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Partnerships: The Nature of the Partnership Before the Law

Darrell L. Peck

statutes of limitation, policy considerations would seem to warrant allowing the federal courts in bankruptcy proceedings to impose federal equitable interpretations upon state statutes of limitations.

The Supreme Court's recent denial of certiorari seems unfortunate inasmuch as the *Austrian* decision cannot be justified on the grounds that the interpretation of 11 e which formed the basis of the decision was that intended by Congress. In addition thereto, the general policy of the Bankruptcy Act aimed at extending the period in which to bring suit would seem to warrant a contrary interpretation of 11 e.

GERALD A. FLANAGAN

Partnerships—The Nature of the Partnership before the Law— In 1946 two persons formed a partnership to operate a Ford sales and service agency. Two years later the same persons formed a second partnership to sell and service tractors. Each partnership had its own building, books, employees and bank account. All they had in common were the two owners, the partners. The Ford agency employed enough men to make it subject to the Michigan employment security act, but the tractor agency did not. However, acting under advice from appellant, the partners included the employment of both firms on the same report. By 1949, because of the good employment record of the two firms, the partners' contribution rate for employment insurance was only one per cent of the wages paid. At that time appellee purchased the Ford agency from the partners, retaining the same employees. Appellant raised the contribution rate of the Ford agency to three per cent on the ground that the two partnerships had legally been but a single firm because they were composed of the identical partners; that appellee therefore was not a successor to the firm that had the one per cent contribution rate, but to a distinct firm. Appellee won on an appeal to a referee. This decision was affirmed by the appeal board and by the circuit court, but the commission appealed. *Held:* Affirmed. A partnership is a legal entity distinct from the individuals composing it. Consequently, two partnerships with the same members are not a single employing unit but must be considered separately. *Michigan Employment Security Commission v. Crane et al. 334 Mich. 411, 54 N.W. 2d 616 (1952).*

The decision of the principal case, that a partnership has a legal existence distinct from its members, follows what is generally known as the entity theory of partnerships. The contention of the appellant—a partnership is not a distinct legal entity but an association of individuals—is known as the aggregate theory.[1] Whether a partnership is

[1] Crane, *The Uniform Partnership Act—A Criticism,* 28 HARV. L. REV. 762 at 763 (1915).

or is not a legal being, though a most fundamental concept, has long been one of the most confused questions of partnership law because of the conflict between these theories.[2]

The aggregate theory may be traced back to the early common law where there were no artificial legal entities recognized by the courts.[3] The entity theory, on the other hand, was embodied in the old Law Merchant.[4] When the Law Merchant was incorporated into English common law, the entity concept of partnerships was inadvertently left behind.[5] Consequently, the aggregate theory was the prevailing common law theory when this country inherited its common law from England. Among the civil law jurisdictions, however, the entity theory has received almost universal recognition.[6]

Although there has been considerable legislation in this country concerning partnerships, statutes defining their specific nature have been conspicuously lacking.[7] Statutes dealing primarily with other phases of the law, and with partnerships only incidentally, generally treat the firm as an entity.[8] For example, a partnership is an entity under the bankruptcy act[9] or for purposes of workmen's compensation.[10] The partnership is usually included in the statutory definition of a "person."[11]

The Uniform Partnership Act is the most important and most generally adopted legislation dealing directly with partnerships.[12] Immediately prior to the drafting of the act, begun in 1902, the entity theory was rapidly growing in popularity, so much so that it was even referred to as the "generally accepted theory."[13] This theory was so

[2] The two theories are discussed in almost every treatise concerning partnership law. See especially: Cowles, *The Firm as a Legal Person,* 57 CENT. L. J. 343 (1903); Burdick, *Some Judicial Myths,* 22 HARV. L. REV. 393 (1909); Lewis, *The Uniform Partnership Act,* 24 YALE L. J. 617 (1915); Crane, *The Uniform Partnership Act—A Criticism,* 28 HARV. L. REV. 762 (1915); Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism,* 29 HARV. L. REV. 158, 291 (1915); Crane, *The Uniform Partnership Act and Legal Persons,* 29 HARV. L. REV. 838 (1916); Drake, *Partnership Entity and Tenancy in Partnership: The Struggle for a Definition,* 15 MICH. L. REV. 609 (1917); Mathews and Folkerth, *Ohio Partnership Law and the Uniform Partnership Act,* 9 OHIO ST. L. J. 616 (1948); Kaesh, *Partnership Law and the Uniform Partnership Act in South Carolina,* 3 S.C.L.Q. 193 (1951).

[3] GILMORE ON PARTNERSHIPS §40 (1st ed. 1911).

[4] For a complete history of the entity theory, see Drake, *Partnership Entity and Tenancy in Partnership: The Struggle for a Definition, supra,* note 2.

[5] *Ibid.* at 620.

[6] *Supra,* note 1 at 764.

[7] Nebraska has adopted the entity theory by statute. NEB. REV. STATS. §67-306 (1943).

[8] *Supra,* note 1 at 768.

[9] TELLER, PARTNERSHIPS §113A (1st ed. 1949).

[10] WIS. STATS. (1951), sec. 102.04 (2); Kalson v. Industrial Commission, 248 Wis. 393, 21 N.W. 2d 644 (1946).

[11] WIS. STATS. (1951), sec. 108.02 (4), 189.02 (2), 120.53 (1), 121.76 (1), 122.01 (6).

[12] 7 UNIFORM LAWS ANNOTATED.

[13] *Supra,* note 3 at 609. It was even claimed that the entity theory had replaced the aggregate theory as the legal concept. See Prof. Beale's Preface to PARSONS, PARTNERSHIP (4th ed.).

popular with the Commissioners on Uniform State Laws that when they undertook to codify partnership law the aggregate theory was originally not even considered. Later two distinct partnership acts were drawn up, one on each theory; and finally the draft based on the aggregate theory was approved.[14] This choice dealt a serious blow to the progress of the entity theory, but contrary to the expectations of some,[15] did not destroy it.

Neither the aggregate nor the entity theory is applied in absolute form in this country. For convenience, the various states may be divided into four groups: 1) the entity theory states, 2) the liberal aggregate theory states, 3) the borderline states, and 4) the strict aggregate theory states.[16]

In the entity theory states, the partnership is a distinct entity before the law for all purposes. The rule is usually applied with admirable consistency in such jurisdictions.[17] In exceptional cases the partnership entity is sometimes ignored, but such departures are rare.[18]

The majority of the states follow a very liberal modification of the aggregate theory. Although it is recognized that the partnership is not technically a legal entity, nevertheless it is often treated as one.[19] Whether or not the courts of such jurisdictions will recognize the partnership as an entity depends entirely on the facts of each case.

A few states are borderline states. Actually these could probably be included among the liberal aggregate theory states; but, instead of declaring that a partnership is not technically a legal person but is only treated as such, they sometimes hold that a partnership is a legal entity and sometimes that it is not.[20] What a partnership actually is in such states is hard to determine.

[14] For a detailed history of the attempt to draft a Uniform Partnership Act, see 7 Uniform Laws Annotated, Prefatory Note; Lewis, *The Uniform Partnership Act, supra,* note 2 at 639; Richards, *The Uniform Partnership Act,* 1 WIS. L. REV. 5, 90 (1920).

[15] Lewis, *The Uniform Partnership Act, supra,* note 2.

[16] This classification must, of course, be rather arbitrary. Aside from the confirmed entity theory states [Iowa, Louisiana (civil law), Nebraska (statute), Oklahoma, South Carolina, and Vermont], it is almost impossible to make any positive classification.

[17] Thurston v. Detroit Asphalt & Paving Co., 226 Mich. 505, 198 N.W. 345 (1924); Chisholm v. Chisholm Construction Co., 298 Mich. 25, 298 N.W. 390 (1941); Lobato v. Paulino, 304 Mich. 668, 8 N.W. 2d 873 (1943); Walker v. Wait, 50 Vt. 668 (1878); Dunbar v. Farnum, 109 Vt. 313, 196 Atl. 237 (1938); Glass v. Newport Clothing Co., 110 Vt. 368, 8 A.2d 651 (1939); Brooks v. Ulanet, 116 Vt. 49, 68 A.2d 701 (1949).

[18] Chisholm v. Chisholm Construction Co., *supra,* note 17 [to avoid fraud]; Calhoun v. Bank of Greenwood, 42 S.C. 357, 20 S.E. 153 (1894) [where there was only one partner].

[19] Note, 41 COL. L. REV. 698 (1941) discusses a number of New York decisions employing the entity theory in certain situations although New York generally follows the aggregate theory.

[20] Fenner & Beane v. Nelson, 64 Ga.App. 600, 13 S.E.2d 694 (1941) states that a partnership is a legal entity. Huiet v. Brown, 70 Ga.App. 638, 29 S.E.2d 326 (1944) declares that a partnership is not a being distinct from its members. Each cites several cases in support of the decision.

The strict aggregate theory states deny that the nature of a partnership is ever such as to make it a legal person. The firm may be an entity only for procedural or conveyancing purposes or other purposes established by statute.[21] Even then, the essential nature of the partnership is not affected.[22]

Wisconsin, in *Westby v. Bekkedal*,[23] its first decision on the legal nature of the partnership, affirmed the aggregate theory as the common law on the subject. The language of the court in the *Thomas* case[24] definitely placed this state in support of the strict aggregate theory.[25] The latest Wisconsin case on the nature of the firm, however, the *Kalson* case,[26] declared that a partnership is recognized as an entity for some purposes.[27] At first glance, this would seem to make Wisconsin a liberal aggregate theory state, but a closer examination raises some doubt.

In the *Thomas* case, the court refused to recognize the firm as an entity even though the workmen's compensation act included a "firm" in the definition of an employer.[28] An employee was said to be employed by the partners as individuals and not by the firm as an entity.[29] This position was reversed in the *Kalson* case which held that the firm entity and not the individual partner was the employer.[30] However, the court may not have been departing from its aggregate position but merely recognizing that statute makes the firm an entity in certain instances. Even a court following the strict aggregate theory cannot ignore legislation recognizing the partnership as an entity.[31]

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[21] Thomas v. Industrial Commission, 243 Wis. 231, 10 N.W.2d 206 (1943).

[22] *Supra*, note 3.

[23] 172 Wis. 114, 178 N.W. 451 (1920).

[24] *Supra*, note 21.

[25] ". . . it is well established that the Uniform Partnership Act is founded on the aggregate, and not on the entity theory so far as all substantive right, liabilities, and duties are concerned. Whatever recognition is given to the entity theory in the partnership act is solely for procedural or conveyancing purposes . . ." *Ibid.* at 239.

[26] Kalson v. Industrial Commission, *supra*, note 10.

[27] "But we cannot sustain the plaintiff's contention that use of the word 'firm' in that phrase [WIS. STATS. (1951), sec. 102.04 (2)] it was not intended to treat, under the compensation act, a firm as a separate entity, as distinguished from an aggregation of individuals who composed these partnerships." *Ibid.* at 396.

[28] WIS. STATS. (1951), sec. 102.04 (2).

[29] *Supra*, note 24 at 239. A husband and wife had formed a partnership which employed their minor son. The son was killed at work and his parents sued for $2000 under the compensation act. The court held the parents, and not the firm as an entity, were actually the employer. Consequently, the parents were both claimant and employer, both a plaintiff and defendant in the action, and could not recover.

In its next session, the state legislature reversed this result by abolishing the defense that the claimant was also the employer, enacting WIS. STATS. (1951), sec. 102.51 (7). Possibly this action by the legislature influenced the courts decision in the Kalson case.

[30] *Supra*, note 26 at 396.

[31] The New Jersey court reached the same result in a case very similar to the KALSON case. Finston v. Unemployment Compensation Commission, 132 N.J.L. 276, 39 A.2d 697 (1944).

By the same token, how can the courts of any state which has adopted the Uniform Partnership Act ignore this legislative confirmation of the aggregate theory by declaring that the partnership is a legal entity? The draftsman of the act has stated that this is impossible.[32] Yet it is almost impossible to find a court, even in states having the Uniform Partnership Act, which have never treated the firm as an entity.[33] Apparently then, the uniform act is not a codification of the aggregate theory. Claim has been made that the act is closer to the entity theory[34] but this conclusion is not generally accepted.[35] The answer must be that the act is not based entirely on either theory.[36] Since the act is in effect in entity as well as aggregate theory states,[37] apparently it does not settle the question one way or the other.[38] Consequently, it is left to each state to decide the question for itself.

The question has been decided with the greatest certainty in the entity theory states.[39] The strict aggregate theory states are also very consistent in their decisions on the subject, but, because of statutes employing the entity theory even in these states, the same degree of certainty is not possible.[40] There is utter confusion as to whether the firm will be treated as an entity or as a group of individuals in a given case in the liberal aggregate theory or borderline states.[41] Very much discretion is left to the courts in the states and, as a result, "hard" cases are avoided at the expense of a definite rule of law.

In addition to being the most certain theory, the entity theory is also

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[32] "It is submitted that there is no warrant for this conclusion [that the Uniform Partnership Act adopts neither the aggregate nor the entity theory]; but that, on the contrary, the adoption of the Act makes it impossible for a court to hold a partnership a legal person. . . ." Lewis, *The Uniform Partnership Act —A Reply to Mr. Crane's Criticism, supra,* note 2 at 298.

[33] The Wisconsin Supreme Court is a good example. See Kalson v. Industrial Commission, *supra,* note 10.

[34] "The language and the effect of provisions of the proposed Uniform [Partnership] Act are more nearly consistent with the legal-person theory of partnership than with any other theory." Crane, *The Uniform Partnership Act and Legal Persons, supra,* note 2 at 843.

[35] *Supra,* note 25; *supra,* note 32.

[36] "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. . . .

"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." WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION 300 (1929).

[37] Michigan, Nebraska, South Carolina, and Vermont are entity theory states which also have the Uniform Partnership Act.

[38] *Supra,* note 1 at 770. Mr. Crane analyzes the Uniform Partnership Act and points out where the entity theory shows its influence.

[39] *Supra,* note 17.

[40] In the *Thomas* case the Wisconsin Supreme Court enunciated the strict aggregate theory but in the *Kalson* case a statute necessitated recognizing the entity theory.

[41] *Supra,* note 19.

closest to the layman's and businessman's view of the partnership.[42] Business is conducted with the firm, not with several individuals. The aggregate theory is a carry over from the old common law prior to its merger with the mercantile law which governed the business world. Under the Law Merchant the partnership was an entity and the Uniform Partnership Act expressly provides that in any case not provided for in that act "the rules of law and equity, including the law merchant, shall govern."[43] It has already been seen that the act does not settle the nature of a partnership. The entity theory should not be avoided merely because it is a departure from the old common law. The modern trend is toward the entity theory.[44] The question is of increasing importance because in recent years the partnership form of doing business has increased in popularity due to income tax benefits it has over the corporation.[45]

The entity theory is closest to the true nature of partnerships and its adoption in Wisconsin would be desirable to avoid recurrences of the confusion and apparent conflict of the *Thomas* and *Kalson* cases.[46] However, if the Wisconsin Supreme Court should decide to take such a step, the aggregate theory should be destroyed with a single blow to avoid the confusion of wavering between theories which is so prevalent today. It is probably better to be certain of the old law than to waver between the old and the new.[47] But it is better still to be certain of the new.

DARRELL L. PECK

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[42] "In common parlance a partnership is referred to as though it had a separate existence like that of a corporation; this is doubtless the mercantile conception, and there seems to be a growing tendency on the part of the courts to adopt this view of the business world which regards a partnership as a legal entity distinct from and independent of the persons composing it." 40 AM. JUR. PARTNERSHIPS §18.

[43] UNIFORM PARTNERSHIP ACT §5.

[44] "While a co-partnership at common law was not considered a distinct entity from the partners composing it, the modern tendency is the other way, *i.e.*, to treat a partnership as an entity distinct and independent of the individuals composing it." Gleason v. Sing, 210 Minn. 253, 297 N.W. 720 (1941).

[45] Note, 97 U. OF PA. L. REV. 52 (1948).

[46] As Justice Learned Hand said, "The whole subject of partnership has undoubtedly been exceedingly confused, simply because our law has failed to recognize that partners are not merely joint debtors. It could be straightened into great simplicity, and in accordance with business usages and business understanding, if the entity of the firm, though a fiction, were consistently recognized and enforced. Like the concept of a corporation, it is for many purposes a device of the utmost value in clarifying ideas and in making easy the solution of legal relations." In re Samuals & Lesser, 207 Fed. 195, 198 (S.D. N.Y. 1913).

[47] Since the decision of the Kalson case, even the old law is none too certain in Wisconsin.