Quasi-Partnership Liability: Martin v. Peyton

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tax laws as applied to an illegal occupation. It has been cogently contended, moreover, that the fear of conviction for failure to file an income tax return would not impel a criminal to disclose the sources of his illegal earnings, no more than the fear of conviction for "bootlegging" influences a criminal from forsaking such an employment.

On the other hand, it may be maintained in consonance with the opinion of Mr. Justice Holmes, that there is no sound reason why an individual should refrain from making an income tax report simply because he was satisfied in the conviction that in so doing he might incriminate himself. In other words, an individual is not to assume functions of the court in determining whether or not the matter would accuse him. The possibility readily suggests itself, too, that to hold otherwise would tend to foster crime in offering an attractive refuge to lawbreakers.

The border line cases in the application of the provisions of the Fifth Amendment will probably be decided according as the judges approve or disapprove of the policy embodied in the guaranty as applied to tax returns.

V. J. M.

QUASI-PARTNERSHIP LIABILITY: MARTIN v. PEYTON — "Much ancient learning as to partnership is obsolete." With these words, the New York Court of Appeals begins its most recent decision upon the question of when persons, not ostensibly partners, may be subject to liability for partnership obligations.

A hundred and fifty years ago, the English Court of Common Pleas, in the case of Grace v. Smith, said, "Every man who has a share of the profits of a trade ought also to bear his share of the loss. And if any one takes part of the profit, he takes part of that fund on which the creditor of the trader relies for his payment." Under the rule of this case, as promulgated by the English courts, the right to share profits was decisive of partnership liability. The

27 27 Columbia Law Rev. 467 (1927); Application of rule against Self Incrimination to Income Tax Returns.
28 Mason, et al., v. United States, 244 U. S. 362 (1917).
2 2 W. Bl. 998 (C. P. 1775).
3 Ibid. 1000.
intention of the parties not to assume the obligations incident to the partnership relation was generally disregarded.4

It was not until 1860 that the stringency of this rule was relaxed. This was accomplished by the decision of the House of Lords in the now historic case of Cox and Wheatcroft v. Hickman.5 In delivering what has been recognized as the prevailing opinion, Lord Cranworth said, with regard to the rule of Grace v. Smith and Waugh v. Carver,6 "This, no doubt, is in general a sufficiently accurate test; for a right to participate in profits affords cogent, often conclusive, evidence that the trade in which the profits have been made was carried on in part for or on behalf of the person setting up such a claim. But the real ground of the liability is that the trade has been carried on by persons acting on his behalf. When that is the case, he is liable to the trade obligations and entitled to its profits, or a share of them."7

The United States Supreme Court, though not approving the method of reasoning by which the English Court reached its conclusion, favored the general relaxation.8 As a rule better suited for common application, Mr. Justice Gray suggested, "That those persons are partners who contribute either property or money to carry on a joint business for their common benefit, and who own and share the profits thereof in certain proportions."9 In rejecting the contention

4 See Waugh v. Carver, Carver and Geisler, 2 H. Bl. 235, 246 (C. P. 1793), "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," yet the defendants were held answerable for a trade obligation incurred by one of them. For a discussion of the earlier English rule and its application, see the opinion of Blackburn, J., in Bullen v. Sharp, L. R. 1 C. P. Cases 86 (1865).

5 8 H. L. Cas. 268 (1860).

6 Supra, Note 4.

7 Cox v. Hickman, supra, note 5, at 306. Though, of the ten reported opinions, Lord Cranworth's has been generally regarded as the true expression of the views of the Court, it is interesting to note that Lord Chief Baron Pollock believed the law to be as set forth in Story, Partn. § 49. "In short, the true rule, ex aequo et bono, would seem to be, that the agreement and intention of the parties themselves should govern all the cases, if they intended a partnership in the capital stock, or in the profits, or in both; then, that the same rule should apply in favour of third persons, even if the agreement were unknown to them; and on the other hand, if no such partnership were intended between the parties, then that there should be none as to third parties * * * ."


9 Meehan v. Valentine, supra, note 8, at 623.
of the plaintiff that the receipt of a contingent share of the profits of a firm as compensation for a loan constituted the lender a partner as to third parties, the Court, while speaking of acts which one might perform without involving oneself in partnership liability, said, "And it is now equally well settled that the receiving of part of the profits of a commercial partnership, in lieu of or in addition to interest, by way of compensation for a loan of money, has of itself no greater effect (citing cases)." \(^{10}\) The decision in Cox v. Hickman met with the general approval of courts elsewhere.\(^{11}\)

The courts of New York, however, did not consider themselves bound by that decision, and in the leading case of Leggett v. Hyde,\(^{12}\) which, nominally at least, remained the law of this jurisdiction until the adoption of the Uniform Partnership Act, the Court cited with approval the earlier English cases. In its opinion, the Court expressly negatived the efficacy of the parties' intention not to become partners\(^{13}\) and in explanation said, "Among the reasons given is this, whether it be strong or weak, that whatever person shares in the profit of any concern shall be liable to creditors for losses also, since he takes a part of the fund, which in great measure is the creditors' security for the payment of the debts to them." \(^{14}\) The Court, though evidently not satisfied with the reason assigned for the earlier rule of law, was of opinion that a change to conform to the needs of commerce could only be effected by legislative enactment. In subsequent decisions, the New York courts, though carefully reiterating the rule of Leggett v. Hyde,\(^{15}\) limited its application.\(^{16}\)

\(^{10}\) Ibid. 624.

\(^{11}\) In the opinions in Eastman v. Clark, 53 N. H. 276, 16 Am. Rep. 192 (1873), reference is had to the leading decisions upon the question. See also the opinions in Thillman v. Benton, 82 Md. 64, 33 Atl. 485 (1895); Austin, Nichols & Co. v. Neil, et al., 62 N. J. L. 462, 41 Atl. 834 (1898); Jackson v. Haynie's Admr., 106 Va. 382, 56 S. E. 148 (1907).

\(^{12}\) 58 N. Y. 272 (1874).

\(^{13}\) Ibid. 278.

\(^{14}\) Ibid.

\(^{15}\) "A rather forceful reiteration is found in Hackett v. Stanley, 115 N. Y. 625, 22 N. E. 745 (1889), "The application of the rule that 'participation in profits' renders their recipient a partner in the business from which profits are derived, as to third persons, has been somewhat restricted by modern decisions; but we think that the division of profits must still be considered the most important element in all contracts by which the true relation of parties to a business is to be determined. We think this rule is founded in strict justice and sound policy.'"

\(^{16}\) King v. Sarria, 69 N. Y. 24, 35, 36, (1877); Smith v. Bodine, 74 N. Y. 30, 33 (1878); Richardson v. Hughitt, 76 N. Y. 55 (1879); Curry v. Fowler, 87 N. Y. 33 (1881); Cassidy v. Hall, 97 N. Y. 159 (1884); Burnett v. Snyder, 81 N. Y. 550, 555 (1880), "It is not every participation in the profits which will make one a partner. Numerous exceptions to the rule have been established."
The adoption of the Uniform Partnership Act\(^{17}\) permitted our courts to follow the dictates of commercial necessity. The Act defines a partnership as “an association of two or more persons to carry on as co-owners a business for profit,”\(^{18}\) and provides statutory tests for determining its existence.\(^{19}\) Contained in the Act is a direction that its provisions, though in derogation of the common law, be liberally construed.\(^{20}\) Since the adoption of this uniform law, which has been enacted in sixteen states, including those of prime commercial importance,\(^{21}\) the courts have denied the existence of partnership liability under circumstances which would have called for a contrary decision but a decade ago.\(^{22}\)

In the recent decision of the Court of Appeals in the case of Martin v. Peyton, \(et\ al.,^{23}\) we find the widest departure from the rules as previously enunciated. In this case, a long established banking firm in New York City had suffered financial reverses during the period of post-war deflation. The value of its working capital, consisting largely of inactive and foreign securities, had been seriously depleted, and in order to continue its business it was imperative that these securities be supplanted by a large amount of readily marketable securities. A member of the firm, through his intimacy with certain of the defendants, was enabled to negotiate a loan of $2,500,000 in desirable securities, the property of persons represented by those defendants. By the terms of the parties’ agreement the inactive securities of the firm were mortgaged to two of the defendants for the benefit of themselves and their co-lenders. As compensation for the loan of the active securities, the lenders were to be entitled to agreed shares of the profits. Two of their number, described as trustees, were to be consulted in all matters of importance and were empowered to prohibit the firm’s participation in ventures which they might deem speculative. The interest of each member in the firm was assigned to the trustees and the signed resignation of each member was deposited as further security. An “option agreement” giving the lenders, or any of them, the right to enter the firm upon compliance with certain conditions also formed part of the transaction.

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\(^{17}\) Laws of 1919, Chap. 408, constituting Chap. 39 of the Consolidated Laws.

\(^{18}\) U. P. A. § 6-1; N. Y. Part L. § 10-1.

\(^{19}\) Ibid. § 7; § 11.

\(^{20}\) Ibid. § 4; § 4.

\(^{21}\) E.g., Illinois, Massachusetts, Michigan, Minnesota, New Jersey, New York and Pennsylvania.

\(^{22}\) E.g., \(In\ re\) Hoyne, 277 Fed. 668 (C. C. A. 7th, 1922) where the decision turned upon U. P. A. § 7, as enacted in Illinois.

\(^{23}\) 246 N. Y. 213, 158 N. E. 77 (1927).
After the effort to forestall bankruptcy had proven unsuccessful, plaintiff sought to enforce a partnership obligation against the lenders. The Court, in holding them not liable, was of opinion that the lenders did not exercise primary control over the acts of the partnership. The control conferred upon the so-called trustees was found to be fully consonant with a desire on the part of the lenders to protect their loan and was not considered indicative of an assumption of the partnership relation.

It is interesting to note that the Court in its opinion relied solely upon two sections of the Partnership Law as expressive of the law of this state. The case of Cox v. Hickman and the leading English cases in conformity therewith, together with decisions of the federal courts and of state courts of other jurisdictions formed the basis of this opinion. The instant case, however, goes further than any of those cited. Here the loan arrangement was not made in the interest of existing creditors who sought thereby to increase the amounts recoverable by them (as was the case in two of the three federal decisions cited), but rather for the benefit of persons, previously unconcerned in the firm's affairs, who were investing new capital presumably in the hope of substantial profit. It is also interesting to note that the property supplied by the lenders constituted, from the time of the loan until the bankruptcy, the entire working capital of the firm. Since no question of liability by estoppel was presented in this case, it was the decision of the Court, that, despite the circumstances above mentioned, the intention of the parties not to constitute themselves partners should prevail.

This decision completely abrogates the rule formerly obtaining in New York, that, as to third parties, one not actually a partner could be held answerable for firm obligations upon proof that he shared, or had a right to share, in the profits of the business. With the exception of liability by estoppel, we can say, in the words of the Court, that "today only those who are partners between themselves may be charged for partnership debts by others." 

H. G. H.

Annulment of Marriage for Fraud: Failure to Participate in a Religious Ceremony.—The law governing annulment of marriage for fraud has been thrown into confusion by the recent decision of the

34 N. Y. Part L. §§ 10, 11.
35 Giles v. Vette, 263 U. S. 553, 44 Sup. Ct. 157 (1924); In re Hoyne, supra, note 22.