made on these sections and Section 9, before referred to, is quoted from the March Number, 1916,
of this Review:

"The legal and practical result of the foregoing sections may be shown, in large part, by the following illustrations.

A, B & C associate themselves as partners to carry on in Carlisle and vicinity the business of buying land and selling the same in bulk or by subdivision. The firm does business under the name and style of Carlisle Land Company. Each member of the firm contributes the sum of $10,000 to capital. Of the total capital $30,000, the sum of $20,000 is used in acquiring a tract of land to be subdivided into building lots. The $10,000, remaining is devoted as working capital for the development of the tract. The legal title to the land is taken in the name of Carlisle Land Company.

A, B & C are recognized under the sections quoted as the legal owners of the land, holding the title to the same, however, as tenants in partnership, using the name of Carlisle Land Company as a convenient designation of what Dean Lewis calls the grouping of activities but which appears to be simply another way of arriving at Professor Parson's theory already alluded to. There is no recognition by the law of the Carlisle Land Company as an entity or legal person but there is, by virtue of the association of A, B & C as partners, a distinct stamp placed upon the partnership property or, to put it directly, there is a peculiar status or condition placed upon the partners in their relation to the partnership property and their rights therein. The partner can only deal with the partnership property for partnership purposes. Furthermore, a partner's separate creditor cannot affect the specific partnership property and on the death of a partner his right in the specific partnership property becomes extinct, the legal title vesting solely in the survivor. Thus there is no subject matter upon which any dower, curtesy or other right of widows, husbands, heirs or next of kin can attach in the case of real estate. A fee simple title is vested by the terms of the statute without the use of
words of inheritance and if it is desired that a lot of ground be conveyed this may be done by any one of the partners executing and acknowledging in the name of the partnership a deed of conveyance."

As already stated, the key to the interpretation of those portions of the Act treating of "the partnership" is that such references are to the partnership as property dedicated to the joint purposes and not to the individual partners merged into an entity or unity. This interpretation is in accord with Professor Parson's theory above outlined and also follows the contract of the partners. To continue the illustration just given, the contributions of the partners yield a total capital of $30,000, which is invested as stated. These investments represent the assets of the partnership and these assets, under the terms of the contract of the co-partners by an implication of law, are dedicated to the specified joint purposes and uses. This stipulation, interpolated by law into the contract, gives rise to what is known as the equity of the partners, which means that each partner has a right against his copartners to insist that all liabilities incurred by them as partners in the joint venture shall be paid first out of the assets held in partnership. Through this right of the partners, firm creditors derive a preferential claim on firm assets to the exclusion of other obligations incurred by the partners individually or jointly but not for partnership purposes. Snodgrass' Appeal, 13 Pa. 474, (1850). See also Overholt's Appeal, 12 Pa. 222 (1849) and Hershey v. Fulmer, 3 Pa. C. C. 442 (1887). Generally, for partner's equity, 25 Dickinson Law Review 99, (1921). In the article just cited, the deduction is drawn that the Uniform Act does not by its terms preclude the partners from waiving their equities against one another and that such acts of waiver do not constitute a fraud upon the rights of firm creditors. However, by the Act of May 21st, 1921, P. L. 1045, the Pennsylvania Legislature passed the Uniform Fraudulent Conveyance Act which reads, in part, as follows:

"Section 8. Conveyance of Partnership Property:—Every conveyance of partnership property and
every partnership obligation incurred, when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred:

(a) To a partner, whether with or without a promise by him to pay partnership debts; or

(b) To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners”.

By the terms of Section 1 of the same Act a conveyance is stated to include “every payment of money, assignment, release, transfer, lease, mortgage, or pledge of tangible or intangible property, and also the creation of any lien or incumbrance.”

By the inclusion of “release” within the meaning of the word “conveyance”, it would appear that a release by the partners of their respective rights to insist upon the application of the firm assets to the liquidation of the firm liabilities would be “fraudulent as to partnership creditors” within the scope of the Act.

Conversely, however, in Gallagher’s Appeal, 114 Pa. 353, (1886) it was held to be no fraud for a partner to pay firm debts out of his separate Estate, even though his separate creditors remain unpaid, and he is rendered thereby unable to pay them.

It may be noted that Section 2 (2) of the Uniform Fraudulent Conveyance Act provides that in determining whether a partnership is insolvent there shall be added to the partnership property the present, fair, salable, value of the separate assets of each general partner in excess of the amount probably sufficient to meet the claims of his separate creditors.

Suppose, however, individual creditors of the partners obtain judgments against them separately, issue executions and levy upon the respective partners’ interests in the partnership as these interests are defined in Section 26 of the Uniform Partnership Act and the facts are similar to Doner v. Stauffer, 1 P. & W. 203 (1829) and its long train of authority, will the result be the same or does the Uniform
Partnership Act make a change in law as heretofore?

The law, following the dictum of Doner v. Stauffer is thus expressed by Brown, P. J. in Richard v. Allen, 117 Pa. 201, (1887):

"However illogical it may appear that a purchaser of two or more intangible interests in property should thereby become the owner of the corpus of the property, such is the well settled law of Pennsylvania as applied to the purchase by the same person, of the interests of all the partners in the partnership property."

As has been pointed out in 25 Dickinson Law Review 103, the same reasoning is applied when at the same sale, both interests are sold to different purchasers. Kelly's Appeal, 16 Pa. 59, (1851); Vandike's Appeal, 17 Pa. 271 (1851); Vandike's Appeal, 57 Pa. 9, (1868).

In the article in 25 Dickinson Law Review at p. 108, it is intimated that the Act has not changed the law. This was written prior to the passage of the Uniform Fraudulent Conveyance Act. Does this Act in the quotation already made throw any light upon this question? It is submitted that it does not. The provisions cited have no bearing upon the acts of creditors. They refer to the acts of the partners exclusively. Furthermore, a judgment obtained by a separate creditor against a partner would not come within these provisions because such judgment would not be a "lien or incumbrance" upon the partnership assets.

So far in Pennsylvania there are no recorded cases throwing light upon the provisions of Section 8 of the Uniform Fraudulent Conveyance Act.

Application of Property at Law

For the contractual obligations incurred in partnership, the co-owners of the business are jointly responsible. This liability is enforced by an action against the partners jointly. If the summons is served upon both defendants, the judgment later entered becomes a lien on all real estate held by the partners as such or as individuals, jointly or separately. Furthermore, such a judgment is a lien on
separate real estate and is entitled to priority over the judgment of a separate creditor of a partner as regards the latter's real estate, if the judgment was entered prior to that of the separate creditor. Cumming's Appeal, 25 Pa. 268, (1855). Conversely, if the separate creditor's judgment is prior in time to the judgment of a firm creditor against all the partners, nevertheless the judgment of the firm creditor is the only lien considered as against the partnership real estate. Kramer v. Arthur, 7 Pa. 165.

If an execution is issued by a firm creditor against the partners, i.e., A and B, the creditor has three possible sources of satisfaction, i.e., (1) the partnership property, (2), the separate estate of A, (3) the separate estate of B.

As stated by Professor Warren, supra, page 25:

"The judgment creditor can satisfy his judgment out of any property of the partners or any one of them. The judgment is against all, but the execution may be against any one,—the judgment is joint, but the execution may be several. And there is no requirement that the partnership creditor must exhaust partnership assets before he takes separate assets."


Application of Property In Equity

When the assets of the partners pass into the custody of law through a bill in equity, insolvency or bankruptcy proceedings, the rule, long observed in equity practice, of keeping distinct the partnership assets and the assets of respective, individual partners prevails universally in this country. The method of marshalling assets and liabilities in such cases is illustrated by Section 5-f of the National Bankruptcy Act of 1898, which provides as follows:

"The net proceeds of the partnership property shall be appropriated to the payment of the partnership
debt, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

This rule of marshalling assets became the law in Pennsylvania after some vicissitude. Said Lowell, J. In Re Wilcox, 94 Fed. 101:

"After prolonged hesitation, Bell v. Newman was explicitly overruled, and the general rule of distribution was definitely established in Pennsylvania. Black's Appeal, 44 Pa. 252; McCormick's Appeal, 55 Pa. 252.

The history of the mutation is interesting. In Bell v. Newman, 5 S. & R. 78, 1819, the question was presented of a dissolved partnership and the right of partnership creditors to come in pro rata with separate creditors in the distribution of the deceased partner's separate estate. The partnership creditors had already participated exclusively in the distribution of an insufficient partnership estate. The Act of April 19th, 1794, applying to a decedent's estate, provided that all creditors of an equal nature should receive an equal share of the intestate's estate. Tilghman, C. J. labors between the English rule requiring that joint, i. e., partnership property be applied to joint, i. e., partnership debts and separate property to separate debts with the requirement of equality of the Act of 1794. The Chief Justice reaches the conclusion that to do equity and at the same time observe the mandate of the Statute respecting all creditors—the partnership creditors being as much creditors of the deceased partner as were his separate creditors—the separate creditors should receive out of the separate estate an equal amount as the partnership creditors received out of the partnership estate, after which the two classes
of creditors should participate pari passu in the distribution of the separate estate. To quote from the opinion of the Chief Justice:

“As the facts are stated in this case, it must be taken for granted, that the joint property in the hands of the defendant belonged equally to the estates of Cookson and Waddington; consequently, when all the joint property has been applied to the payment of the joint debts, the partnership creditors will have, in fact, received the amount of one-half from the estate of Waddington. I suppose, for example, that they have received twenty cents in the dollar; then ten cents in the dollar have been paid from the estate of Waddington, and to administer equity to his separate creditors, it will be proper that the plaintiffs (the only separate creditors known to the Court) should first receive ten cents in the dollar from the separate estate, after which each of the joint creditors and the plaintiffs are to divide the balance of the separate estate among them equally, pro rata, according to the balance of their debts respectively. This puts all the creditors of Waddington on an equal footing, so far as concerns his estate, and is in exact conformity to our act of assembly; the whole estate of Waddington, that is to say, his whole separate property, and his whole interest in the joint property being divided among all his creditors of equal degree, equally, pro rata. As to the portion which the joint creditors receive from that part of the joint property belonging to Cookson's estate, the separate creditors have no reason to complain of it, because they trusted Waddington only; but the joint creditors trusted both Waddington and Cookson. It will be remembered, that I have assumed it as a fact in this case, that the joint property in the hands of the defendants belonged equally to the estate of each partner. No rule, therefore, is intended to be laid down, which may affect cases differently circumstanced. Where the equity between the partners is different, it may perhaps occasion a difference of equity between
the creditors.”

With this conclusion Duncan, J. concurred, but Justice Gibson defended the general rule that partnership creditors were confined to the partnership estate and separate creditors to the separate estate, urging:

“But it appears to me, the rule is founded in the most substantial justice. Why should any class of creditors, in preference to the rest, be exclusively entitled to the joint fund, and concurrently entitled to the separate estate? Equality is equity; and the joint creditors, in being exclusively entitled to the partnership fund, have already an immense advantage over the separate creditors; it is the largest; for men in trade usually embark their all in it; and seldom have much separate property. And independently of distributive rights, the joint creditors have a degree of security for their debts, and facilities in recovering them, which the separate creditors have not; they can sell both joint and separate estate on an execution; while the separate creditors can sell only the separate estate, and the interest in the concern that may remain to the partner, after the accounts of the debts and effects of the partnership are taken, as between the partners and their creditors, and as between the partners themselves. This exclusive liability of the partnership estate to the joint creditors is founded on no equity peculiar to themselves, but results from the nature of the contract of partnership, which requires the joint debts to be paid before the equity can be settled between the partners, each being individually liable till all is paid; concede the present question to the joint creditors, and you give them in effect a monopoly of the insolvent’s whole estate. What merit do they possess that the separate creditors may not lay claim to? In the usual course of transactions, each class indiscriminately trusts to the whole estate, both joint and separate.”

In Houseal & Smith’s Appeal, 45 Pa. 484, 1863, an effort was made by separate creditors of a partner to be admit-
ted pari passu with the firm creditors against the firm assets. In the interval, however, between this case and Bell v. Newman, the Supreme Court had repudiated the majority opinion in the latter case. Andress v. Miller, 15 Pa. 316, 1450; Walker v. Eyth, 25 Pa. 216, 1855; Black's Appeal, 44 Pa. 503, 1863. Consequently, in Houseal & Smith's Appeal, the rule adopted was accorded further adherence, the case being this: A and B were partners and became insolvent. The firm owed A, consequently the separate creditors of A asked to be let in upon the partnership assets, but the partner was the debtor of the partnership creditors, hence his claim could not compete with the firm creditors, and his separate creditors would have no higher rights. For the converse of this situation there is McCormick's Appeal, 55 Pa. 252, 1866, wherein the firm as creditor of a debtor partner was denied participation in the estate of a deceased partner, the respective estates, of course, being insolvent. The case was this: H and M were partners and, H dying, it was found that the partners individually and the firm were insolvent. At the time of H's death he owed the firm $17,600.00 and M owed the firm $11,205.00. M as surviving partner made an assignment of the firm property for the benefit of its creditors. The account of H's administrator showed a balance of $3207.60, and an auditor was appointed to distribute this balance among H's creditors. The assignees claimed to come in on the fund for a dividend on the whole amount of H's indebtedness to the firm. The claim was excluded by the auditor and his report was confirmed by the Orphan's Court. Upon appeal the Supreme Court per Agnew, J., held that the indebtedness of the partners to the firm should be set off and in the adjustment one-half of the difference taken, which would be the amount the assignees could prove against the partners estate. The difference between the two debts was $5585.45 and the one-half of this was $2792.72 upon which latter amount a dividend of $701.81 was allowed. The Court said:-

"It is a question of the marshalling of assets in which the equities of each class of creditors must be preserved. The firm creditors have no standing in the
distribution of the fund belonging to the separate estate, until the separate creditors are satisfied. It is only the surviving partner representing the firm who can claim as the separate creditor of his partner for the balance found due on the adjustment of the partnership affairs. It is therefore through him that the partnership creditors receive anything from the separate estate, and it is only when paid to him as a separate creditor by survivorship their interest attaches. They can claim nothing in their own right. The case of Houseal & Smith's Appeal, 9 Wright 484, is not in point. That was a case where the individual creditors of one of the partners asked to be let in upon the partnership assets on the ground that he was a creditor of the firm. But the difficulty which met them was, that the partner, under whose wing they attempted to shelter themselves, was himself the debtor of the partnership creditors, and they met him with a superior equity, which postponed his claim until they were satisfied, and, as a consequence, postponed his individual creditors who asked to be subrogated to his rights."


See also Leidy v. Messinger, 71 Pa. 177. In Bankruptcy see In re Telfer, 184 Fed. 224; In re Wells, 298 Fed. 109.

However, the rule under discussion only applies to partnership estates and does not include mere joint estates, Snodgrass' Appeal, 13 Pa. 471, 1850, and likewise it is only applicable in the case of partnership liabilities as distinguished from simple joint debts. Appeal of Collins, 1 Penny-packer 339, 1882.

The advocates of the entity theory of partnership maintain that the rule of marshalling assets is a recognition of the firm as a distinct person. However, Judge Lowell, in his scholarly opinion, In Re Wilcox, 94 Fed. 104, observes:

"The historical origin of the rule lies not improbably in an ancient practice of distributing the joint estate under a joint commission and the separate estate under a separate commission, each commission
dealing with its corresponding creditors. The best theoretic defense of the rule is probably this: The operation of the law of partnership which gives to any separate partner or his assignee only his net share of the partnership assets—a rule manifestly founded in justice and convenience—usually insures to the joint creditors a priority in the application of the joint estate, and therefore this half of the rule has seldom been questioned. The priority given to the separate creditor in the application of the separate estate is a rough, but practical, offset to the inequality caused by the rule governing the application of the joint Estate.” See the dissenting opinion of Judge Gibson in Bell v. Newman, 5 S. & R. 78. Entirely apart from statute, however, two things are quite clear: First, that the general rule, with some variations, is established in the Courts of this Country and of England; and, Second, that these variations, and particularly the exception in the absence of joint estate, have tended to discredit the rule, and to confuse its operations, rather than to obviate its difficulties.”

In Murrill v. Neill, 8 Howard 414, the Supreme Court of the United States said:

“The rule in equity governing the administration of insolvent partnerships is one of familiar acceptance and practice; it is one which will be found to have been in practice in this country from the beginning of our judicial history, and to have been generally if not universally received. This rule, with one or two eccentric variations in the English practice which may be noted hereafter, is believed to be identical with that prevailing in England, and is this: That partnership creditors shall, in the first instance, be satisfied from the partnership estate; and separate or private creditors of the individual partners from the separate and private estate of the partners with whom they have made private and individual contracts: and that the private and individual property of the partners shall not be applied in extinguishment of partnership debts until
the separate and individual creditors of the respective partners shall be paid. The reason and foundation of this rule, or its equality and fairness, the Court is not called upon to justify. Were these less obvious than they are, it were enough to show the early adoption and general prevalence of this rule to stay the hand of innovation at this day, at least under any motive less strong than the most urgent propriety.”

Nevertheless, it has been held under the present Bankruptcy Act that a partnership as distinct from the partners may be adjudged a bankrupt. *Liberty National Bank v. Bear*, 265 U. S. 365; *Meek v. Center Co. Banking Co.*, 268 U. S. 426; *Myers v. International Trust Co.*, 273 U. S. 380.

**Exceptions**

The following cases illustrate exceptions to the rule as they have been recognized in England and in parts of this country.

In *Farmers & Mechanics National Bank v. Ridge Avenue Bank*, 240 U. S. 498, 1916, the question of law presented to the Supreme Court upon certificate of the court below was as follows:

“When a partnership as such is insolvent, and when each individual member is also insolvent, and when the only fund for distribution is produced by the individual estate of one member, are the individual creditors of such member entitled to priority in the distribution of the fund?”

The Court in answering this question in the affirmative repudiated the English exception to the rule in favor of the right of partnership creditors to prove pari passu with the individual creditors against the individual estate and denied that this exception had attained such recognition in the American Cases as to warrant its interpolation into Section 5-f of the Bankruptcy Act of 1898, declaring further that the origin and source of the English exception had no justification or place in our present Bankruptcy Act.
In *Estate of Sperry*, 1 *Ashmead* 347, an undated decision of President Judge King of the First Pennsylvania Judicial District, the reports being published in 1831 and the case decided sometime between 1825 and 1831, it was held that where there was no partnership estate and no living solvent partner, the partnership creditors would be permitted to prove their claims pari passu with the separate creditors against the separate estate of a partner.

This decision came under the influence of *Bell v. Newman*, 5 S. & R. 78, 1819, but has never been followed and apparently has never been commented upon judicially. On the contrary in *Estate of Bennett*, 13 Phila. 331, 1880, Penrose, J. declared:

“It is true that in England, where there is no joint estate and no solvent partner, the joint creditors are entitled to rank as separate creditors against the separate estate of the individual partner . . . . Whether in Pennsylvania the rule which gives separate creditors priority over joint creditors with respect to separate assets is subject to the qualification established in England, and above referred to, is, in view of what was said by C. J. Thompson, in *Black's App.*, 8 Wright 507-8, very doubtful.”

The same observations will be found in *Estate of D'Invilliers*, 13 Phila. 362, 1880 and *Stauffer's Estate*, 3 D. R. 794, 1894. See also Pepper & Lewis' Digest of Decisions, Volume 15, Col. 26034. This exception is apparently not accepted as law in Pennsylvania and, if this is correct, is in accord with Bankruptcy Law and the view of the Supreme Court of the United States.

In *Jamison's Estate*, 163 Pa. 143, 1894, a creditor held a judgment against a partnership and also a separate judgment against the individual partners for the same debt. It was held that he was entitled to prove the full debt against not only the partner fund but the funds of the respective separate estates of the partners. Said Mitchell, J.

“The partners are liable individually, but it is by reason of their membership of the firm, and their in-
individual property is liable only secondarily. It is the settled rule that where there are partnership and separate assets, and the firm is insolvent, each class has priority upon its respective estate: Black's Appeal, 44 Pa. 503. The appellant was in both classes, he had a judgment in each which gave him a primary claim on that particular fund."

In Fourth National Bank v. Mead, 216 Mass. 521, 1914, the same ruling was made on similar facts. Referring to Section 81 of the Negotiable Instruments Law the Court said:

"The result is that a partner who individually endorses before delivery Commercial paper made by his firm is a "person, not otherwise a party" in the sense in which those words are employed in Section 81. It follows that the claims of each of the plaintiff's should be allowed against the estate of the deceased partner."

In Robinson v. Seaboard National Bank, 247 Fed. 667, 1918, Buffington, Circuit Judge for the Third Circuit, applied the same ruling in administering the bankruptcy law saying:

"This is not a case of double proof on a single contract, but of single proof of two separate contracts."

In Jamison's Estate, supra, Mitchell, J. said further:

"The main question is whether appellant, having a judgment against the partnership, and also a separate judgment against the individual partners for the same debt, is entitled to a dividend on each out of its respective estate.

It is settled that a creditor of an assigned estate is entitled to a dividend on the full amount of his debt at the date of the assignment, notwithstanding he has collateral security of any kind on which he has, or may hereafter receive a partial payment of his debt: Morris v. Oltwine, 22 Pa. 441; Patten's Appeal, 45 Pa. 151; Borough's Est., 71 Pa. 460; Graeff's Appeal, 79 Pa. 148; Miller's Est., 82 Pa. 113."
In *Appeal of York County Bank, 32 Pa. 446, 1859*, the facts were that A and B had entered into partnership and by their articles agreed that A should have the exclusive ownership of the capital stock until B should contribute certain sums of money to said stock. An execution creditor of A levied on the firm property and this was followed by another execution by a firm creditor. The question was which execution was superior in point of law. Said Thoms

son, J:

"When a creditor levies on the property of a firm, his execution fixes and attaches to this right to the same extent that it existed in the partners, and hence the preference over a separate execution-creditor in the distribution. All this is predicable of a case of joint property only. But where there was no joint property, the rule has nothing to operate on. The mere name is not enough in such case—there must be an equity. If that equity never existed, a creditor's execution could not attach to any right, amounting to a lien, to have the assets appropriated to a partnership debt. That Moore has no interest in the firm property is found by the auditor. That this was a necessary conclusion from the article of copartnership, and a failure to comply with it, cannot be doubted. In fact, that the very appearance of claim was renounced by Moore, before the execution was issued by the appellant, was also an ascertained fact by the auditor. This being so, the property levied on was individual property in fact, although seized in the firm's name. The appellant cannot work out his equity through the partners, for they, as such, did not exist, inter se, and the individual owner could not give him this right over a prior execution against him individually. The property was all individual property, and priority of seizure gave priority of right in the distribution. To the complaint that the property was in appearance firm property, that it is a fraud on a creditor of the firm not to hold it so in fact, notwithstanding it may not have been so, it may be answered, that a creditor can seize no more
than belongs to the debtor, and succeeds only to his rights as defined by law, and that he can blame no one but himself for becoming a creditor."

In *Bogue's Appeal, 83 Pa. 101, 1876*, the principle of *York County Bank's Appeal* was recognized but the facts there were distinguished. The contest was between a separate and a partnership creditor, both of whom had issued executions. The separate creditor contended that there was no partnership, hence no partnership property, but the return of the sheriff on the separate execution stated distinctly that the levy was made on the debtor's interest in the partnership. The Court held that the auditor in distributing the fund raised on the execution sales could not inquire into the matter further than the record disclosed and the separate creditor was concluded by the return which stated distinctly that his levy was on an interest in the partnership and thus, as the Court observed, recognized the partnership as such.

In *Appeal of Scull, 145 Pa. 141, 1886*, A advertised in newspapers that he intended carrying on business as A & Company, "admitting B and C to interests." No partnership ever actually existed although B and C were employed in the business. The contest was between individual creditors of A who first issued executions and other creditors of A and Company who subsequently issued executions, both levying upon the assets of the business. The individual creditors prevailed, the Court deciding that the case fell within the rulings of *Doner v. Stauffer, 1 P & W 198*, *Baker's Appeal, 21 Pa. 76* and *York County Bank's Appeal, 32 Pa. 446*. Another illustration is found in *Bixler v. Kresge*, 169 Pa. 405, 1895, wherein a boy under age permitted himself to be held out as the partner of an adult. Actually the boy was merely an employee and had contributed nothing of property value to the business. He signed notes along with the adult in affairs connected with the business but on coming of age he disaffirmed these obligations. It was decided that the case fell within the doctrine of *York County Bank's Appeal*. To the same effect is *Himmelreich v. Shaffer, 182 Pa. 201, 1897*. 
The following two cases will illustrate further exceptions to the general rule:

In *McGrudden v. Jonas*, 173 Pa. 507, 1896, there were two partnerships doing business, one under the name of Parisian Cloak & Suit Company of Pittsburgh, and the other I. Jonas & Company of Chicago. The former was composed of four persons and the latter of three persons. All members of I. Jonas & Company were members of the Parisian Cloak & Suit Company but the Parisian Cloak & Suit Company had one more partner, making four in that firm. The Parisian Cloak & Suit Company executed three notes payable to the order of I. Jonas & Company who endorsed the same to Yetta Greenboum as collateral security for a pre-existing indebtedness of the payees to her. Both firms become insolvent and the question arose in the matter of the distribution to creditors. Held: Where an insolvent partnership composed of four persons gives a promissory note to another insolvent partnership composed of three persons, all of whom are members of the drawer partnership, and the note is transferred by the payee as collateral security for a pre-existing debt to a third person who has full knowledge of the affairs of both partnerships, such holder of the note will be postponed to the other creditors of the firm which made the note. An insolvent partnership composed of three of the four members of a second insolvent partnership cannot, as a creditor of the latter, share equally with the latter’s other creditors in the distribution of its assets.

There is nothing in the Act of April 14, 1838, P. L. 457, which will sustain such a claim. Said McCollum, J:

"The learned Court below in awarding to Mrs. Greenboum the balance of the fund remaining after paying thereout the claims of the other creditors in full gave her all that she was entitled to, and all that the parties to whose rights she succeeded could possibly have received from it. As they were liable for all the claims of the other creditors they could not have participated in the distribution until those claims were satisfied. This is a proposition in accordance
with equity and well sustained by the decisions of this court: Erb's Appeal, 2 P. & W. 296; Himès v. Barnitz, 8 Watts, 39; Worral's Appeal, 41 Pa. 524, and Datesman's Appeal, 77 Pa. 243. There is nothing in the Act of April 14, 1838, which sustains the contention that an insolvent partnership composed of three of the four members of another insolvent partnership can as a creditor of the latter share equally with its other creditors in the distribution of its assets. This act has been severely and justly criticised in most if not all of the cases in which it has been considered but it has never yet produced such results as are contended for in this case: Tassey v. Church, 6 W. & S. 465; Pennock v. Shayne, 6 W. & S. 239, and Allen v. Erie City Bank, 57 Pa. 129."

Commenting on the Act of 1838, Warren, Corporate Advantages Without Incorporation, at page 119 says:

"In Pennsylvania, it was provided by the Act of 14th of April, 1838, that (to speak in terms of the letters we have used above) A., B. and C. might maintain an action at law against A., D. and E. When the Court came to consider this, it said that apparently the legislature was soon aware that this Act, if the judgment were carried out by execution, might work the most palpable injustice, and that to prevent such injustice the legislature gave the Courts, by the Act of 13th of October, 1840, all the power of a Court of Chancery in settling partnership accounts." See also Huffman Farm Company v. Rusk, 173 Pa. 264."

On the other hand in Haines & Company's Estate, 176 Pa. 354, a firm consisted of seven members and engaged in the wholesale business. Two of the members of this firm formed a partnership and engaged in a retail business. Funds from the first partnership were withdrawn by the second partnership and certain transactions were engaged in between the two firms and at the instance of the members of the second firm which resulted very disastrously to the first firm. Both firms subsequently became insolv-
ent and it appeared that the firm of seven members was a creditor of the firm of two in a large sum of money. Held: That in the distribution of the respective partnership estates in insolvency proceedings the assets of each partnership constitutes separate funds for its own creditors and as to their respective creditors these two firms are to be considered as distinct and separate entities. The Lower Court had refused to allow the claim of the creditor firm against the debtor firm because of its construction of a certain agreement between the two firms which the court deemed to make them both interested in the profits and losses of the debtor firm. On appeal the Supreme Court rejected this view saying, per Mitchell, J.:

"It is urged that the assignee, appellant, is not entitled to prove against the fund until the accounts between the partners of Wood, Brown & Co. shall have been settled, and then only for the amount that may be found due to the partners other than Wood and Brown. In other words that Wood and Brown being partners in the debtor firm cannot be creditors also of that firm as against other creditors. But this argument overlooks the effect of the insolvency of Wood, Brown & Co. The moment that fact is ascertained the creditors acquire a right to all the assets of that firm, among which undoubtedly is their claim against Haines & Co. If Haines & Co. were solvent there could be no question of the validity of this claim, although Brown and Wood might be creditor partners; the right would be in the creditors of Wood, Brown & Co. as a firm without reference to the status of the individual partners in either firm among themselves. And the insolvency of Haines & Co. does not change the rights of Wood, Brown & Co's creditors. As to their respective creditors the two firms are separate and distinct entities, and the assets of each are a separate fund for its own creditors, just as the firm assets and the individual property of the partners are separate funds for partnership and individual creditors in ordinary cases, although the partners are equally debtors to
both. Each class has a prior claim on its own fund, and only a secondary or postponed claim on the other after the latter's preferred creditors are satisfied."

The difference in result as it appears from this latter case must be based upon the fraudulent acts of the second firm in its conduct with the first firm and to the detriment of the first firm and its creditors.

In Huffman Farm Company v. Rush, 173 Pa. 264, 1896, it was held that under the Act of April 14, 1838, P. L. 457, a partnership may bring an action against two joint purchasers of the firm's goods, although one of the purchasers is a member of the partnership.

A. J. WHITE HUTTON