



NORTH CAROLINA LAW REVIEW

Volume 36 | Number 2

Article 15

2-1-1958

Partnerships -- Liability of Partners -- Marshalling Assets

Harold C. Mahler

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>

 Part of the [Law Commons](http://scholarship.law.unc.edu/nclr)

Recommended Citation

Harold C. Mahler, *Partnerships -- Liability of Partners -- Marshalling Assets*, 36 N.C. L. REV. 229 (1958).

Available at: <http://scholarship.law.unc.edu/nclr/vol36/iss2/15>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

dictum the court stated that the assignment of the mortgage sufficed to transfer the debt, so why should a transfer of a mortgagee's interest in the mortgaged property not have the same effect? No North Carolina cases on this point were found. The courts in other jurisdictions adopt various views. One view is that the grantee acquires at least an equitable right to the secured indebtedness.¹⁷ Another view is that the grantee acquires the secured indebtedness only if the mortgagee was in possession of the mortgaged property at the time he executed the deed.¹⁸

It is submitted that the better view is to give effect to the intention of the parties where such can reasonably be done. Normally, it seems the intent would be to transfer all the mortgagee's interest in the property and the debt, else the grantee would receive nothing of value. However, where the mortgagee has transferred the secured debt to a third party for value and then conveys the mortgaged property, the grantee of the mortgaged property would have to suffer for his own negligence or ignorance of the facts.¹⁹

PHILLIP C. RANDELL

Partnerships—Liability of Partners—Marshalling Assets

The law in North Carolina relative to the rule of marshalling assets for the benefit of firm and individual creditors is somewhat uncertain. Before the Uniform Partnership Act¹ was passed in 1941, the court held in *Virginia-Carolina Chemical Co. v. Walston*² that the firm creditor did not have to exhaust the firm assets before reaching the individual assets of the partners. The firm was in the hands of receivers who were in the process of settling the affairs of the business. Partner *A* had died, thus dissolving the partnership. Partner *B* was insolvent and the firm owed some \$62,000, of which \$12,500 was owed to the Chemical Company. *A*'s personal estate was valued at \$9,000, with \$3,000 outstanding personal debts against it. The Chemical Company sought to share in the personal assets of *A* along with the open unsecured creditors of the personal estate. The trial court held that the Chemical Company could share in the individual assets of *A* only to the extent of the balance unpaid after all dividends from the firm assets had been received. From this ruling the Chemical Company appealed and the court, looking to C.S. § 3259,³ reversed the holding of the lower court.

¹⁷ *Sadler v. Jefferson*, 143 Ala. 669, 39 So. 380 (1905); *Hawkins v. Elston*, 58 Cal. 400, 146 Pac. 254 (1915).

¹⁸ *Wyman v. Porter*, 108 Me. 110, 79 Atl. 371 (1911).

¹⁹ For a general discussion of this problem, see Ross, *The Double Hazard of a Note and Mortgage*, 16 MINN. L. REV. 123 (1932).

¹ UNIFORM PARTNERSHIP ACT, N.C. GEN. STAT. §§ 59-31 to 59-89 (1950).

² 187 N.C. 817, 123 S.E. 196 (1924).

³ N.C. CODE ANN. § 3259 (Michie 1935). The statute provided in part:

The court, Justice Stacy writing the opinion, held that the equitable doctrine that firm creditors could not reach the personal assets of the partner until the obligations of the separate and private creditors had been satisfied did not apply in this state since the effect of C.S. § 3259 was to convert creditors of the firm into individual creditors of each member of the firm.⁴ Since the liability of the partners was joint and several, and since the firm assets were not sufficient to pay the firm debts, the creditors of the partnership were entitled to have their claims allowed in full, both as against the firm assets and as against the individual assets of partner *A*; they were allowed to enforce the two liabilities concurrently and to obtain their ratable share of each fund.⁵

In 1941 the Uniform Partnership Act⁶ was enacted and C.S. § 3259, under which the *Walston* case was decided, was repealed.⁷ The new act provided that the partners were liable jointly for all firm debts and obligations other than torts and breaches of trust.⁸

In 1954 *Casey v. Grantham*⁹ was decided by the supreme court. The plaintiff and another were partners in a cotton ginning and saw-milling business. The plaintiff and his partner had executed notes totaling \$15,000 to the firm creditor and had secured these notes with a deed of trust conveying the partnership property and the home and farm of the plaintiff. The plaintiff sought to have a dissolution, a settlement and an accounting of the firm assets, and an injunction to prevent the trustee from selling the property under the power of sale contained in the deed of trust. The court, in overruling the dissolution of the temporary injunction by the lower court,¹⁰ held that each partner had the right to have partnership property applied to the payment of partnership debts in order to relieve him from personal liability.¹¹ The court further stated:

"General and Special Partners; Liability. Such partnership may consist of one or more persons, who are general partners, and are jointly and *severally* responsible as partners are now by law . . ." (Emphasis added.)

⁴ 187 N.C. at 821, 123 S.E. at 198.

⁵ 187 N.C. at 822, 123 S.E. at 198.

⁶ See note 1 *supra*.

⁷ N.C. Public Laws 1941, c. 251, § 31.

⁸ N.C. GEN. STAT. § 59-45 (1950). This statute provided: "All partners are liable

"(a) Jointly and severally for everything chargeable to the partnership under §§ 59-43 [torts] and 59-44 [breaches of trust].

"(b) Jointly for all other debts and obligations of the partnership . . ."

⁹ 239 N.C. 121, 79 S.E.2d 735 (1954).

¹⁰ Transcript of Record, p. 11, *Casey v. Grantham*, 239 N.C. 121, 79 S.E.2d 735 (1954). The defendant demurred to the complaint on the grounds of misjoinder of parties and causes and that the complaint failed to state a cause of action. The judge, hearing the motion on demurrer, sustained the demurrer, dismissed the action, and dissolved the temporary restraining order.

¹¹ The court relied, in part, on two Iowa cases: *Bankers Trust Co. v. Knee*, 222 Iowa 988, 270 N.W. 438 (1938), and *Simmons v. Simmons*, 215 Iowa 654, 246 N.W. 597 (1933).

It appears that under the general rule as to marshaling partnership and individual assets, or under the application of a principle of equity similar to that rule, the rule that partnership debts may be paid out of individual assets is subject to the modification that the individual assets may be so applied where, and only where, there are no firm assets, or where the firm assets have become exhausted.¹²

The equitable doctrine of marshaling assets of a partnership is that when the partnership property and the individual properties of the partners *are before the court for distribution*, the firm creditors have priority on firm assets, and individual creditors have priority on individual assets.¹³ G.S. § 59-70(h)¹⁴ is a codification of that rule. The court, in deciding the *Casey* case, did not cite this statute, but based its decision, at least in part, on G.S. § 59-68 (1).¹⁵ This statute, while not the rule of marshaling assets, is an application of part of the same principle. It provides that upon *dissolution*, each partner, as against his co-partners and all persons claiming through them, may have the partnership property applied to discharge partnership liabilities. Thus, if the statutes are read literally, the doctrine of marshaling assets can only apply when the assets, both firm and individual, are before the court for distribution. G.S. § 59-68 (1) may be applied at the dissolution stage. In applying G.S. § 59-68 (1) in the *Casey* case, the court spoke of the rule of marshaling assets¹⁶ and cited two Iowa cases¹⁷ to support its view. This infers that in North Carolina the rule of marshaling assets is applicable not only when the assets are before the court for distribution, but also upon dissolution. It will be observed that in the *Casey* case the point being decided was the propriety of an injunction against the trustee to prevent sale of the individual property under the deed of trust. The court did not order a dissolution. This leaves the further inference that the rule of marshaling assets may be applied even before the dissolution.

This raises a problem in the application of G.S. § 59-45.¹⁸ In 1953 this statute was amended¹⁹ so as to hold partners liable jointly *and severally* for all obligations of the partnership. This was done to remove a direct conflict with G.S. § 1-72,²⁰ which declared partners to be jointly and severally liable for contracts of the partnership.²¹ Hence,

¹² 239 N.C. at 126, 79 S.E.2d at 738. ¹³ 187 N.C. at 820, 123 S.E. at 197.

¹⁴ N.C. GEN. STAT. § 59-70(h) (1950).

¹⁵ N.C. GEN. STAT. § 59-68(1) (1950).

¹⁶ 239 N.C. at 126, 79 S.E.2d at 738.

¹⁷ See note 11 *supra*.

¹⁸ N.C. GEN. STAT. § 59-45 (Supp. 1955).

¹⁹ See note 18 *supra*.

²⁰ N.C. GEN. STAT. § 1-72 (1950).

²¹ *A Survey of Statutory Changes in North Carolina in 1953*, 31 N.C.L. REV. 375, 429 (1953).

today the language in the statute is essentially that of C.S. § 3259 under which the *Walston* case was decided.

The effect of the 1953 amendment of G.S. § 59-45 was not referred to in the *Casey* decision; the amendment did not become operative until after the action was filed.²² However, should such a situation arise today involving a simple unsecured partnership debt,²³ the court would have to decide whether there is a conflict between the marshalling of assets rule in G.S. § 59-70(h), giving the individual creditor priority as to individual assets when assets of the dissolved firm and its partners are being distributed by the court, and G.S. § 59-45, which makes all firm debts joint and several obligations of the parties. The *Walston* case, in such a situation, held that a statutory provision like the present G.S. § 59-45 made every firm creditor a creditor also of each individual partner, with a right to share in the separate assets of each on the same basis as his separate personal creditors, and that consequently that statutory provision barred or interfered with the marshalling of assets. The same result might be ascribed to the present G.S. § 59-45.²⁴

It is at least doubtful, however, whether there be any inconsistency between these two sections of the North Carolina Uniform Partnership Act. The marshalling of assets rule is expressly applicable only after dissolution²⁵ and only when all the assets involved are in the hands of the court for distribution.²⁶ Before that, the debts of the firm are joint and several obligations under G.S. § 59-45, so that a firm creditor may, if he desires, get a judgment against an individual partner and collect from him alone. When the court takes over the assets for distribution, in marshalling the assets the holder of such a judgment not yet paid must be recognized as a creditor of any partners who are named as judgment debtors, and presumably also as a creditor of the firm. Similarly, the holder of a note signed by the firm, and signed or endorsed also by the separate partners, would be entitled to proof against the estates of all his promisors; the creditor who has taken steps to formalize his claim against the individual partners must be given the benefit of his foresight. But it does not follow that the creditor whose

²² The action was filed in the superior court in December, 1952. Transcript of Record, p. 1, *Casey v. Grantham*, 239 N.C. 121, 79 S.E.2d 735 (1954). The amendment did not become effective until July 1, 1953. N.C. GEN. STAT. § 59-45 (Supp. 1955).

²³ The last clause in G.S. § 59-70(h) expressly excludes "lien and secured creditors" from subjection to the rule of marshalling assets.

²⁴ The marshalling of assets provision in G.S. § 59-70(h) might be held so inconsistent with the 1953 amendment of G.S. § 59-45 that the latter enactment repealed the former by implication. Or it might be held that the effect of the amendment of G.S. § 59-45 is simply to enlarge the class of those who are to be treated as creditors of the individual partners in applying G.S. § 59-70(h), placing all firm creditors in that class.

²⁵ See the first sentence in G.S. § 59-70.

²⁶ See note 14 *supra*.

contract was with the firm alone, a contract which is made by statute a joint and several obligation of the several partners, is by that statute entitled not only to priority in the firm assets as a firm creditor, but also to parity of treatment in the separate partners' individual estates with the partners' personal creditors. The rule of marshalling assets contained in G.S. § 59-70(h) does not deny firm creditors rights also as creditors of the separate partners; but it does deny them the preferred position as to individual assets which it grants to the personal creditors of the partners (just as it gives firm creditors a like preference as to firm assets).

The statute as to joint and several liability is procedural only.²⁷ The firm creditor with no more than a joint obligation is in truth a creditor of the separate partners; but in order to enforce his claim he must join them all as defendants. Once he has overcome this procedural obstacle and has his judgment, he may collect the whole amount out of property of any one of the judgment debtors, exactly as if his claim were joint and several.²⁸ There seems to be no sound reason for any difference between a joint and several creditor, as to their substantive rights.

The theory of the *Walston* case, however, is hardly consistent with this view. Until the court deals with the problem again, it cannot be concluded whether the *Casey* decision has resulted in a liberalization of the rule of marshalling assets, confusion in the application of the doctrine, or both.

HAROLD C. MAHLER

Property—Restrictive Covenants—Equitable Servitudes and Notice

In *Reed v. Elmore*,¹ a landowner subdivided a tract of land into seven lots and sold five of them with no restrictions as to use. She conveyed Lot No. 3 to plaintiff by deed stipulating that the land therein conveyed should be subject to the restriction that no structure be erected thereon by the grantee within a stipulated distance from the public road. This deed, which was properly recorded by plaintiff, contained the further provision, "This restriction shall likewise apply to Lot No. 4, retained by the grantor, said Lot No. 4 being adjacent to lands hereby conveyed." Subsequently, the owner sold this adjacent Lot No. 4, which defendant had obtained by mesne conveyances, the deed containing no reference to the restriction. The plaintiff covenantee, owner of

²⁷ CRANE, PARTNERSHIP 519 (2d ed. 1952).

²⁸ 2 WILLISTON, CONTRACTS § 316 (rev. ed. 1936); 4 CORBIN, CONTRACTS § 928 (1951).

¹ 246 N.C. 221, 98 S.E.2d 360 (1957).