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Who Owns Christmas Trees? The Disposition of Property Used by a Partnership

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Abstract

Two partners form an enterprise. One (the K partner) supplies the assets used by the enterprise. The other partner (the L partner) supplies only labor. When the enterprise ends, the partners disagree about how to divide the property used in the partnership business. The K partner wants his or her property returned. The L partner wants his or her share of the business assets. If some of the property has appreciated while in partnership use, the dispute will be especially complicated. How do the partners divide the value of the property as originally brought into the business? Who benefits from the previously unrealized appreciation?

This Article explores the property allocation issues that arise when the members of a K and L partnership lack a dispositive agreement. In such circumstances the default rules should provide clear guidance, and the Uniform Partnership Act (U.P.A.) seeks to do so. Unfortunately, many of the decided cases misapply or distort the U.P.A. As a body, the decided cases point in three different and mutually exclusive directions. Individually, they often ignore basic principles of partnership law.

This Article takes those basic principles as its lodestar and seeks to determine how the law of partnership should analyze a K and L dispute over property disposition. Part II sets the context for the analysis, introducing partnership law as the applicable law. Part III explains the four basic partnership law concepts necessary to a proper analysis of the Christmas tree paradigm. Part IV describes the three different and mutually exclusive ways that courts have applied partnership concepts to evaluate the courts' incompatible approaches.

The analysis presented in Part IV suggests outcomes that some readers may find unfair. Part V confronts the problem of unfairness and tries to determine why courts find K and L property disputes so troublesome. Part V begins by highlighting some of the unbalanced results produced by strict application of partnership law principles. Part V then explores the rationale behind those principles and suggests that courts sometimes disregard the letter of the law in order to serve that underlying, and largely hidden, rationale. Part V next identifies the philosophical and practical problems that arise when courts disregard the clear letter of the law in favor of hidden rationales and instead twist a generally applicable statute in order to avoid reaching a particular unpalatable result. Part V concludes by offering an approach to the Christmas tree problem that substantially alleviates the unfairness problem while remaining faithful to the law. Part VI exemplifies the suggested approach, using concepts developed in previous Parts to resolve correctly the actual Christmas tree case.

Keywords

Partnership, Uniform Partnership Act, Dissolution of partnership, Property disposition

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Who Owns the Christmas Trees? The Disposition of Property Used by a Partnership

Daniel S. Kleinberger & Barbara A. Wrigley***

I. The Paradigmatic Story

Two individuals, *K* and *L*, decide to combine efforts and form a business raising and selling Christmas trees. They consult no lawyers and make no formal agreement. They do, however, agree to share profits from the enterprise.

K has been running a successful Christmas tree business for several years. He brings to the enterprise his experience, expertise, and business contacts. He also brings several plots of land, the Christmas trees growing on that land, and the trucks and other equipment used in cultivating and harvesting the Christmas trees. The fair market value of this real and personal property is approximately $500,000.

L brings his labor. For the next eight years he directs the day-to-day operations of the business and works full time at this task.

After twelve years, *K* and *L* decide to end their business relationship. The original trucks that *K* brought into the business have worn out and have been replaced. Funds generated by the business paid for the replacements. The original land is still in place, but

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has appreciated by 300% over the twelve years. Many of the original Christmas trees are gone, having been harvested and sold. Others, tended by *L*, have reached maturity and increased in value. New trees are also on the land, planted by *L* and paid for with funds generated by the business.

Now that *K* and *L* are going separate ways, who owns the trucks? Who owns the land? Who profits from the increase in land value? Who owns the Christmas trees?

The story of the Christmas tree business comes from one particular case,[1] but that case reflects a problem common in the law of general partnerships. Two partners form an enterprise. One (the *K* partner) supplies the assets used by the enterprise—money or other property, real or personal. The other partner (the *L* partner) supplies only labor.[2] When the enterprise ends,[3] the partners disagree about how to divide the property used in the partnership business. The *K* partner wants his or her property returned. The *L* partner wants his or her share of the business assets. If some of the property has appreciated while in partnership use, the dispute will be especially complicated. How do the partners divide the value of the property as originally brought into the business? Who benefits from the previously unrealized appreciation?[4]

If the partners have adequately planned and documented this planning, then their documents will resolve such issues. By their agreement the partners will have displaced various default rules that the law of partnership provides in the absence of contrary agreement.[5] If, however, the partners have no agreement, then the default rules will resolve the disagreement.

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1. The story is based loosely on the facts in Schaefer v. Bork, 413 N.W.2d 873 (Minn. Ct. App. 1987).

2. "It is not unusual for two or more persons to unite in business, one contributing money and the other labor, the profits being divided between them; and in such cases it is often held that a partnership is formed." Cyrus v. Cyrus, 242 Minn. 180, 188, 64 N.W.2d 538, 542 (1954) (citing 40 AM. JUR. *Partnership* § 45 (1942)).

3. In formal legal terms, the end of the enterprise involves the dissolution of the partnership, followed by the winding up of the partnership's affairs and then, and only then, the actual termination of the partnership. U.P.A. § 30 (1916); *see infra* notes 67-75 and accompanying text.

4. Complexity also increases if the property has declined in value or if the business has otherwise lost money. *See infra* notes 125-28, 154-56 and accompanying text.

5. The Uniform Partnership Act (U.P.A.) allows partners to structure all aspects of their *inter se* relationship as they please, including how property will be divided upon dissolution. Liechty v. Liechty, 231 N.W.2d 729, 731 (N.D. 1975) (quoting J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 5(b), at 43 (1968) (to a remarkable extent "partners may write their own ticket")); 59A AM. JUR. 2D *Partnership* § 101 (1987). Most Christmas tree situations develop informally, however, without planning or legal advice.

This Article explores the property allocation issues that arise when the members of a *K* and *L* partnership lack a dispositive agreement. In such circumstances the default rules should provide clear guidance, and the Uniform Partnership Act (U.P.A.) seeks to do so.[6] Unfortunately, many of the decided cases misapply or distort the U.P.A. As a body, the decided cases point in three different and mutually exclusive directions. Individually, they often ignore basic principles of partnership law.

This Article takes those basic principles as its lodestar and seeks to determine how the law of partnership should analyze a *K* and *L* dispute over property disposition. Part II sets the context for analysis, introducing partnership law as the applicable law. Part III explains the four basic partnership law concepts necessary to a proper analysis of the Christmas tree paradigm. Part IV describes the three different and mutually exclusive ways that courts have applied partnership law to distribute the partnership property, and then applies partnership concepts to evaluate the courts' incompatible approaches.

The analysis presented in Part IV suggests outcomes that some readers may find unfair. Part V confronts the problem of unfairness and tries to determine why courts find *K* and *L* property disputes so troublesome. Part V begins by highlighting some of the unbalanced results produced by strict application of partnership law principles. Part V then explores the rationale behind those principles and suggests that courts sometimes disregard the letter of the law in order to serve that underlying, and largely hidden, rationale. Part V next identifies the philosophical and practical problems that arise when courts disregard the clear letter of the law in favor of hidden rationales and instead twist a generally applicable statute in order to avoid reaching a particular unpalatable result. Part V concludes by offering an approach to the Christmas tree problem that substantially alleviates the unfairness problem while remaining faithful to the law. Part VI exemplifies the suggested approach, using concepts developed in previous Parts to resolve correctly the actual Christmas tree case.

II. THE LEGAL CONTEXT—THE LAW OF PARTNERSHIP

Because courts typically apply the partnership label to cases within the Christmas tree paradigm, it is important to understand

6. The National Conference of Commissioners on Uniform State Laws is in the process of developing a Revised Uniform Partnership Act (R.U.P.A.). The most recent draft is a Discussion Draft dated December 6, 1990 (Discussion Draft). The Discussion Draft is incomplete in that it considers only U.P.A. §§ 1-17. An earlier draft, dated May 24, 1990 (May Draft) considers the entire U.P.A. None of the revisions in either draft would resolve the problems or change the analysis presented in this Article.

the basic business characteristics that trigger partnership status.[7] Partnership is a consensual relationship among participants who join forces to carry on a business for profit.[8] The participants co-own,[9] comanage,[10] and share profits[11] from the business. Thus, when two people informally agree to pool their resources and energies to form an enterprise and further agree to share what profits may result, they have most likely created a partnership.[12]

Partnership is a consensual status,[13] and to become partners the participants must intend a business relationship.[14] They need not,

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7. The existence of a partnership is a question of fact, and there are legions of cases on the issue. Most cases acknowledge that "there is no arbitrary test for determining the existence of a partnership, [and that] each case must be decided according to its own peculiar facts." Cyrus v. Cyrus, 242 Minn. 180, 183, 64 N.W.2d 538, 541 (1954); *see* J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 4(b), at 33-34 (1968) (some courts assert that no definition is possible; others eschew definition and merely analogize to situations familar as partnerships); *cf.* Cooper v. Knox, 197 Va. 602, 606, 90 S.E.2d 844, 847 (1956) ("The courts have been unable to formulate an exclusive test or general rule by which to determine in every case the question of partnership as to third parties."). A detailed analysis of the elements necessary to sustain a finding of partnership status is beyond the scope of this Article. *See generally* J. CRANE & A. BROMBERG, *supra*, § 4.

8. U.P.A. § 6(1) (partnership is an association of co-owners seeking to carry on a business for profit); Karrick v. Hannaman, 168 U.S. 328, 334 (1897) (mutual consent is an essential prerequsite to creation of partnership); Beckerman v. Sands, 364 F. Supp. 1197, 1199 (S.D.N.Y. 1973) (intentional and consensual undertaking); Cullingworth v. Pollard, 201 Va. 498, 504-05, 111 S.E.2d 810, 814-15 (1960) (intentional undertaking); Garner v. Garner, 31 Md. App. 641, 647, 358 A.2d 583, 588 (1976) (consensual relationship).

9. They co-own the business as a whole, and have only limited and generally indirect rights in the assets that the business uses to operate. U.P.A. § 25; J. CRANE & A. BROMBERG, *supra* note 7, § 40(b), at 231. See *infra* notes 21-54 and accompanying text for a discussion of partnership property and the rights of partners in that property.

10. All partners have equal rights in the management of the business. U.P.A. § 18(e). Partners can agree to restructure the management rights, however, because all of § 18's provisions can be varied by agreement. *Id.* § 18; *see infra* note 20.

11. *See* U.P.A. § 7(4). A right to receive profits is a necessary characteristic of partner status. There can be no partnership without profit sharing. Chaiken v. Employment Sec. Comm'n, 274 A.2d 707, 710 (Del. Super. Ct. 1971). Subject to specified exceptions, "[t]he receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business." U.P.A. § 7(4). When participants in a venture dispute the existence of a partnership, the disputes frequently involve contesting characterizations of profit sharing. *See, e.g.*, Zajac v. Harris, 241 Ark. 737, 739, 410 S.W.2d 593, 594 (1967) (one party claimed profit share to be wage incentive).

12. U.P.A. § 6(1) (partnership an association of co-owners seeking to carry on a business for profit); *id.* § 7(4) (receipt of profits prima facie evidence of partnership); Cyrus v. Cyrus, 242 Minn. 180, 184, 64 N.W.2d 538, 541-42 (1954). The participants need not be people, and partnerships can contain more than two partners. U.P.A. § 6(1) ("A partnership is an association of two or more persons . . . ."); *id.* § 2 (" 'Person' includes individuals, partnerships, corporations, and other associations."). The cases canvased by this Article, however, typically involve two or three human partners.

13. *See supra* note 8.

14. Nelson v. Seaboard Sur. Co., 269 F.2d 882, 887 (8th Cir. 1959); Vlamis v.

however, have in mind the legal status of partnership. They need not intend the legal label of partnership or even contemplate the consequences attending that label.[15] If they intend the business relationship that the law denominates a partnership, the law infers the label.[16]

Partnerships can thus arise inadvertently,[17] and individuals can find themselves legally related without having given any thought to the content of their relationship. Furthermore, individuals can consciously choose to become partners but neglect to predetermine all the material aspects of their relationship.[18]

Both for inadvertent partners and for purposeful partners who plan inadequately, the U.P.A. provides a comprehensive set of default rules.[19] These rules apply in the absence of contrary agree-

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DeWeese, 216 Md. 384, 389, 140 A.2d 665, 668 (1958); Minder v. Gurley, 37 Wash. 2d 123, 222 P.2d 185, 188-89 (1950).

15. *Zajac*, 241 Ark. at 740, 410 S.W.2d at 594; Stephens v. Stephens, 213 S.C. 525, 50 S.E.2d 577 (1948); Duryea v. Whitcomb, 31 Vt. 395, 396-98 (1858); Note, *Farm Partnership: Ownership and Use of Real Property*, 47 IOWA L. REV. 689, 691-92 (1962).

16. McCormick v. McCormick, 342 Mich. 525, 530, 70 N.W.2d 706, 708 (1955). Even if the parties expressly disclaim an intent to qualify for the label, courts will look to the facts of the business relationship. *Nelson*, 269 F.2d at 885-87; San Joaquin Light & Power Corp. v. Costaloupes, 96 Cal. App. 322, 274 P. 84 (1929); Southern Can Co. v. Hartlove, 152 Md. 303, 312-13, 136 A. 624, 627 (1927); *see* Fenton v. State Indus. Accident Comm'n, 199 Ore. 668, 673, 264 P.2d 1037, 1038-40 (1953) (in workers' compensation case, parties held to be coventurers, despite signed agreement designating one as "owner" and the other as "worker"). On the other hand, a party's expressed intent to form a partnership strongly supports the finding that a partnership was created. *Cyrus*, 242 Minn. at 184, 64 N.W.2d at 542.

17. Partnership formation thus differs fundamentally from the formation of corporations or limited partnerships. To create a corporation or a limited partnership the participants (or their attorneys) must consciously and formally elect the status and then file papers with a public authority. *See, e.g.*, DEL. CODE ANN. tit. 8, § 101 (1983) (requiring the filing of a certificate of incorporation to create a corporation); Revised Model Business Corporations Act § 2.01 (1984) (requiring the filing of articles of incorporation to create a corporation); Uniform Limited Partnership Act § 2 (1985) (requiring the filing of a certificate of limited partnership).

18. Schaefer v. Bork, 413 N.W.2d 873, 874 (Minn. Ct. App. 1987) (partners made no agreements regarding "sharing of property, the return of capital, payment of liabilities, methods of dissolving their agreement, or the management of the business"); *cf.* Reese v. Melahn, 45 Ill. App. 3d 585, 588, 359 N.E.2d 1248, 1250 (1977) (The parties to a joint venture failed to detail "the amount of stated capital, financing, etc. Unfortunately, all of these matters are of prime concern in determining the rights of the parties.").

19. Where not displaced by U.P.A. provisions, the common law of partnership also supplies default principles. U.P.A. § 5. Accordingly, when appropriate, this Article will make use of cases decided under common law principles. The Discussion Draft retains both the concept of default rules and the reliance on common law. R.U.P.A. §§ 4X, 4 (Discussion Draft at 10, 8).

ment among the partners[20] and cover, either expressly or by implication, issues relating to the ownership and eventual disposition of property used by a partnership. Properly applied, these default rules determine distribution when a *K* and *L* partnership dissolves.

III. FUNDAMENTAL PARTNERSHIP CONCEPTS FOR SOLVING THE CHRISTMAS TREE PROBLEM

Proper analysis of the Christmas tree situation requires an understanding of four fundamental partnership law concepts: partnership property, the default rules on remuneration of labor performed by partners, the default rules on distribution of partnership assets at dissolution, and the function of partners' capital accounts.

A. Partnership Property

Like any start-up business, a nascent partnership needs assets to operate. These assets can come from outside the partnership through loans from third parties.[21] Typically, however, at least some of the assets come from the partners themselves. Usually, partners "contribute" the assets they provide, thus transfering their rights in the assets to the business.[22] Capital contributions can be in the

20. *See, e.g.*, U.P.A. § 18 ("[t]he rights and duties of the partners in relation to the partnership . . . subject to any agreement between them"); *id.* § 40 (structuring the "settling of accounts between the partners after dissolution . . . subject to any agreement to the contrary").

21. Outsiders may make loans directly to a partner, who then makes a contribution to the partnership. *E.g.*, Jackson v. Jackson, 150 Ga. App. 87, 88-89, 256 S.E.2d 631, 631 (1979) (partner borrowed and then contributed $15,000). Outsiders also may make a loan directly to the partnership. Outsiders who loan assets to a partnership and receive a share of the profits as part of their remuneration risk being characterized as partners. Martin v. Peyton, 246 N.Y. 213, 221-23, 158 N.E. 77, 79-80 (1927). Such a characterization endangers the lender because partners are jointly liable for the debts of the partnership. U.P.A. § 15(a). U.P.A. § 7(4)(a) does state that "profits . . . received in payment [a]s a debt" do not imply the existence of a partnership. That provision, however, merely occasions a factual dispute. Did a partner contribute capital and thereby qualify for a partner's share in the profits and partnership liability, or did an outsider make a loan and receive a profit share as compensation? *E.g.*, San Joaquin Light & Power Corp. v. Costaloupes, 96 Cal. App. 322, 330-36, 274 P. 84, 87-90 (1929).

22. Partners can and frequently do contribute capital after the business begins. For simplicity's sake, however, this Article will usually assume that all contributions occur at the inception of the partnership. This assumption will not limit the import of the analysis, because capital contributions produce the same legal consequences among the partners regardless of the time of contribution. *See* U.P.A. § 18(d) ("A partner shall receive interest on the capital contributed by him only when repayment should be made.").

form of money, real property, personal property, or some combination of these.[23]

Partners can also furnish assets to the businss via loans or leases. For example, in *Sundstrom v. Sundstrom*,[24] two brothers operated a newspaper partnership, and one supplied, as a loan, the physical plant used to produce the paper. Likewise, in *Brooke v. Tucker*,[25] one partner owned the assets used to publish the partnership's newspaper. In *Gabrielle v. Marini*,[26] two partners operated a restaurant, and one partner owned the facility and rented it to the partnership for $175 per month. In *Speka v. Speka*,[27] a bakery partnership rented a bakery from one of its partners.

The loaning or renting out of an asset does not change the ownership of that asset, and thus not all property used by a partnership necessarily reflects property contributed to the partnership.[28] For assets merely "furnished" and not contributed, the

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23. *E.g.*, Stillwell v. Trutanich, 178 Cal. App. 2d 614, 3 Cal. Rptr. 285 (1960); Brown v. Fairbanks, 121 Cal. App. 2d 432, 263 P.2d 355 (1953); Uhrig v. Redding, 150 Fla. 480, 8 So. 2d 4 (1942); Watson v. Watson, 231 Ind. 385, 108 N.E.2d 893 (1952); Edwards v. Arvin, 272 Ky. 528, 114 S.W.2d 778 (1938); Schaefer v. Bork, 413 N.W.2d 873 (Minn. Ct. App. 1987); Langness v. "O" Street Carpet Shop, Inc., 217 Neb. 569, 353 N.W.2d 709 (1984); Badran v. Bertrand, 214 Neb. 413, 334 N.W.2d 184 (1983); Ruta v. Werner, 1 N.J. Super. 455, 63 A.2d 825 (1948); Bengston v. Shain, 42 Wash. 2d 404, 255 P.2d 892 (1953). *But see* White v. Reger, 49 Or. App. 43, 50, 618 P.2d 1304, 1308 (1980) (erroneously defining capital as "money contributed . . . for the purpose of carrying on the business") (citing M & C Creditors Corp. v. Pratt, 172 Misc. 695, 712-15, 17 N.Y.S.2d 240, 258-59 (Sup. Ct.), *aff'd*, 7 N.Y.S.2d 662 (N.Y. App. Div. 1938), *aff'd*, 281 N.Y. 804, 24 N.E.2d 482 (1939)).

24. 75 S.D. 555, 558-59, 70 N.W.2d 65, 68 (1955) (as compensation for the loan/rental of the facility, the lender/lessor brother benefited from a 55/45 split of the profits).

25. 149 Ala. 96, 97-98, 43 So. 141, 142-43 (1907).

26. 80 R.I. 458, 461, 98 A.2d 363, 364 (1953).

27. 124 Cal. App. 2d 181, 183, 268 P.2d 129, 130 (1954).

28. Fenton v. State Indus. Accident Comm'n, 199 Or. 668, 671-72, 264 P.2d 1037, 1039 (1953) (quoting Hackett v. Multnomah Ry. Co., 12 Or. 124, 130, 6 P. 659, 662 (1885)), contains a good statement of the law:

> All property employed in a given partnership enterprise is not necessarily owned by the partnership and . . . the title to all or a part so used may repose in one or more of the copartners as individuals, subject to the right of use only in the partnership. . . . "The capital [of a partnership] may consist in the mere use of the property owned by the individual partners separately."

See also Clark v. Feldman, 79 Or. App. 497, 499, 503, 719 P.2d 909, 911, 913 (1986) (en banc) (Christmas tree partnership rented land from partner); Ellis v. Mihelis, 60 Cal. 2d 206, 218, 384 P.2d 7, 14, 32 Cal. Rptr. 415, 422 (1963) (in bank) ("not unusual that property be used for partnership purposes and not belong to the partnership"); Burdick, *Partnership Realty*, 9 COLUM. L. REV. 197, 201 (1909) ("Land may be used for a partnership, however, without becoming firm property.") (footnote omitted); Note, *supra* note 15, at 700 ("Contributing the mere use of the property does not make it the property of the partnership.") (footnote omitted).

answer to the Christmas tree problem is simple. Once the joint enterprise ceases, the loan or rental period ends. The property simply returns to the party who furnished it.[29]

Hays v. Johnson[30] exemplifies this simple solution. The partnership in *Hays* operated a commercial center. One partner had provided the property comprising the center. When he died, his estate and the other partners disputed the disposition of that property. A written agreement among the partners reserved ownership of the property to the deceased partner.[31] Observing that "[t]he agreement indicates that the deceased may have intended to contribute only the *use* of the property to the . . . partnership," the court allocated the property to the estate.[32]

In contrast, if a partner actually contributes assets to the partnership, the legal status of that property is considerably more

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29. Degen v. Brooks, 77 N.D. 514, 530, 43 N.W.2d 755, 764 (1950) (while almost all assets used in the business were partnership property, partners furnished and retained ownership of their personal tools); *cf.* U.P.A. § 38(1) (at dissolution, each partner has the right to require liquidation of *partnership* property); *id.* § 40(a) (at dissolution the assets of the partnership consist of partnership property). For a discussion of the process of partnership dissolution and termination, see *infra* notes 67-86 and accompanying text.

Complications can arise if a partner contributes only the use of property and yet partnership funds pay for permanent improvements to that separately owned property. In such a case the partner who owns the property owes the partnership "the net enhanced value of such improvements" and the court may impose a lien on the partner's interest in the property to protect the partnership's claim. *Gabrielle*, 80 R.I. at 465, 98 A.2d at 366 (partnership funded improvements to a restaurant facility, which the partnership had rented from one of the partners); *see* Minikin v. Hendrix, 15 Cal. 2d 338, 341-43, 101 P.2d 473, 476 (1940) (woodworking partnership funded improvements to land owned by one of the partners); Wiese v. Wiese, 107 So. 2d 208, 212-13 (Fla. Dist. Ct. App. 1958) (improvements to land used as a marina); *cf.* Nelson v. Gish, 103 Idaho 57, 60-61, 644 P.2d 980, 983-84 (Ct. App. 1982) (for work prior to formation of partnership which transformed other partner's unimproved land into a functioning rock quarry, partner entitled to recovery in unjust enrichment). *But see* Knauss v. Hale, 64 Idaho 218, 226-27, 131 P.2d 292, 295-96 (1942) (no recovery where partner had not agreed to reimburse partnership for improvements; analogy made to landlord's lack of obligation when tenant voluntarily improves leased property).

Complications can also arise if the immediate return of the separately owned asset would cause great unfairness. In *Clark*, 79 Or. App. at 503, 719 P.2d at 913, for example, a partnership rented land from one of its partners for the growing of Christmas trees. When dissolution occurred many of the partnership's growing trees were not yet ready to harvest. To avoid the waste inherent in premature harvesting, the court allocated the trees in kind. To make that allocation possible, the court gave the partner who did not own the land an option to rent part of the other partner's land until the first partner's trees were ready for harvest.

30. 187 Neb. 307, 189 N.W.2d 475 (1971).

31. *Id.* at 307-10, 189 N.W.2d at 477-78.

32. *Id.* at 310, 189 N.W.2d at 478.

complicated.[33] The contribution of capital works a sudden metamorphosis. The property ceases to belong to the contributor, and the partnership itself becomes the owner.[34]

To describe the relationship of partners to property contributed to the partnership, the U.P.A. created a new category of property ownership: tenancy in partnership.[35] For purposes of this Article, the most important aspect of that tenancy is the rights the tenancy does *not* provide to a partner who contributes property. Under the U.P.A., the contribution eliminates any direct interest of the contributor in the contributed property and severs any special relationship the contributor had to that property. Like any other partner, the contributor may "possess specific partnership property for *partnership* purposes," but, again like any other partner, the contributor "has no right to possess such property for any other purpose without the consent of his partners."[36]

33. The analysis which follows in the text applies as well to property purchased with the revenues generated by the partnership business. U.P.A. § 8(2) ("Unless the contrary intention appears, property acquired with partnership funds is partnership property."); Webber v. Rosenberg, 318 Mass. 768, 769, 64 N.E.2d 98, 99 (1945) (no contrary intention, therefore real estate considered partnership property). For cases finding evidence of a contrary intention, see, *e.g.*, Baum v. McBride, 152 Neb. 152, 156, 40 N.W.2d 649, 652 (1950) (cars held to be individual property when cars used in partnership and maintained with partnership funds, and car payments made with partnership funds but charged to each partner's account); Kook v. American Sur. Co., 83 N.J. Super. 43, 54-55, 210 A.2d 633, 640 (1965) ("even if the moneys [to purchase certain property] were advanced by the partnership, they may have been charged to the separate capital accounts of the respective partners, the property purchased then becoming individually owned"); Reiners v. Sherrad, 89 S.D. 446, 450, 233 N.W.2d 579, 581-82 (1975) (partners repeatedly used partnership funds for personal purposes).

34. Before the adoption of the U.P.A. (specifically § 8(3)), the common law generally precluded a partnership from holding legal title to real property. Note, *supra* note 15, at 703 & n.71. In response, individual partners frequently held title to realty for the benefit of their partnership. *In re* Perry's Estate, 121 Mont. 280, 309, 192 P.2d 532, 546 (1948) (Gibson, J., dissenting). Even in such situations, however, the property belonged, at least in the eyes of equity, to the partnership. Claflin v. Ambrose, 37 Fla. 78, 87, 19 So. 628, 630 (1896) (legal title held in trust); Robinson Bank v. Miller, 153 Ill. 244, 253-54, 38 N.E. 1078, 1080 (1894) (same); Betts v. Smither, 310 Ky. 402, 407, 220 S.W.2d 989, 992 (1949) (partner holds title as a trustee for the partnership). Formal title notwithstanding, the partners' interests in the realty were indirect interests and were personal, not real, property. Burdick, *supra* note 28, at 200. U.P.A. § 26 reaches the same result. The partnership's inability to hold title under common law produced many disputes about whether particular realty titled to an individual partner actually belonged to the partnership. *See infra* notes 46-54 and accompanying text.

35. U.P.A. § 25. This section is also applicable to property acquired by the partnership. *See supra* note 34. Although for the sake of clarity R.U.P.A. changes some of the terminology involved here, the basic approach remains the same. *See, e.g.*, R.U.P.A. (May Draft, second segment at 26) (deleting the concept of tenancy in partnership).

36. U.P.A. § 25(2)(a) (emphasis added).

The contribution of property thus erects a barrier between the contributor and the contributed property. The contributor can no longer say, "That is mine." To the contrary, "[i]t is a well settled rule of law that the joint effects of a partnership belong to the firm and not the partners and that a partner has no individual property in any specific assets of the firm."[37]

Estate disputes sometimes highlight the transformation of individual property into partnership property. When a partner dies, his or her estate sometimes claims a direct interest in property that the deceased partner had contributed to the partnership. The partnership's status as owner defeats the estate's claim. In *Eggleston v. Eggleston*,[38] for example, the settling of an estate could not affect assets that the deceased partner had contributed to the partnership because the contributor himself did not own the assets at the time of his death.[39]

Likewise, individual creditors of partners cannot reach property that a partner has contributed to the partnership.[40] Once the metamorphosis has occurred, the partner has no direct claim on the property and neither do the partner's creditors. *Wiseman v.*

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37. Commissioner v. Shapiro, 125 F.2d 532, 535 (6th Cir. 1942); *see* Hogan v. Hogan, 234 Ark. 383, 390, 352 S.W.2d 184, 188 (1961). U.P.A. § 25 mirrors the common law approach. Taft v. Schwamb, 80 Ill. 289, 300 (1875) (quoting N. Gow, PARTNERSHIP 47-48 (1830)), exemplifies the common-law approach:

> "[E]ach [partner] has a joint interest in the whole, but not a separate interest in any particular part of the partnership property . . . . To whatever share a partner may be entitled, in whatever sum the firm may be indebted to him, he has no *exclusive right* to any part of the joint effects until a balance of accounts be struck between him and his copartners, and it be ascertained precisely what is the actual amount of his interest."

The R.U.P.A. makes this transformation clear beyond peradventure. R.U.P.A. § 25(a) (May Draft, second segment at 27) ("Property transferred to or otherwise acquired by a partnership becomes property of the partnership rather than of the partner's individually.").

38. 225 Iowa 920, 926, 281 N.W. 844, 848 (1938).

39. *See also* Vlamis v. DeWeese, 216 Md. 384, 395, 140 A.2d 665, 669 (1958) (because realty was partnership property, no direct interest in it passed to deceased partner's estate); *cf.* Moore v. DuBard, 318 Mich. 578, 592-93, 29 N.W.2d 94, 100 (1947). The case concerned the rights to a contract that the decedent had signed while allegedly a partner. The court stated that if a partnership existed, the contract entered into under the name of a partner would be partnership property. On the signatory's death, the surviving partner would have the right to wind up partnership affairs, including the contract. Also, the signatory's estate would have no claim on the contract.

40. U.P.A. § 25(2)(c) ("A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership."); All Florida Sand v. Lawler Constr. Co., 209 Ga. 720, 720, 75 S.E.2d 559, 559-60 (1953). Conversely, if a creditor of the partnership attaches partnership property, a partner's individual exemptions from attachment are inapplicable. U.P.A. § 25(2)(c).

Martorano[41] provides an especially ironic example of this rule. Two individuals purchased land, which became a partnership asset. Partner *A* advanced all funds to buy the land, and partner *B* agreed to pay his share of the cost directly to partner *A*. As security, partner *A* took from partner *B* a mortgage on partner *B*'s interest in the land. Partner *A* subsequently foreclosed, but the court held that partner *A* could not reach any interest in the land because the land was partnership property.[42]

The barrier between contributor and contributed property continues when the partnership enterprise ends.[43] No partner has any special claim on property that the partner may have contributed to the enterprise. For example, in the partnership discussed in *Langness v. "O" Street Carpet Shop, Inc.*,[44] a partner had contributed the vendee's interest in a purchase agreement on a piece of realty. During the life of the partnership, the partnership purchased the realty and the realty appreciated substantially. When the partnership came to an end, the contributing partner had no special rights in the proceeds from the property purchased under the purchase agreement.[45]

Thus, the question of whether a partner has contributed or merely furnished property is fundamentally important to determining the disposition of that property when the partnership ends. "Contribution" means that ownership of the property has shifted to the partnership. "Furnishing" means that the partner retains ownership. Ownership by the partner dictates one disposition; ownership by the partnership dictates another.

The issue of furnished or contributed is accordingly a threshold question in any Christmas tree dispute. If *K* loaned or rented the

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41. 405 Pa. 369, 175 A.2d 873 (1961).

42. *Id.* at 371-72, 175 A.2d at 875.

43. *See* Taft v. Schwamb, 80 Ill. 289, 300 (1875). For a partnership the beginning of the end is called "dissolution." Dissolution is the moment after which the partnership ceases to undertake new business, begins to wind up its old business, and eventually settles accounts among its partners. *See* Craig v. Hamilton, 213 Kan. 665, 669, 518 P.2d 539, 543 (1974); U.P.A. §§ 37, 40; *see also infra* notes 71-86 and accompanying text.

44. 217 Neb. 569, 353 N.W.2d 709 (1984).

45. *Id.* at 570-79, 353 N.W.2d at 711-14. At dissolution, any partner who has not wrongfully caused dissolution has a right to require that the property be liquidated. This right applies to contributor and noncontributor alike. U.P.A. § 38(1). For the consequences of wrongful dissolution, see U.P.A. § 38(2). As the partnership is terminated, the contributing partner has a right to return of the value of capital he or she contributed. U.P.A. § 40(b)(III); *see* Hunter v. Allen, 174 Or. 261, 267, 147 P.2d 213, 215, *modified on reh'g on other grounds*, 174 Or. 286, 148 P.2d 936 (1944) ("The amount contributed by each partner is looked upon as a debt of the firm to him.") (citing 47 C.J. PARTNERSHIP § 47 (1929)).

property to the partnership, the analysis is short and direct. When the partnership ends, *K* regains the property. In contrast, if *K* contributed the property, the end of the partnership does not entitle *K* to the return of the property.

How, then, does the law answer the threshold question? Like the question of partnership existence,[46] the question of furnish versus contribute depends on the parties' intent and is a question of fact.[47] The U.P.A. is silent on how to decipher intent,[48] but the case law is plentiful.[49] Case law suggests that the following factors indicate that property has been contributed to a partnership:[50]

> (1) use of the property in the partnership business, especially if the property is crucial or central to that business;[51]

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46. *See supra* notes 8, 13-15 and accompanying text.

47. Vlamis v. DeWeese, 216 Md. 384, 392, 140 A.2d 665, 669 (1958); McCormick v. McCormick, 342 Mich. 525, 530, 70 N.W.2d 706, 708 (1955) (citing Johnson v. Hogan, 158 Mich. 635, 635, 123 N.W. 891, 891 (1909)); Note, *supra* note 15, at 699; *cf.* Cyrus v. Cyrus, 242 Minn. 180, 187, 64 N.W.2d 538, 543 (1954) ("The fact that such realty is used for partnership purposes is not of itself, when standing alone, sufficient to establish an intent to contribute it to the partnership assets.") (citing 40 AM. JUR. *Partnership* §§ 100, 105 (1942)).

48. U.P.A. § 8(1) does state that "[a]ll property originally brought into the partnership stock . . . is partnership property," but this language provides little guidance for property other than inventory or raw materials. What does it mean for a piece of land or capital equipment to be brought into the "stock" of a business? *See* Ribstein, *An Analysis of Georgia's New Partnership Law*, 36 MERCER L. REV. 443, 480-82 (1984). R.U.P.A. § 8 would provide some additional guidance, principally in the form of presumptions. ((Discussion Draft) at 17).

49. The cases deal almost exclusively with realty. *See supra* note 34. At least one court, however, has considered the case law equally applicable to personal property questions. *In re* Schyma, 68 Bankr. 52, 60-61 (D. Minn. 1985) (giving no rationale and citing no authority). The realty cases do present an aspect seldom found in personal property cases. Most of the realty cases involve land titled in the name of a partner, and much of the discussion relates to the impact of this on the claim that the land is partnership property. *See generally*, Robinson Bank v. Miller, 153 Ill. 244, 260, 38 N.E. 1078, 1081 (1894) (determining priority between creditors of the firm and creditors of the individual holding legal title); Burdick, *supra* note 28, at 200-01. For a case dealing with equipment, see Bode v. Prettyman, 149 Neb. 179, 30 N.W.2d 627 (1948) (a tractor, tilt dozer, and a scraper).

50. *See generally*, Annotation, *When Real Estate Owned by Partner Before Formation of Partnership Will Be Deemed to Have Become Asset of Firm*, 45 A.L.R.2d 1009 (1956).

51. All Florida Sand v. Lawler Constr. Co., 209 Ga. 720, 720, 75 S.E.2d 559, 560 (1953) (land not partnership property because no evidence that land purchased for use in the partnership business or ever put to that use); *Vlamis*, 216 Md. at 392, 140 A.2d at 670 ("The real estate had been bought and the building built for the very purpose of conducting the garage and automobile sales business that the firm carried on."); National Union Bank v. National Mechanics' Bank, 80 Md. 371, 389, 30 A. 913, 916 (1894) (if paper mills and real estate "necessary for the convenient and proper conduct of the business," finding of partnership property appropriate; other property "not incident to the business of the firm"

(2) use of partnership funds in improving, maintaining, insuring, or paying taxes on the property;[52]
(3) indications in the partnership's books that the property belongs to the partnership;[53]
(4) nonreceipt of rent or other compensation by the partner who provided the property to the partnership.[54]

B. *U.P.A. Default Rules on Remuneration for Partner Labor and Contributed Capital*

Partnerships need more than just capital to operate. They also need labor. Labor frequently comes, at least in part, from the

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not partnership property); Kook v. American Sur. Co., 88 N.J. Super. 43, 54, 210 A.2d 633, 640 (1965) (questioning whether an apartment building would be an asset of a partnership engaged in the plumbing business); Thompson v. Beth, 14 Wis. 2d 271, 276, 111 N.W.2d 171, 174 (1961) ("purchased for partnership purposes"). *But see* Bank of Southwestern Georgia v. McGarrah, 120 Ga. 944, 949-50, 48 S.E. 393, 395 (1904) (when warehousing partnership paid for, obtained, and operated farm land, land was partnership property despite use being unconnected to the central purpose of partnership).

Although important, use for partnership purposes cannot by itself establish the necessary intent. *See* Ellis v. Mihelis, 60 Cal. 2d 206, 218, 384 P.2d 7, 14, 32 Cal. Rptr. 415, 422 (1963) (in bank) ("not unusual that property be used for partnership purposes and not belong to the partnership"); Cyrus v. Cyrus, 242 Minn. 180, 187, 64 N.W.2d 538, 543 (1954) ("The fact that such realty is used for partnership purposes is not of itself, when standing alone, sufficient to establish an intent to contribute it to the partnership assets.") (citing 40 AM. JUR. *Partnership* §§ 100, 105 (1942)); Norcross v. Gingery, 181 Neb. 783, 786, 150 N.W.2d 919, 921 (1967) (warning that "[u]se of the property alone is not sufficient because an owner may intend to contribute only the use, as distinguished from the ownership, to the partnership.").

52. McKinnon v. McKinnon, 56 F. 409, 414 (8th Cir. 1892) (expenses for care and management of a farm); *In re* Urban Dev. Co., 452 F. Supp. 902, 905-06 (D. Md. 1978) (maintenance, taxes); Swarthout v. Gentry, 62 Cal. App. 2d 68, 80, 144 P.2d 38, 44 (1943) (payment of taxes); Steinmetz v. Steinmetz, 125 Conn. 663, 666, 7 A.2d 915, 917 (1939) (improvements, taxes); Emerson v. Campbell, 32 Del. Ch. 178, 185, 84 A.2d 148, 152-53 (1951) (maintenance, taxes); Kay v. Gitomer, 253 Md. 32, 37, 251 A.2d 853, 856 (1969) (taxes); *Cyrus*, 242 Minn. at 186, 64 N.W.2d at 543 (improvements, taxes); Klingstein v. Rockingham Nat'l Bank, 165 Va. 275, 281, 182 S.E. 115, 117 (1935) (payment of taxes, improvements).

53. *Emerson*, 32 Del. Ch. at 185, 84 A.2d at 152; *Kay*, 253 Md. at 36, 251 A.2d at 856; *Klingstein*, 165 Va. at 278-79, 182 S.E. at 116-17. *But cf. National Union Bank*, 80 Md. at 387, 30 A. at 916 (when land held in individual's name, mere fact that partnership books showed land as partnership property should not defeat claim of creditor claiming against the party holding formal title to the land).

54. *McKinnon*, 56 F. at 414 (partnership paid no rent to partner who held legal title to land); Wagner v. Wagner, 17 Ill. App. 2d 307, 311, 149 N.E.2d 770, 772 (1958) (in furniture and undertaking partnership, "no proof of rental by the partnership of [certain fixed assets] from [partner claiming direct, personal ownership]"); 2 A. BROMBERG & L. RIBSTEIN, PARTNERSHIP § 6.02(g), at 6:35 & nn.109 & 110 (1988); *cf.* Flagg v. Stowe, 85 Ill. 164, 167 (1877) (in dissolution accounting, partner, who contributed use of machinery, credited for its fair market value). Conversely, receipt of compensation by the partner furnishing the property suggests no contribution. *See* Sundstrom v. Sundstrom, 75 S.D. 555, 558-59, 70 N.W.2d 65, 67-68 (1955).

partners themselves. The partners can agree to have the partnership compensate them for their labor.[55] In the absence of such an agreement, however, the U.P.A. provides a clear default rule. "No partner is entitled to remuneration for acting in the partnership business . . . ."[56] So, while laborers may be worthy of their hire,[57] absent a contrary agreement partners receive compensation only through their respective shares of the profits.[58]

Capital contributions receive somewhat parallel treatment. No matter how long the firm has used the contributed value, the contributing partner receives no interest.[59]

Applied to a *K* and *L* partnership, the default rules on labor and capital remuneration operate to define the following bargain:

> (1) To the benefit of the joint enterprise:
> (a) *K* forgoes the opportunity to obtain personal gain from some other use of the contributed capital;
> (b) *L* forgoes the opportunity to obtain personal gain from some other use of the labor.
> (2) Neither *K* nor *L* receives direct compensation for their foregone opportunities:
> (a) *K* receives no interest on the value of the capital contributed;
> (b) *L* receives no remuneration for the value of the labor provided.
> (3) In return for incurring these opportunity costs, *K* and *L* receive a return; they share equally in any profits made by the enterprise.[60]

Under the default rules, *K* and *L* do not receive completely parallel treatment. Absent a contrary agreement, *K* has the right not only to a share of profits but also, when the enterprise ends, to a return of the value of the contributed capital.[61] *L*, in contrast,

55. *See, e.g.*, Busick v. Stoetzl, 264 Cal. App. 2d 736, 740, 70 Cal. Rptr. 581, 584 (1968). A course of conduct can imply an agreement to compensate. *E.g.*, Neilson v. Holmes, 82 Cal. App. 2d 315, 323-24, 186 P.2d 197, 202 (1947); Schwartz, *Compensation of a Partner for Services: Problems in Interpreting the U.P.A. and Partnership Agreements* 19 Sw. U.L. Rev. 1, 6 (1990).

56. U.P.A. § 18(f). The provision contains an exception not relevant here: "[A] surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs." The R.U.P.A. § 18(g) (May Draft, second segment at 3) continues this approach.

57. The precise expression is, of course, "the labourer is worthy of his hire." *Luke* 10:7.

58. Hunter v. Allen, 174 Or. 261, 267, 147 P.2d 213, 215, *modified on reh'g on other grounds*, 174 Or. 286, 148 P.2d 936 (1944).

59. U.P.A. § 18(d). Interest accrues "only from the date when repayment should be made." A partner who advances money "in aid of the partnership . . . *beyond the amount of capital which he agreed to contribute*" will draw interest from the date of the advance. *Id.* § 18(c) (emphasis added).

60. U.P.A. § 18(a) states that, absent a contrary agreement, each partner "shall . . . share equally in the profits."

61. U.P.A. §§ 18(a), 40(b)(III).

has no right to any compensation for the labor provided other than his or her share in profits.[62]

Whether such asymmetrical treatment is unfair in any particular case will depend on the definition of fairness and on the relative values of the labor provided and the capital contributed.[63] Let us take "fair" to mean that, in order to obtain the same benefit (an equal share of the profits), each partner foregoes the same economic value. As to the relative value of labor and capital, let us first assume that (1) at the inception of a partnership *K* contributes $200,000 in cash, (2) the partnership lasts five years, (3) during those five years the generally available commercial interest rate for invested capital is 10%, (4) during each of the five years *L* provides 2,000 hours of semiskilled labor, and (5) during those five years semiskilled labor brings a wage of $10 per hour.

During each year of the partnership, *K* foregoes $20,000 in interest to earn his or her share of the profits. *L* foregoes $20,000 in wages. For the deal to be fair, *K* must regain the $200,000 value of the original capital contribution when the partnership ends. Only in that way will both *K* and *L* have foregone the same value ($20,000 per year for five years) to qualify for the same benefit (an equal share of the profits). So, in these circumstances the asymmetry of the default rule will produce a fair result.

To see an unfair result, assume in contrast that in a five-year partnership *K* makes a capital contribution worth only $100,000 and *L* foregoes wages worth $30,000 annually. Given a 10% interest rate, *K* annually foregoes $10,000, for a total of $50,000. *L* foregoes a total of $150,000. Returning the full value of the capital contribution to *K* (per the default rule) would not be fair. To the contrary, fairness would require that half of the value of *K*'s contribution be transfered to *L*. The arithmetic would be as follows:

Foregone by K	
Interest ($10,000 per year for 5 years)	$ 50,000
Half of the contributed capital value	50,000
Total foregone to earn profit share	$100,000
Foregone by L	
Wages ($30,000 per year for 5 years)	$150,000
Reduced by half of *K*'s contributed capital value	(50,000)
Total foregone to earn profit share	$100,000[64]

62. *Id.* §§ 18(f), 40(b)(IV).

63. Also important is the relative value of intangible benefits brought to the partnership, such as business reputation or the partnership's increased ability to obtain financing due to one partner's personal net worth. *See infra* note 65 and accompanying text.

64. These two examples do not account for the time value of money, as that would complicate the arithmetic but leave the examples' basic import unaltered.

Any default rule for labor and capital remuneration will produce occasional unfairness. Every default rule has some implicit assumptions about the relative worth of capital and labor, and particular circumstances will on occasion deviate from those assumptions.

Some default rule is nonetheless necessary. Otherwise, when the partners neglect to address the matter by agreement, the courts will be left with the virtually impossible task of evaluating the relative value of what the partners have provided. In the simple examples just given, the evaluation seems easy enough. But these examples hypothesize away any difficulties in valuing foregone opportunities. Moreover, and more importantly, they also ignore the virtually insurmountable difficulties involved in valuing the intangible benefits that partners often provide the partnership enterprise.

> [T]he law never undertakes to settle between [partners] their various and unequal services in the transaction of their private affairs. The attempt would be altogether impracticable. One man may possess advantages over his partner in one respect, which may be made up to the latter in the possession of some quality in which the former is deficient. One may have an established reputation in the neighborhood in which he lives for honesty and fair dealing; he may be surrounded by numerous and powerful friends; he may enjoy in an eminent degree the confidence of his fellow citizens; he may possess wisdom and sagacity in directing the general management of his affairs. Another, though destitute of some of these advantages, may nevertheless be a valuable partner, for his activity in business, his knowledge and skill as an accountant, or his tact as a salesman.[65]

Of necessity, therefore, the U.P.A. must have a default rule. The rule contained in the statute provides: (1) No interest on contributed capital; (2) no remuneration for labor provided; and (3) at the partnership's end, a return to the contributing partner of the value of any contributed capital.[66]

C. *U.P.A. Default Rules on Dissolution and the Distribution of Partnership Assets*

K and *L* property disposition problems typically arise when a partnership ends. The U.P.A. default rules on partnership disso-

65. Caldwell v. Leiber, 7 Paige Ch. (N.Y.) 483, 495 (1839) (citation omitted).

66. Some readers may object to the U.P.A.'s choice of a default rule as biased in favor of property owners or as oblivious to the labor theory of value. Such objections are certainly legitimate grounds for advocating a change in the statute. For the reasons stated *infra* notes 201-13 and accompanying text, however, the objections do not warrant ignoring the statute's plain language.

lution and on post-dissolution property distribution are therefore crucial to the solution of the Christmas tree problem.

Unlike corporations, partnerships do not have perpetual existence. Unless the partners have agreed to a particular duration,[67] any partner may call an end to the enterprise at any time and thereby cause a dissolution of the partnership.[68] If the partners have agreed to a partnership for a "definite term or particular undertaking," the expiration of the term or accomplishment of the undertaking dissolves the partnership.[69] Even in a partnership for a definite term or undertaking, each partner retains the power, though not the right, to cause premature dissolution.[70]

Dissolution is not the end of the partnership; it is merely the beginning of the end. Dissolution puts the partnership into a period of winding up. Only when winding up is complete does the

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67. The duration may be either a length of time or the accomplishment of a specific task or tasks. U.P.A. § 31 (1)(a). Some states apply the label "joint venture" to partnerships for a single task. Nupetco Assocs. v. Jenkins, 669 P.2d 877, 882 n.3 (Utah 1983). The difference in labels makes little substantive difference, however, because in those states the law of joint ventures is remarkably parallel to the law of partnerships. *Id.*; 46 AM. JUR. 2D *Joint Ventures* §§ 36, 37 (1969) (quoted in Legum Furniture Corp. v. Levine, 217 Va. 782, 787, 232 S.E.2d 782, 786 (1977)).

68. U.P.A. § 31(1)(b). The R.U.P.A. proposes 66 changes to U.P.A. provisions dealing with dissolution and winding up. R.U.P.A. (May Draft, comments, third segment at 2). One major thrust of these changes is to allow in some circumstances a partnership to continue in business without liquidation even though a partner has ceased to be associated with the business. *Id.* § 29X (May Draft, third segment at 4). Under the U.P.A., a partner's dissociation from the partnership automatically causes dissolution, and, unless the dissociating partner has caused a wrongful dissolution, for the business to continue both the dissociating partner and the remaining partners must agree. U.P.A. § 38(1). For the situations dicsussed in this Article, the R.U.P.A.'s changes will be in form rather than in substance. Even under the R.U.P.A., when *K* and *L* break up their partnership each will have a right to demand liquidation of the business unless one of them has wrongfully caused the breakup or unless they have agreed that the business will continue unliquidated in the event of a breakup. R.U.P.A. §§ 31Y(1)-(2) (May Draft, third segment at 18). U.P.A. §§ 38(1)-(2) produce essentially the same result. *See infra* note 74.

69. U.P.A. § 31(1)(a).

70. Exercise of the power will cause a wrongful dissolution. *Id.* § 31(2). The wrongfully dissolving partner will be liable for any resulting damages. *Id.* § 38(2)(a)(II). The remaining partners also may retain the partnership assets and continue the business under a new partnership. *Id.* § 38(2)(b) (all remaining partners must agree, must pay off or bond the value of the wrongfully dissolving partner's interest, and must indemnify the wrongfully dissolving partner from third party claims). For an argument that in some circumstances partners should not have the power to wrongfully dissolve, see Infusaid Corp. v. Intermedics Infusaid, Inc., 739 F.2d 661, 668-69 (1st Cir. 1984) (no human partner should be compelled to continue to associate against his or her will, so indissolubility perhaps appropriate when all partners are corporations), and Hillman, *Indissoluble Partnerships*, 37 U. FL. L. REV. 691 (1985).

partnership actually terminate.[71] Winding up has two aspects. First, the partnership must settle its affairs with outsiders. Projects must be completed, or the obligee satisfied in some other way. Debts must be paid and receivables must be collected.[72] Second, the partners must settle accounts with each other.[73]

It is possible for the partnership *business* to continue even though the original partnership entity has been dissolved, is being wound up, and will be terminated. By agreement some of the original partners may form an enterprise to retain the key assets of the original partnership, assume the original partnership's liabilities, and cash out or otherwise compensate the partners who do not join the new enterprise.[74] In the simplest of winding up scenarios, however, the business of the partnership comes to an end along with the partnership entity, and the partnership liquidates all of its assets. Indeed, except in the case of a contrary agreement or a wrongful dissolution, each partner may compel the partnership to follow this path.[75]

K and *L* disputes about post-dissolution property distribution invariably involve the simpler scenario. Although that scenario may involve practical difficulties,[76] the process for distributing assets is theoretically very simple. In the absence of a contrary agreement, the U.P.A. default rules define the process. Property

71. U.P.A. § 30.

72. *See* Commonwealth Capital Inv. Corp. v. McElmurry, 102 Mich. App. 536, 539-40, 302 N.W.2d 222, 224 (1980); *see also* U.P.A. § 40(b)(I) (placing liabilities "owing to creditors other than partners" as the top priority in settling accounts among partners).

73. U.P.A. § 40.

74. Even in the absence of a pre-existing contrary agreement, partners may arrange to buy each other out. Such buy-outs avoid the loss in value occasioned by a "fire sale" of an ongoing enterprise. *See, e.g.*, Marso v. Graif, 226 Minn. 540, 543, 33 N.W.2d 717, 719 (1948). When the business of the partnership does continue, typically the new partnership assumes the liabilities of the old partnership. The old partnership thus winds up its outstanding obligations to outsiders by transferring them to the new partnership. That transfer will not, however, actually discharge the personal liability of the old partners unless the obligee so agrees, or, in some circumstances, unless the obligee subsequently agrees with the new enterprise to materially alter the old obligation. U.P.A. §§ 36(1)-(3); *cf.* Craig v. Hamilton, 213 Kan. 665, 669, 518 P.2d 539, 543 (1974) ("The rights and obligations of the partners do not cease until all affairs of the partnership are liquidated or satisfactorily transferred to another entity.").

75. U.P.A. § 38(1). A partner who wrongfully dissolves a partnership cannot force liquidation if all the other partners wish to continue the business. *Id.* § 38(2)(b).

76. *See, e.g.*, King v. Stoddard, 28 Cal. App. 3d 708, 712-13, 104 Cal. Rptr. 903, 906 (1972) (inappropriate to incur expenses to operate business at length in ostensible effort to build up sale value); *In re* Trust Estate of Schaefer, 91 Wis. 2d 360, 382, 283 N.W.2d 410, 421 (Ct. App. 1979) (winding up delayed pending litigation over existence of partnership).

that a partner has merely loaned or rented to the partnership returns to the partner as the partnership business comes to an end.[77] The assets owned by the partnership are marshalled and liquidated.[78] From those assets, outside creditors are paid off, inside creditors[79] are paid off, partners are repaid their capital contributions,[80] and any remaining funds are divided, as profit, according to each partner's ordinary profit percentage.[81] If the partnership does not have sufficient funds to repay capital contributions, the partners must pay into the partnership according to their respective obligations to share losses.[82]

The U.P.A. expressly provides for the settling in cash of accounts among partners.[83] Division of assets in kind raises significant problems of valuation and is therefore disfavored.[84] Partners may of course agree to settle accounts with each other through an in-kind asset distribution,[85] but absent such an agreement, in-kind distribution is permissible only to avoid great unfairness or extraordinary waste.[86]

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77. *See supra* notes 45-46 and accompanying text.

78. U.P.A. § 38(1).

79. *E.g.*, partners who have made loans.

80. *I.e.*, each partner receives the value of his or her capital account.

81. Houstoun v. Albury, 436 So. 2d 224, 226 (Fla. Dist. Ct. App. 1983); U.P.A. § 40(b) (ranking in priority the liabilities of the partnership).

82. U.P.A. §§ 40(a)(II), 40(d). The R.U.P.A. makes no significant changes in the operation of § 40. R.U.P.A. § 40 (May Draft, third segment at 59). Other R.U.P.A. provisions, however, may make it more likely that a partnership's business will continue without liquidation even though a partner has ceased to be associated with the partnership. *See supra* note 67.

83. The U.P.A. expressly states that, except in the event of wrongful dissolution, "each partner . . . may have the partnership property applied to discharge its liabilities, and the surplus applied to pay *in cash* the net amount owing to the respective partners." U.P.A. § 38(1) (emphasis added). The official comment notes that "[t]he right given to each partner, where no agreement to the contrary has been made, to have his share of the surplus paid to him in cash makes certain an existing uncertainty. At present it is not certain whether a partner may or may not insist on a physical partition of the property remaining after third persons have been paid." *Id.* § 38 comment j; *see* Davis v. Davis, 149 Colo. 1, 5, 366 P.2d 857, 859 (1961) ("It is a general rule that in an action for a partnership accounting and dissolution the entire partnership property will be converted into cash.").

84. *See Davis*, 149 Colo. at 5, 366 P.2d at 859; Wiese v. Wiese, 107 So. 2d 208, 211 (Fla. Dist. Ct. App. 1958) (liquidation is the best way to determine value of partnership assets); Bagg v. Osborn, 169 Minn. 126, 129, 210 N.W. 862, 864 (1926) (same); Dreifuerst v. Dreifuerst, 90 Wis. 2d 566, 572, 280 N.W.2d 335, 339 (Ct. App. 1979) (same).

85. U.P.A. § 38(1) applies "unless otherwise agreed."

86. *See* Swarthout v. Gentry, 62 Cal. App. 2d 68, 84, 144 P.2d 38, 46 (1943) (allowing partition only if it "can be made without serious loss to the partners"). *Wiese*, 107 So. 2d at 210-12, holds that, in a proper case, when innocent partners will suffer no harm, a

D. *The Function of Partners' Capital Accounts*

Capital accounts are bookkeeping devices that track the amount the partnership owes each partner for property contributed to the partnership.[87] Contributed assets increase the contributing partner's capital account by an amount equal to the fair market value of the asset at the time of contribution.[88] Payments made to partners as return of capital decrease their respective capital accounts.[89] The post-contribution depreciation or appreciation of a contributed asset does not affect the contributing partner's capital account. The contribution severs the contributor's direct connection to the asset. Subsequent vicissitudes in the asset's value are for the partnership's account.[90]

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court may order in-kind distribution. In-kind distribution is not available, however, when claims of creditors are outstanding. *Davis*, 149 Colo. at 5, 366 P.2d at 859; *Swarthout*, 62 Cal. App. 2d 68, 84, 144 P.2d 38, 46 (1943). Clark v. Feldman, 79 Or. App. 497, 719 P.2d 909 (1986) (en banc), involved an appropriate situation for in-kind distribution. The partnership grew Christmas trees on land rented from one of the partners. When the partnership dissolved, growing trees, unready for harvest, were a substantial partnership asset. Liquidation was impractical because ordering the trees harvested and sold would have wasted the asset. Instead, the trial court divided the trees between the partners. To have allocated the trees to the partner who owned the land would have required a highly speculative determination of the trees' value at harvest, discounted by the cost of bringing the trees to harvest and by the possibility that harm might befall the trees in the interim. *Id.* at 501, 719 P.2d at 911-12. The R.U.P.A. continues this approach and, indeed, makes more explicit the disfavoring of in-kind distributions. R.U.P.A. §§ 18X, 31Z(a) (May Draft, second segment at 7, third segment at 27).

87. A. BROMBERG & L. RIBSTEIN, *supra* note 54, § 6.02(a); J. CRANE & A. BROMBERG, *supra* note 7, § 40(b), at 231-32; R. HAMILTON, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS 94-97 (3d ed. 1986); W. KLEIN & J. COFFEE, BUSINESS ORGANIZATION AND FINANCE - LEGAL AND ECONOMIC PRINCIPLES 77-79 (3d ed. 1988). The amounts so credited reflect a debt of the partnership. U.P.A. § 40(b)(III) (characterizing as a liability of the partnership, "those [liabilities] owing to partners in respect of capital"); Taft v. Schwamb, 80 Ill. 289, 300 (1875); Hunter v. Allen, 174 Or. 261, 267, 147 P.2d 213, 215, *modified on reh'g on other grounds*, 174 Or. 286, 148 P.2d 936 (1944) ("The amount contributed by each partner is looked upon as a debt of the firm to him."); Newman v. Newman, 145 Tex. 433, 436, 198 S.W.2d 91, 93 (1946) (liability for return of capital contribution a "charge" on the assets of the partnership).

88. For an explanation of why valuation is made as of the time of contribution, see *infra* notes 104-06 and accompanying text.

89. Typically capital is returned when the partnership is dissolved. U.P.A. § 40(b)(III). Early return is possible by agreement. *E.g.*, Langness v. "O" Street Carpet Shop, Inc., 217 Neb. 569, 573, 353 N.W.2d 709, 712-13 (1984) (part of one partner's contribution immediately transferred to another partner, reducing the capital contribution of the second partner; third partner received monthly payments in partial return of capital).

90. *See supra* notes 33-42 and accompanying text. If the partnership as a whole decreases in value, each partner's capital account may decrease according to his or her share of partnership losses. *See infra* note 94 and accompanying text.

When the partnership dissolves and partners settle accounts, each partner receives the amount in his or her capital account as a return of capital.[91] If during its existence a partnership has neither made nor lost money, has not suffered depreciation of its noncash assets, and has not generated any saleable goodwill, the sum of the capital accounts at dissolution will equal the net worth of the firm.

Such equality, however, is by no means the norm. If, for example, the firm's assets have appreciated in value, the net worth of the firm will exceed the sum of the partners' capital accounts. The same result will occur if the firm makes a profit and some or all the partners choose to leave some or all their profit share in the firm.[92] In any event, the amount remaining after paying creditors and discharging the capital accounts is, by dint of statute, profit to be distributed according to the partners' respective profit shares.[93]

In contrast, if the firm has lost money or if the firm's assets have depreciated, then at dissolution the sum of the capital accounts will exceed the firm's net worth. The loss or depreciation will have affected the firm's assets, but not the separate claims of the partners to be repaid the value of their respective contributions.[94] Under U.P.A. section 40(d) the parties will have to provide

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91. Heath v. Spitzmiller, 663 S.W.2d 351, 354-55 (Mo. Ct. App. 1983); W. KLEIN & J. COFFEE, *supra* note 87, at 79.

92. Sometimes a partnership will treat such undistributed profits as if they had been contributed to capital, and the partnership's books will credit the appropriate capital accounts. *In re* Rosenberg, 251 N.Y. 115, 122, 167 N.E. 190, 192 (1929) (partners agreed that one partner's share of profits would be left in the business and credited to partner's capital account); *cf. In re* Adams & Lester's Estate, 215 Mo. App. 606, 612-13, 257 S.W. 142, 144-45 (1923) (partners left some of their profits in the pharmacy business to purchase additional stock; deceased partner's estate argued unsuccessfully that these retained profits had been converted into capital, which under the partnership agreement had a higher repayment priority than retained profits).

93. The structure of U.P.A. § 40(b) compels this conclusion. This section provides for the assets of the partnership to be applied in the following order: debts to outsiders, debts to partners, return of partner's capital, and profit. Neither § 40(b) nor any other part of the U.P.A. provides for any other post-dissolution distribution of partnership assets. Therefore, when partnership assets have gone to discharge debts to outsiders, discharge debts to partners, and to return partners' capital, anything remaining is by process of elimination "owing to partners in respect of profits." U.P.A. § 40(b)(IV); *see also* W. KLEIN & J. COFFEE, *supra* note 87, at 78.

94. By agreement or custom, a partnership may allocate losses periodically during the life of the firm. In that case, the partnership will periodically debit each partner's capital account according to his or her share of the partnership's losses. If the partnership accurately calculates the actual depreciation and the amount of other unrealized losses, then the sum of the capital accounts will continue to equal the actual net worth of the firm.

additional funds, either to permit a full return of capital or at least to adjust the capital accounts so that losses are shared as agreed.

The following example, modeled in simplified form on *Langness v. "O" Street Carpet Shop, Inc.*,[95] illustrates the operation of capital accounts. Three individuals, *A*, *B*, and *C*, form a partnership. They agree to share profits equally. *A* contributes $14,000. *B* contributes the vendee's interest in a real estate purchase agreement. At the time, the fair market value of the real estate is $65,000. The purchase agreement sets a price of $56,000, so the value of the contribution is $9,000. *C* makes no capital contribution, providing instead legal services in the drafting of the partnership agreement. At that point the capital accounts would stand as follows:

A	$14,000
B	$9,000
C	$0[96]

Soon after, by agreement, *B* receives $8,000 as a return of capital. The capital accounts would then stand at:

A	$14,000
B	$1,000
C	$0

The partnership later purchases the property subject to the purchase agreement, and *B* contributes $4,000 in cash to be used toward the down payment. The capital accounts then would stand at:

A	$14,000
B	$5,000
C	$0

Later the partnership sells the property, realizing $52,000 on the sale. The partnership then dissolves, owing $3,000 to creditors. The sale proceeds are the partnership's only asset. Under U.P.A. section 40(b)(I), first, $3,000 of the $52,000 is used to pay the creditors. Next, U.P.A. section 40(b)(III) mandates that *A* and *B* receive the value of their respective capital accounts. The three partners then divide the remaining $30,000 equally, according to

95. 217 Neb. 569, 353 N.W.2d 709 (1984).

96. *B*'s providing of legal services qualifies *B* for a share in the profits, but not for any credit in *B*'s capital account. Such a credit would be "remuneration for acting in the partnership business." U.P.A. § 18(f) prohibits this absent a contrary agreement. See *supra* notes 55-66 and accompanying text and *infra* notes 143-50 and accompanying text.

their original agreement on sharing profits. In tabular form:

Assets of the partnership	$52,000
Less payment to creditors per section 40(b)(I)	(3,000)
Available prior to return of capital	$49,000
Less discharge of *A*'s capital account per section 40(b)(III)	(14,000)
Less discharge of *B*'s capital account per section 40(b)(III)	(5,000)
Remaining for distribution as profits per section 40(b)(IV)	$30,000

By agreement, each partner receives one-third of the profits:

A	$10,000
B	$10,000
C	$10,000

Total payout per partner:

A	$24,000
B	$15,000
C	$10,000

IV. CHRISTMAS TREE DISPUTES IN THE CASE LAW: THE CASE LAW EVALUATED

Courts handle the Christmas tree paradigm in three different and mutually exclusive ways. Some courts commit "the heresy of capital" and allocate all partnership property to *K*. Other courts commit the "heresy of labor," treating *L*'s labor as a capital contribution and dividing the partnership property accordingly. Still other courts "split the baby" by allocating to *K* the value of the contributed property and dividing between *K* and *L* the value of any postcontribution appreciation of that property. This Part of the Article describes in detail the three disparate approaches and evaluates each against the basic partnership principles developed in Part III.

A. *The Heresy of Capital*

Courts that commit the heresy of capital favor *K*, the partner who originally contributed capital to the business,[97] and upon

97. The capital contribution may be in the form of money, personal property, real property, or some combination. *See supra* note 23 and accompanying text.

dissolution typically return all the partnership assets to *K* in kind.[98] At dissolution, *L*, the partner who contributed labor, derives no benefit from any previously unrealized appreciation of those capital assets.[99]

In *Schaefer v. Bork*,[100] for example, one partner contributed substantial amounts of land, equipment, and growing trees to an enterprise that the court later found to be a partnership. The enterprise raised and sold Christmas trees. Much of the contributed property appreciated significantly during the life of the partnership,[101] and the partnership also acquired additional property.[102] After the partners fell out, the court awarded all of the partnership's assets to the partner who had made the original contribution. This award effectively included all the capital appreciation that had occurred during the life of the partnership.[103]

In *Bork* and similar cases, the heresy of capital worked directly. By awarding all partnership property to *K*, without any credit to *L* for appreciation that occurred while the partnership owned the property, the court overtly allocated all appreciation to the contributor partner.

The heresy can also operate indirectly. To allocate all appreciation to *K* indirectly, the court simply values the contributions as of the date of dissolution. For example, in *Halsey v. Choate*,[104] *K* had contributed, *inter alia*, a license to sell a certain amount of milk. During the life of the partnership, the license increased substantially in per unit value.[105] When the partnership sold its dairy operation, the license constituted an important asset. From the proceeds of the license sale, the court awarded *K* the value of

98. This allocation can only occur after the partnership has discharged any debts it may have to third parties. Houstoun v. Albury, 436 So. 2d 224, 226 (Fl. Dist. Ct. App. 1983) (in-kind division may be permissible after creditors paid off); Rinke v. Rinke, 330 Mich. 615, 628, 48 N.W.2d 201, 207 (1951) (affirming trial court's in-kind division of "the assets of the partnerships" when no creditors interested); U.P.A. § 38(1) (allocation to partners to be made from "surplus" remaining after the partnership has "discharge[d] its liabilities").

99. Edwards v. Arvin, 272 Ky. 528, 531, 114 S.W.2d 778, 779 (1938); Schaefer v. Bork, 413 N.W.2d 873, 877 (Minn. Ct. App. 1987); Badran v. Bertrand, 214 Neb. 413, 416, 334 N.W.2d 184, 186 (1983).

100. 413 N.W.2d 873.

101. *Id.* at 875, 878.

102. *Id.* at 875.

103. *Id.* at 875, 877. The court did make an award to *L* for profits that were due but had not been paid. *Id.* at 875.

104. 27 N.C. App. 49, 217 S.E.2d 740, *cert. denied*, 288 N.C. 730, 220 S.E.2d 350 (1975).

105. *Id.* at 52, 217 S.E.2d at 742. The license also increased in quantity. *Id.*

his contribution calculated according to the price per pound the partnership received from the sale of the license. At the time of contribution, the license was virtually worthless as its value per unit was close to zero. This ruling thus allocated all the per unit appreciation to *K*.[106]

Language in some partnership cases can be read to support the heresy of capital. *Edwards v. Arvin*,[107] for example, quotes from a treatise of its day and states:

> Where one partner furnishes no capital but contributes merely his time, skill and services, the presumption on dissolution of the partnership is that he is not entitled to any part of the firm capital; and even where the agreement is that the profits and losses are to be shared equally, the partner who contributes only his services is not entitled on dissolution to any part of the firm capital.[108]

In *Edwards*, however, the firm capital had apparently depreciated,[109] so the quoted language is arguably dictum regarding appreciation cases. Moreover, this language does not unambiguously support allocating appreciation to *K*. Appreciation of capital constitutes unrealized profits and, therefore, strictly speaking, is not really part of "the firm capital."[110]

Hunter v. Allen[111] contains language similar to the language quoted in *Edwards*. The *Hunter* language is likewise ambiguous, referring to the firm capital and likewise dictum with regard to appreciation.[112] *Johnson v. Jackson*[113] also seems to support the heresy of capital. "It is . . . the established rule that [in a *K* and

106. Langness v. "O" Street Carpet Shop, Inc., 217 Neb. 569, 353 N.W.2d 709 (1984), exemplifies proper valuation timing. A partner contributed the vendee's interest in a purchase agreement on realty. The purchase price on the property was $56,000, and its fair market value was $65,000, "for a [capital] contribution of property worth $9,000." *Id.* at 572, 353 N.W.2d at 712. This valuation applied at dissolution even though the property subject to the agreement appreciated substantially after the partnership acquired the agreement. The appreciation prior to contribution, from contract price of $56,000 to fair market value of $65,000, belonged to the contributor and constituted a capital contribution. Subsequent appreciation belonged to the partnership. *Id.* at 572-73, 353 N.W.2d at 712-13; *see also* Baum v. McBride, 152 Neb. 152, 156-57, 40 N.W.2d 649, 652-53 (1950) (when partner contributed contracts for future purchase of potato bags, increase in the value of the contracts that occurred between the time the partner entered into the contracts and the time the partner contributed the contracts was the partner's capital contribution).

107. 272 Ky. 528, 114 S.W.2d 778 (1938).

108. *Id.* at 531, 114 S.W.2d at 779 (quoting 20 R.C.L. 1022, § 264).

109. *Id.* at 532, 114 S.W.2d at 780.

110. *See infra* note 121; *see also* Eisner v. Macomber, 252 U.S. 189, 207-15 (1920).

111. 174 Or. 261, 267-68, 147 P.2d 213, 215, *modified on reh'g on other grounds*, 174 Or. 286, 148 P.2d 936 (1944).

112. The case does not consider appreciation. *Id.*

113. 130 Ky. 751, 114 S.W. 260 (1908).

L partnership] the excess of capital advanced should be restored from the firm assets to the partner advancing [the capital] . . . ."[114] *Johnson*, however, was a depreciation case. One partner contributed at least $3,250 in capital, and the business sold for $3,000.[115] Moreover, as support for its "established rule," *Johnson* cites only one case. That case, *Chamberlain v. Sawyers*,[116] did not involve a *K* and *L* partnership. "The terms of the partnership [between Chamberlain and Sawyers] are conceded to be that each party was to contribute an equal portion of the capital . . . ."[117] Moreover, the partnership capital did not appreciate. To the contrary, the partnership suffered a capital loss.[118]

In any event, if these cases stand for the proposition that all appreciation belongs to *K*, then the cases are wrong. The heresy of capital is heresy because it ignores the metamorphosis property undergoes when contributed to a partnership. The property ceases to belong to the contributor, and the partnership becomes the owner.[119] This transfer of ownership has two significant consequences. First, the contributor has no special claim on the property when dissolution occurs. The contributor has no right to an in-kind settling of the contributor's capital account.[120] Second, whatever appreciation has occurred does not belong to the contributor. The appreciation is owned by the same entity that owns the underlying property—the partnership.[121] The contributor is due

114. *Id.* at 756, 114 S.W. at 262.

115. *Id.* at 753, 114 S.W. at 261.

116. 17 Ky. L. Rptr. 716, 32 S.W. 475 (1895).

117. *Id.*

118. *Id.* at 718, 32 S.W. at 477 (describing how to apportion the loss).

119. *See supra* notes 33-45 and accompanying text.

120. *See supra* note 75 and accompanying text. Some cases have divided property in kind, but even those cases have recognized that it is partnership property that is being divided. Thus, the asset being allocated in kind is part of the overall value being divided among the partners, and the allocation to one partner of an appreciated asset is balanced by the allocation of other assets to other partners. Houstoun v. Albury, 436 So. 2d 224, 226 (Fl. Dist. Ct. App. 1983); Wiese v. Wiese, 107 So. 2d 208, 212 (Fla. Dist. Ct. App. 1958) (distribution in kind permissible if to the parties' advantage); Rinke v. Rinke, 330 Mich. 615, 628, 48 N.W.2d 201, 207 (1951) (affirming trial court's in-kind division of "the assets of the partnership" when no creditors interested).

121. Swann v. Mitchell, 435 So. 2d 797, 799 (Fla. 1983) ("profits . . . include the increment in the value of the capital assets"); Uhrig v. Redding, 150 Fla. 480, 484, 8 So. 2d 4, 6 (1942) (labor contributing partner only entitled to "his half share in any *increment* in the value of the capital assets") (emphasis added). Partners can, of course, agree to a different result. Stark v. Reingold, 18 N.J. 251, 267, 113 A.2d 679, 687 (1955) (appreciated property a partnership asset; increase in value therefore to be distributed between partners after one partner reimbursed for having personally paid off a lien); *see Swann*, 435 So. 2d at 801-02 (McDonald, J., dissenting) (partnership agreement read to limit a partner to a share of operating profits).

only the value of the contribution calculated as of the time of contribution.[122] Thus, when contributed property has appreciated, the heresy of capital gives the capital partner more than is due.[123]

In the obverse context, when partnership capital has depreciated, the capital heresy works to the benefit of the labor partner. If the transformation of individual property into partnership property leaves the contributor connected to the benefits of appreciation, that transformation should leave the contributor likewise connected to the detriments of depreciation. Under the capital heresy, contribution brings no metamorphosis. Logically, partners who contribute capital that declines in value should bear the loss alone.

Some labor partners have indeed urged the capital heresy in depreciation cases, arguing that the depreciation of partnership property is solely for the contributor's account. The courts, however, have rejected such attempts.[124] In *Edwards v. Arvin*,[125] for example, the *L* partner acknowledged that he had no right to any

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122. *See* Johnston v. Ballard, 83 Tex. 486, 489, 18 S.W. 686, 687 (1892) (quoting a partnership treatise of the day, Pol. Partn., at art. 32: " 'Subject to the right of each partner to be credited in account *with the firm with the amount of capital actually brought in by him* . . . the share of all the partners are presumed to be equal . . . .' ") (emphasis added); Nupetco Assocs. v. Jenkins, 669 P.2d 877, 883 (Utah 1983) ("Our statutes provide that, subject to any agreement to the contrary, the rules for distribution in settling accounts between partners after dissolution require . . . that each of the partners *be returned to his/her status at the creation of the partnership* by returning to each partner his/her capital contribution . . . .") (emphasis added).

123. In the absence of an agreement, allocating appreciation to *K* cannot be justified as compensation for the use of *K*'s assets during the life of the partnership. That justification would overturn the bargain that gives rise to the partnership. *See* Jackson v. Johnson, 18 N.Y. Sup. Ct. 509, 509-10 (1877), *modified on other grounds*, 74 N.Y. 607 (1878):

> It is insisted that the appellant should have been allowed interest on his capital. . . .
>
> . . . [W]here labor and skill, under an agreement . . . are put in against capital, it is understood by the parties that the one is deemed equal to the other, and, therefore, if interest be computed on cash capital, the same interest should be allowed upon the labor capital, to carry out the idea of equality in value, with which the parties set out in the undertaking.

Moreover, such a justification would violate at least the spirit of U.P.A. § 18(d) (no interest accrued on contributions of capital until date repayment due). *See also* Annotation, *Rights of Partners* Inter Se *in Respect of Interest*, 66 A.L.R. 3, 12-14 (1930).

124. A few cases shield the labor partner from loss sharing, but they do so on a basis unrelated to the heresy of capital. Cases such as Kovacik v. Reed, 49 Cal. 2d 166, 315 P.2d 314 (1957), and Becker v. Killarney, 177 Ill. App. 3d 793, 532 N.E.2d 931 (1988), *appeal denied*, 126 Ill. 2d 557, 541 N.E.2d 1104 (1989), simply hold that, absent a contrary agreement, a labor partner shares profits but not losses. This holding contravenes U.P.A. § 18(a) (absent contrary agreement partners share in losses in proportion to their respective profit shares).

125. 272 Ky. 528, 532, 114 S.W.2d 778, 780 (1938).

return of capital. He contended, however, that *K*'s return of capital should reflect not the original invoice value of goods contributed, but rather some diminished value. The court rejected the argument. The appellants in *Taft v. Schwamb*[126] made a similar claim and were likewise unsuccessful. According to the partnership agreement, Schwamb had contributed to the partnership capital a building, an engine, a boiler, machinery, and tools.[127] All the contributed property had been destroyed, and Schwamb's partners asserted that they should not share in that loss. The court rejected the argument.[128]

Thus, the heresy of capital fails in both the context of appreciation and the context of depreciation. In the former, the heresy deprives the labor partner of his or her share of the partnership profits reflected in appreciation. In the latter, courts have implicitly rejected the heresy by refusing to impose on the contributor alone all loss from depreciation.

B. The Heresy of Labor

In contrast to the heresy of capital, the heresy of labor favors *L*, the partner who contributed labor to a *K* and *L* partnership. The labor heresy places a value on *L*'s labor, treats that value as a capital contribution, and at dissolution returns that value to *L* apart from and prior to any sharing of profits.

Thompson v. Beth,[129] for example, involved a partnership formed to construct and operate a lake resort. In the planning and con-

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126. 80 Ill. 289 (1875).

127. *Id.* at 291.

128. *Id.* at 298-300. In contrast, if a partner merely furnishes assets through a loan or a lease, absent a contrary agreement the risk of depreciation rests with the partner who furnishes. Tutt v. Land, 50 Ga. 339, 351 (1873), involved a partner's claim against the partnership for depreciation in stock he had furnished to the partnership. The court viewed the furnishing of stock as being in the nature of a loan and classified the depreciated stock together with a facility rented by the partner to the partnership. The court rejected the partner's claim for depreciation in the furnished stock and used the following analogy:

> If A and B were to form a partnership for farming purposes, A to furnish the land, and horses and mules for ploughing, and B his skill, labor and superintendence, and the profits to be divided equally or in any given ratio between them, could A, at the end of two years or other period, when the dissolution might take place, claim compensation for the decreased value of *his* horses or mules on account of their increased age, or for the wear and waste of *his* land from time and cultivation . . . ? It would scarcely occur to the mind of any one that such a right existed on the part of A, unless it was so specified "in the bond."

Id. at 352 (emphasis added).

129. 14 Wis. 2d 271, 111 N.W.2d 171 (1961).

struction of the resort, *K* had furnished "something over $13,000" in capital and *L* "had *invested* approximately $400 and over 2,000 hours of labor."[130] Although *K* and *L* initially agreed to be equal partners, a subsequent agreement reduced *L*'s share to one-third.[131] The partnership eventually sold the resort for $14,250, and the trial court awarded one-third of the sale proceeds to *L*.[132] The Wisconsin Supreme Court affirmed, approving the award to *L* as reflecting *L*'s capital contribution of labor.[133]

In most labor heresy cases, the heresy operates or is urged overtly. In *Thompson* the court expressly characterized *L*'s efforts as "his contribution to the capital assets of the partnership."[134] Likewise, in *Schymanski v. Conventz*,[135] the trial court credited *L* with a capital contribution of $70,000 for architectural and managerial services.[136] In *Langness v. "O" Street Carpet Shop, Inc.*,[137] the *L* partner argued that his legal services entitled him not only to an agreed upon 10% profit share, but also to a 10% capital share.[138]

Occasionally, however, the transformation of labor into capital occurs sub silentio. *Halsey v. Choate*,[139] for example, involved an

130. *Id.* at 276, 111 N.W.2d at 173 (emphasis added).

131. *Id.*

132. *Id.* at 275-76, 111 N.W.2d at 172-73.

133. *Id.* at 279-80, 111 N.W.2d at 174-75. The court modified the judgment to add interest to the award.

134. *Id.* at 279, 111 N.W.2d at 175.

135. 674 P.2d 281 (Alaska 1983).

136. *Id.* at 283-84. The Supreme Court reversed and remanded for "specific findings and/or evidentiary proceedings regarding . . . the existence of any express or implied agreement by the partners to treat [*L*'s] personal services as . . . capital contributions . . . ." *Id.* at 287. Partners certainly may *agree* to treat labor as if it were a capital contribution. Coleman v. Lofgren, 633 P.2d 1365, 1367-68 (Alaska 1981) (by agreement, each of two *L* partners credited with a $15,000 contribution to capital; *K* partner denied any such agreement; trial court specifically found the *L* partners more credible); Beaman v. DeShazor, 197 Or. 669, 683, 255 P.2d 157, 163 (1953) (agreement entitled labor-contributing partner to one-half the book value of the partnership); *cf.* Clark v. Feldman, 79 Or. App. 497, 501, 719 P.2d 909, 912 (1986) (en banc) (partnership agreement gave a one-third interest to one partner on account of management contributions and a one-third interest to another partner on account of labor contributions; unclear from opinion whether those interests related only to profits or to profits and a division of the partnership's original capital).

137. 217 Neb. 569, 353 N.W.2d 709 (1984).

138. The court quite properly rejected the argument. *Id.* at 573, 353 N.W.2d at 712.

139. 27 N.C. App. 49, 217 S.E.2d 740, *cert. denied*, 288 N.C. 730, 220 S.E.2d 350 (1975). The appeals court reversed and committed the heresy of capital. See *supra* notes 104-06 and accompanying text for a more detailed statement of the facts and for the appeals court decision.

accounting following the sale of a partnership business. The trial court split the proceeds from a key asset in half between *K* and *L*, even though *K* had initially contributed most of the appreciating asset. The decision in essence capitalized *L*'s labor efforts and equated them to the actual capital contributed by *K*.[140]

140. A simple example will demonstrate how the splitting of proceeds in effect transforms labor into capital. *K* and *L* agree to share profits and losses equally. *K* contributes capital worth $10,000. *L* contributes labor. The partnership breaks even and then dissolves. U.P.A. § 40(b) sets the priorities of payout. Under the "breaks even" hypothesis, there are no outstanding debts to outsiders and no loan repayments owed partners. First assume that *L*'s efforts are not treated as capital. The only payment at dissolution will be to *K*, for $10,000. This payment will discharge all liabilities of the partnership "owing to partners in respect of capital." U.P.A. § 40(b)(III). As no assets remain, U.P.A. § 40(b)(IV), the division of profits provision, is not reached. The final accounting: $10,000 to *K* and $0 to *L*.

Now assume, instead, that the final accounting reflects an equal split of assets: $5,000 to *K* and $5,000 to *L*. The payment to *L* cannot be a distribution of profits. U.P.A. § 40(b) precludes payment of profits until all liabilities "owing to partners in respect of capital" have been satisfied, and *K* still has $5,000 owing ($10,000 contributed; only $5,000 returned). Moreover, by hypothesis, there are no profits to be distributed because the partnership merely broke even. The only way to fit the payment to *L* into the statute is to treat *L*'s effort as a credit of $10,000 on *L*'s capital account. Then each partner is owed $10,000 in respect of capital, and the payment of $5,000 to each reflects a pro rata partial discharge of the partnership's liabilities. In theory, U.P.A. § 40(d) would require *K* and *L* to contribute enough money to allow the partnerhip to pay off the rest of the capital accounts. Because *K* and *L* are owed equal amounts and share equally in losses, however, additional contributions would serve no purpose. Each partner would have to contribute the same amount he or she is due to receive. If the partnership makes a profit or suffers a loss, the arithmetic involved in the example would be a bit more complicated but the result would be the same.

Cases that split the proceeds may rest on a misunderstanding of what it means for partners to share equally. Smiley v. Smiley's Adm'x, 112 Va. 490, 492, 71 S.E. 532, 533 (1911) (quoting 2 LINDLEY ON PARTNERSHIP 676) provides an example:

> "When it is said that the shares of partners are prima facie equal, although their capitals are unequal, what is meant [is] that the losses of capital, like other losses, must be shared equally; but is not meant that on a final settlement of accounts capitals contributed unequally are to be treated as one aggregate fund, which ought to be divided among the partners in equal shares."

See also Newman v. Newman, 145 Tex. 433, 435-36, 198 S.W.2d 91, 92-93 (1946):

> There was no repugnance between the allegations that the four partners owned the partnership business and assets equally and the assertion that [the *K* partner] was entitled upon dissolution to withdraw the value of the capital she originally put into the enterprise . . . . [T]hese assets [of the partnership] were charged, upon an accounting and dissolution, with all outstanding liabilities, including the claim [*K*] had . . . in respect of the return of her capital contribution.

For an attempt to use the covert version of the heresy of labor when the partnership lost money, see Jackson v. Jackson, 150 Ga. App. 87, 87-88, 256 S.E.2d 631, 631-32 (1979) (*K* had contributed $20,000 to a grocery partnership that was eventually sold for approximately $9,000; *L* unsuccessfully sought 50% of the proceeds of the sale).

Whether operating overtly or covertly, the heresy of labor is wrong for three reasons. First, by remunerating *L* for labor in absence of an agreement to do so, the heresy violates the express commands of the U.P.A. Second, by creating "ersatz"[141] capital for *L*, the heresy transfers to *L* wealth that the U.P.A. default rules reserve to *K*. Third, if the partnership has not made and retained enough profit to fund the wealth transfer, the heresy imposes an out-of-pocket loss on *K* so as to make possible the return of *L*'s ersatz capital.

The first problem with the heresy of labor is also the most obvious. The heresy violates the U.P.A. provision prohibiting remuneration of partner labor. With an exception not relevant here, U.P.A. section 18(f) states that "[n]o partner is entitled to remuneration for acting in the partnership business." The weight of case law is equally clear that "a partner who contributes no capital, but merely devotes his time, skill and services to the business . . . is limited to his share in the profits of the enterprise as compensation for his services."[142]

The dictionary defines "remunerate" as "to pay an equivalent to for a service, loss, or expense"[143] and defines "compensate" as

141. "Ersatz" means artificial or substitute. WEBSTER'S SEVENTH NEW COLLEGIATE DICTIONARY 389 (1977). In the sense of economics and finance, labor cannot be "real" capital. W. PETERSON, PRINCIPLES OF ECONOMICS: MICRO 335-36 (1977); *cf.* I.R.C. § 721 (1988). Under I.R.C. § 721 a partner's acquisition of a partnership interest is a nonrecognition event only if the partner obtains the interest in return for "property" contributed to the partnership. Under I.R.C. § 721 the concept of "property" does not include services that the partner has or will render to the partnership. Treas. Reg. § 1.721-1(b) (1956). Johnson v. Jackson, 130 Ky. 751, 114 S.W. 260 (1908), takes the same view under the common law of partnership. " 'With regard to the view sometimes stated that time, labor, and skill expended by a partner in the partnership business constitute his capital, it would seem that, while these may form a consideration for the partnership contract, they should not properly be called capital, as they give to such partner no rights in the final distribution of the firm capital.' " *Id.* at 756, 114 S.W. at 262 (quoting 22 AMERICAN AND ENGLISH ENCYCLOPEDIA OF LAW 86 (2d ed. 1902)). *But cf.* Meadows v. Mocquot, 110 Ky. 220, 223, 61 S.W. 28, 28-29 (1901) (if appellant "advance[d] the money as his part of the capital, and appellee . . . render[ed] services in buying and selling as his part of the capital," appellant would lose his money and appellee would lose his labor); W. WOOD & H. CAMPBELL, COST BENEFIT ANALYSIS AND THE ECONOMICS OF INVESTMENT IN HUMAN RESOURCES 1-4 (1970) (chapter entitled "Human Capital").

142. Hunter v. Allen, 174 Or. 261, 267-68, 147 P.2d 213, 215, *modified on reh'g on other grounds*, 174 Or. 286, 148 P.2d 936 (1944); *see also* Chamberlain v. Sawyers, 17 Ky. L. Rptr. 716, 719, 32 S.W. 475, 477 (1895) ("In the absence of [an express or implied agreement to the contrary], the law does not raise any presumption of a promise, or any obligation, to pay."); Nupetco Assocs. v. Jenkins, 669 P.2d 877, 882 (Utah 1983) (reversing trial court's award of compensation to partner for efforts in getting partnership land rezoned).

143. WEBSTER'S SEVENTH NEW COLLEGIATE DICTIONARY 979 (1977).

"to make an appropriate . . . payment to."[144] When a court credits *L*'s capital account for services rendered, the court is indirectly, but nonetheless ineluctably, providing for the remuneration and compensation of *L*. The capital account numbers have a practical effect. They reflect a debt of the partnership—the amount in *L*'s capital account is an amount that *L* is to be paid.[145] Thus, capitalizing labor inevitably remunerates *L* and inevitably violates the U.P.A.[146]

Thompson v. Beth[147] is the only heresy of labor case that even addresses the remuneration issue. The case attempts to escape section 18(f) by simply asserting that the remuneration prohibition applies only when "a partner has been active in contributing his skill and labor toward the affairs of the partnership on a day-to-day basis" and not when "the skill and labor of the partner are his contribution to the capital assets of the partnership."[148]

The opinion does not explain what distinguishes "day-to-day" activities from "a contribution to the capital assets of the partnership," but only one distinction can be inferred from the facts and language of the case. "Day-to-day" activities go toward operating an established business. "Contribution" activities go toward establishing the business and getting it ready to operate.

In *Thompson*, most of *L*'s efforts went toward designing and constructing a resort, and that resort became the partnership's key operating asset. Thus, *L*'s contributed labor went toward getting the business ready to operate, not toward operating it. According to the court, efforts of this type did not contribute "toward the affairs of the partnership on a day-to-day basis." Presumably, had *L* "invested"[149] his efforts in managing a fully operational resort, he would have been "contributing toward the affairs of the partnership on a day-to-day basis," and U.P.A. section 18(f) would have barred any capital contribution credit. It appears, therefore, that under *Thompson* labor contributed in getting the

144. *Id.* at 229.

145. U.P.A. § 40(b)(III); *see supra* note 87.

146. See *supra* note 140 for an example of how capitalization inevitably leads to remuneration. *See also* Langness v. "O" Street Carpet Shop, Inc., 217 Neb. 569, 573, 353 N.W.2d 709, 712 (1984) ("It is the general rule that a partner who contributes only services to the partnership is not deemed to have made a capital contribution to the partnership such as to require capital repayment upon dissolution unless the parties have agreed to the contrary.").

147. 14 Wis. 2d 271, 111 N.W.2d 171 (1961).

148. *Id.* at 279, 111 N.W.2d at 175.

149. The court uses this term to describe *L*'s efforts. *Id.* at 276, 111 N.W.2d at 174.

partnership business ready to operate is capital, but labor contributed in the operation of the business is not.[150]

Unfortunately, although this distinction would put some limit on *Thompson*, the distinction cannot withstand scrutiny. No legal authority exists for distinguishing among types of contributed labor. The opinion cites none, and the statutory language itself provides no basis for separating labor that gets a facility "up and running" from labor that runs the facility. Moreover, the distinction is illogical. It privileges start-up contributions over operating contributions, even though in some partnerships running the business may be immeasurably more time consuming and difficult than preparing the business to operate.

The labor heresy's impact does not stop at U.P.A. section 18(f). Capitalizing labor has substantial economic effects, and those effects offend other provisions of the U.P.A. Specifically, the labor heresy reallocates partner wealth in a way contradictory to the U.P.A.'s default rules on post-dissolution property distribution. For example, if at dissolution a partnership has retained profits, including unrealized appreciation and saleable goodwill, equal to or exceeding the amount of *L*'s ersatz capital, then the heresy of labor will deprive *K* of some of *K*'s share of the partnership profits. Funds to repay the ersatz capital must come from somewhere, and under the U.P.A. payment of capital takes priority over payment of profits.[151]

Assume, for instance, that *K* and *L* agree to share profits equally, that *K* contributes $10,000 in real capital, and that *L* seeks a $10,000 erstaz capital valuation for labor. Assume also that, after

150. The rule of *Thompson* would have provided capital credit for the legal services performed by Friedman, the *L* partner in *Langness*. Friedman's services to the partnership apparently preceded the execution of the partnership agreement and were therefore in the nature of "getting it up and running" contributions. *Langness*, 217 Neb. at 570-71, 353 N.W.2d at 711. Kirkpatrick v. Christensen, 68 Ariz. 364, 206 P.2d 577 (1949), contains an even broader formulation of the labor heresy than does *Thompson*. *Kirkpatrick* quotes a litigant's view as follows: " 'A partner who is entrusted by his fellow partners with the entire management of and responsibility for the partnership business is entitled, irrespective of agreement, to just compensation for his services, and especially where the other partners are devoting their entire time to their private affairs.' " *Id.* at 368, 206 P.2d at 580. It is not clear whether the Arizona Supreme Court agreed. The opinion notes the point was not in controversy on appeal, because the trial court had awarded the litigant the amounts he had sought for his services. *Id.* The opinion cites no supporting authority.

151. U.P.A. § 40(b); Legum Furniture Corp. v. Levine, 217 Va. 782, 787, 232 S.E.2d 782, 786 (1977) (joint venture, with partnership law applied by analogy). For cases in which capital appreciation has funded the return of *L*'s ersatz capital, see Coleman v. Lofgren, 633 P.2d 1365 (Alaska 1981); B.B. & S. Constr. Co. v. Stone, 535 P.2d 271 (Alaska 1975); Craig v. Hamilton, 213 Kan. 665, 518 P.2d 539 (1974); Thompson v. Beth, 14 Wis. 2d 271, 111 N.W.2d 171 (1961).

all creditors have been paid, the net worth of the partnership at dissolution is $30,000. Without the heresy of labor, the return of *K*'s capital contribution will leave $20,000 to be distributed to the partners as profit.[152] *K* will receive one-half of the $20,000. If, however, the heresy prevails and *L*'s ersatz capital contribution claim succeeds, the return of *L*'s capital will reduce the profit fund to $10,000 and *K*'s share to $5,000. Compared to the dissolution scenario mandated by the U.P.A., the heresy of labor will have caused a transfer of $5,000 from *K* to *L*.[153]

If at dissolution the partnership's retained profits do not equal or exceed the value of the ersatz capital, the effect on *K* is even worse. *K* will have to suffer an out-of-pocket loss in order to fund repayment to *L*. Assume for example that *K* and *L* agree to share profits and losses equally, that *K* contributes property worth $30,000, that *L*'s labor contribution has a capital value of $10,000, and that at dissolution the partnership's net worth is $30,000. The partnership is $10,000 short of the amount needed to return all the real and ersatz capital. For the partners to share equally the $10,000 capital loss, *K* will have to be satisfied with a $25,000 return from his or her capital account of $30,000. *K*'s resulting $5,000 loss will enable the partnership to return $5,000 to *L*. The two partners will thus have lost equal amounts.[154]

In *Thompson v. Beth*,[155] the *K* partner's loss actually did fund the partial return of *L*'s ersatz capital. *K* had made capital con-

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152. U.P.A. §§ 40(b)(III)-(IV).

153. The trial court decision in Schymanski v. Conventz, 674 P.2d 281, 283-84 (Alaska 1983), produced just this effect, costing *K* $35,000 of profit. The transfer issue is especially problematic in at-will partnerships. How long must the partnership endure and how much labor must *L* contribute before *L*'s ersatz capital equals *K*'s real capital? In Hillock v. Grape, 111 A.D. 720, 97 N.Y.S. 823 (1906), *L* claimed that his labor in a cartage business entitled him to 50% of the profits and 50% of the capital. *K* had contributed all of the capital.

> The construction put upon the alleged agreement by the plaintiff would work out a result which could not possibly have been intended by [*K*] . . . . If the title to an equal share of the horses, wagons, equipments, and money of [*K*], passed to [*L*] by virtue of the alleged agreement, [*L*] could have terminated the copartnership at any time; at the end of a week he could have demanded that [*K*] account to him for one-half of the property.

Id. at 724-25, 97 N.Y.S. at 826; *see also* Johnston v. Ballard, 83 Tex. 486, 490, 18 S.W. 686, 687 (1892) (equal split of firm's capital in *K* and *L* partnership especially problematic when "the partnership is to continue for a short period, or may be determined at will").

154. The appellants in Larsen v. Claridge, 23 Ariz. App. 508, 534 P.2d 439 (1975), unsuccessfully urged just such a result. Appellants had contributed labor to a farming partnership and claimed that their labor contribution matched the financial capital contributed by appellees. Appellants asserted that, therefore, on dissolution the capital originally contributed by appellees should be split between the parties. *Id.* at 509, 534 P.2d at 440.

155. 14 Wis. 2d 271, 111 N.W.2d 171 (1961).

tributions of approximately $13,000, and *L* had made real capital contributions of $400. Profits were to be split two-thirds to *K* and one-third to *L*. After payment of creditors, the partnership had $14,250 left. Under U.P.A. sections 40(b) and 18(f), the court should have divided those funds as follows:

	K	*L*	
Return of capital	$13,000	$400	
Remainder to be divided as profits			$850
Profits	567	283	
Total	$13,567	$683	

Instead, the court equated *L*'s ersatz capital to *K*'s real capital and awarded *L* one-third of the partnership funds. In tabular form:

	K	*L*	
Owed as return of real capital	($13,000)	($ 400)	
Distributed to partners	9,500	4,750	(Total: $14,250)
K partner's loss (amount by which distribution falls short of capital account)	$(4,750)		
L partner's profit (amount by which distribution exceeds capital account)		$4,350[156]	

Thus, the heresy of labor contravenes the U.P.A. prohibition against labor remuneration and deviates from the U.P.A. default scenario for post-dissolution property division.

C. *Splitting the Baby*

As the name suggests, cases that engage in splitting the baby take an intermediate approach. At dissolution, *K*, the capital contributing partner, receives as a return of capital an amount equal to the fair market value of *K*'s contribution. The contribution is valued as of the time contributed.[157] Any post-contribution appreciation belongs to the partnership, and the partners divide it as they share profits.[158]

156. The actual amount awarded to *L* was $4,482.91 plus interest. *Id.* at 280, 111 N.W.2d at 175. A full one-third would have been $4,750, and the opinion does not explain the discrepancy.

157. If the contribution were valued at the time of dissolution, the valuation would effectively allocate the appreciation to *K*. *See supra* notes 104-06 and accompanying text.

158. Uhrig v. Redding, 150 Fla. 480, 8 So. 2d 4 (1942); Langness v. "O" Street Carpet Shop, Inc., 217 Neb. 569, 353 N.W.2d 709 (1984).

For example, in *Langness v. "O" Street Carpet Shop, Inc.*,[159] one partner contributed the right to purchase a piece of realty. By the time the partnership ended, the realty had appreciated substantially. In dividing the partnership assets among the partners, the court credited the contributor only with the fair market value of the right to purchase as of the time of contribution. The court treated the increase in value as profit, to be divided among the partners.[160]

As should be apparent by now, courts that split the baby are complying with the U.P.A. Their decisions respect the transformation of contributed property into partnership property and allocate the appreciation to the owner of the appreciating property—the partnership. So, if one partner contributes all the capital to run a profitable breeding operation, and the other partner furnishes labor, on dissolution each partner is entitled to a "half share in any increment in the value of the capital assets."[161] If one partner contributes the right to purchase a rental property, and that property subsequently appreciates, on dissolution all partners share in the appreciation.[162] If one partner provides all the capital to operate a plumbing business, at dissolution the capital appreciation benefits the labor-contributing partner as well.[163]

V. WHY COURTS ERR—THE LAW'S HIDDEN PRESUPPOSITION OF BALANCE

Schaefer v. Bork[164] and *Thompson v. Beth*[165] are respectively the leading examples of the heresy of capital and the heresy of labor. Although each case errs in its reasoning, each has an attractive result. In each case, strict application of the U.P.A. default rules would have put the partners' respective returns substantially out of proportion to the benefits they individually brought into the partnership business.

159. 217 Neb. 569, 353 N.W.2d 709 (1984).

160. *Id.* at 574-75, 353 N.W.2d at 713.

161. *Uhrig*, 150 Fla. at 484, 8 So. 2d at 6.

162. *Langness*, 217 Neb. at 571-72, 353 N.W.2d at 712.

163. Degen v. Brooks, 77 N.D. 514, 528-30, 43 N.W.2d 755, 763-65 (1950) (showing accounting calculations dividing appreciated assets between partners); *cf.* Grimm v. Pallesen, 215 Kan. 660, 663, 527 P.2d 978, 981 (1974) (as evidence of party's intention not to form partnership, court noted that party never claimed interest in assets furnished by other party, including " 'plaintiff's one-half of the cows *and increase*' ") (emphasis added) (quoting trial court findings).

164. 413 N.W.2d 873 (Minn. Ct. App. 1987).

165. 14 Wis. 2d 271, 111 N.W.2d 171 (1961).

Section *A* of this Part of the Article highlights the imbalance that U.P.A. default rules may produce between partners' inputs[166] into the business and partners' returns from the business. Section *B* considers the rationale underlying the U.P.A. default rules and suggests that in the heresy cases the courts may be disregarding the letter of the law in order to serve its spirit. Section *C* argues that, for reasons of political philosophy and business practicality, courts should not disregard plainly stated statutory commands, even to avoid occasional unfair or unbalanced results. Section *D* then suggests ways to avoid unfair imbalances in *K* and *L* disputes without offending democratic values and without sacrificing coherence and predictability in the law of partnership.

*A. Examples of Imbalance—*Thompson v. Beth *and* Schaefer v. Bork

The partnership in *Thompson v. Beth*[167] designed, constructed, and eventually sold a small, lake-front resort. Thompson supplied over 2,000 hours of labor toward the design and construction work.[168] Presumably the labor was skilled, as Thompson had experience as an electrician and eventually became a general superintendent of construction projects.[169] Beth supplied approximately $13,000 in capital, plus some labor that the court apparently considered unworthy of valuation.[170]

The court provided no indication that either partner drew any profit from the operation of the enterprise, and the eventual sale of the resort brought only $14,250.[171] The U.P.A.'s default rules mandated a full return of Beth's capital contribution,[172] and that return would have left only $1,250 for division as profits. Of that, Thompson's one-third share would have amounted to approximately $417. Under the U.P.A. approach, Thompson would have put 2,000 hours of skilled labor into the enterprise, and essentially all of it would have been lost. Beth would have come out substantially unscathed, at least as to the principal amount he in-

166. By "input" we mean anything or any effort of value which a partner "brings to the party." We use the economist's jargon, "input," instead of the more euphonious "contribution" to avoid confusion with the far more limited concept of "contribution of capital."

167. 14 Wis. 2d 271, 111 N.W.2d 171 (1961).

168. *Id.* at 276, 111 N.W.2d at 173.

169. *Id.* at 273-74, 111 N.W.2d at 172.

170. *Id.* at 276, 111 N.W.2d at 173.

171. *Id.*

172. *See supra* notes 155-56 and accompanying text.

vested.[173] The imbalance between partners' input and partners' return would have been substantial.[174]

The imbalance avoided by the decision in *Schaefer v. Bork*[175] was even more substantial. For twelve years that partnership raised and sold Christmas trees. Bork's inputs included hundreds of acres of owned land, containing between 500,000 and 750,000 growing evergreen trees,[176] between 250,000 and 500,000 trees growing on rented land,[177] a business reputation that was essential to the partnership's success,[178] and all significant managerial decisions.[179] Schaefer's input " 'was confined to the directing of the labor force, often at the direct suggestion or order of . . . Bork, together with . . . assuring that various items of machinery were maintained.' "[180]

In a practical sense, the business risks were likewise imbalanced. Legally, perhaps, the partners stood at equal risk for liabilities of the partnership and for losses. They made no agreement on these matters,[181] so U.P.A. sections 18(a) and 40(d) by default obliged them to share losses and liabilities as they were eventually to share profits—equally.[182] Practically, though, Bork bore all the risk. The court did not indicate that Schaefer had any significant personal assets with which to fund his obligations in the event that the partnership lost money or its property depreciated in value.

The determination that the Bork-Schaefer enterprise constituted a partnership[183] inevitably produced a substantial return for Schae-

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173. The $834 he and his wife would have received as their two-thirds of the profit would have been a paltry return on a decade-long investment of capital. At least Beth would have preserved his initial investment, however.

174. *Cf.* Reese v. Melahn, 45 Ill. App. 3d 585, 590-91, 359 N.E.2d 1248, 1252 (1977) (distinguishing *Thompson*, 14 Wis. 2d 271, 111 N.W.2d 171, from a partnership in which the partner providing labor received payment by agreement).

175. 413 N.W.2d 873 (Minn. Ct. App. 1987).

176. *Id.* at 874.

177. *See id.* The total number of growing trees at the inception of the partnership was approximately 1,000,000. *Id.*

178. *Id.* at 875.

179. *Id.*

180. *Id.* (quoting trial court).

181. *Id.* at 874.

182. *But see* Kovacik v. Reed, 49 Cal. 2d 166, 315 P.2d 314 (1957) (in bank) (absent a contrary agreement, a labor partner shares profits but not losses); Becker v. Killarney, 177 Ill. App. 3d 793, 532 N.E.2d 931 (1988), *appeal denied*, 126 Ill. 2d 557, 541 N.E.2d 1104 (1989) (same). Regardless of any agreements or issues *inter se*, they would be at least jointly liable to outsiders for debts of the partnership. U.P.A. § 15.

183. Bork unsuccessfully denied the existence of a partnership. *Schaefer*, 413 N.W.2d at 875.

fer. Although an oral agreement limited Schaefer to an annual salary of $8,200 for the partnership's first five years,[184] he received an award of over $214,000 in "back profits" covering the partnership's last seven years.[185] This award was in addition to the amounts Schaefer had already received during the last seven years of the partnership. Neither the trial court opinion nor the appellate decision specify those amounts, but the trial court findings indicate that in one of those seven years Schaefer actually received more than Bork.[186]

Strict application of the U.P.A. rules would have produced an even greater imbalance of input versus return. The jury found the net value of the partnership at dissolution to be $1,503,767[187] and Schaefer claimed Bork's interests at the partnership's inception amounted in value to only $498,821.[188] Strictly speaking, the $1,004,946 difference was profit, and Schaefer was due his 50% share—$502,473.[189]

So, with the law strictly applied, the relationship between Schaefer's input and return would have been roughly as follows:

> *Input*: No capital; no significant risk; twelve years of labor, apparently mostly as a foreman; for five of the twelve years paid at the rate of $8,200 per year.[190]
> *Return*: $41,000 (payment for the first five years), unspecified amounts paid during the last seven years, $716,000 ($214,000 from disparity of profits in years 6 through 12, plus 50% of property appreciation).

Twelve years of work as a foreman, without any investment or risk of capital, in a business in which success depended not on him but on Bork, would have brought Schaefer a return of over $700,000.[191]

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184. *Id.* at 874.

185. *Id.* at 875.

186. Schaefer v. Bork, No. CX-85-283 (Minn. Dist. Ct. Jan. 8, 1987) (amended finding of fact 14).

187. *Schaefer*, 413 N.W.2d at 875.

188. *Id.* at 878. Schaefer's brief to the Court of Appeals actually contended that Bork had valued his contribution to the partnership at $201,571. Brief of Appellant, p. 3.

189. *See supra* notes 121-23 and accompanying text.

190. Neither the trial court decision nor the appellate opinion indicate whether $8,200 per year was a below-market rate. If not, during the first five years of the partnership Schaefer did not forego any opportunity for the benefit of the enterprise. *See supra* notes 60-65 and accompanying text.

191. The input/return analysis for Bork would have looked approximately as follows:

> *Input*: Over $400,000 in actual capital, crucial business reputation, key managerial skills and decision making, 12 years of labor, essentially all the risk of loss of capital.
> *Return*: All profits during years 1 through 5 of the business, profits equal to

B. The Rationale of the Default Rules

To alleviate problems of imbalance both *Schaefer* and *Thompson* disregarded the letter of the law. The cases may, however, have comported with the law's spirit. Finding that spirit means finding the rationale underlying the applicable U.P.A. default rules.

The essence of those rules is simply stated: When one partner contributes only capital and the other only labor, the exclusive form of compensation for each is an equal share in the profits.[192] Absent a contrary agreement, *L* receives no payment for labor, and *K* receives neither interest on nor the appreciation of the contributed capital.[193]

The rationale behind the rule is a bit more difficult to find. The Official Comments to the U.P.A. provide no guidance, and the scholarly articles that followed promulgation of the U.P.A. do not consider the issue.[194] Modern cases take the rule for granted,[195] but an instructive rationale does appear in some of the older cases and commentaries.

According to these old authorities, the absence of an agreement superseding the default rules means that the partners must have viewed their respective inputs as being roughly equal. If the part-

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Schaefer's during years 6 through 12, approximately $500,000 as his share of property appreciation.

Considered in isolation, Bork's return is substantial. But given Schaefer's input/return ratio, Bork seems disproportionately treated.

192. Schymanski v. Conventz, 674 P.2d 281, 284-85 (Alaska 1983) (profit share sole compensation for labor, in absence of contrary agreement); Johnson v. Jackson, 130 Ky. 751, 756, 114 S.W. 260, 262 (1908) (profit share sole compensation for labor); Sanford v. Barney, 4 N.Y. 500, 501 (N.Y. App. Div. 1888) (capital compensated by profits, not interest); Morgan v. Child, Coe & Co., 47 Utah 417, 429, 155 P. 451, 456 (1916) (same).

193. U.P.A. §§ 18(f), (d); *see also supra* notes 56-59 and accompanying text. When the partnership ends, *K* does receive back the value of the contributed capital. *See supra* notes 61-62 and accompanying text.

194. There are, for instance, no official comments to U.P.A. § 18(a) (presumptive equal share in profits), 18(d) (no interest on contributed capital), or 18(f) (no remuneration for partner's labor). The main scholarly articles from the time of promulgation focus on the entity aggregate debate. *See* Crane, *The Uniform Partnership Act and Legal Persons*, 29 HARV. L. REV. 838 (1916); Crane, *The Uniform Partnership Act—A Criticism*, 28 HARV. L. REV. 762 (1915); Drake, *Partnership Entity and Tenancy in Partnership: The Struggle for a Definition*, 15 MICH. L. REV. 609 (1917); Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism*, 29 HARV. L. REV. 158, 291 (1915-1916); Lewis, *The Uniform Partnership Act*, 24 YALE L.J. 617 (1915); Lewis, *The Desirability of Expressing the Law of Partnership in Statutory Form*, 60 U. PA. L. REV. 93 (1911); Lichtenberger, *The Uniform Partnership Act*, 63 U. PA. L. REV. 639 (1915); Williston, *The Uniform Partnership Act, With Some Remarks on Other Uniform Commercial Laws*, 63 U. PA. L. REV. 196 (1914).

195. *See supra* note 192.

ners had considered their inputs to be out of balance, then the partners themselves would have taken care to arrange for unequal returns.[196] In the words of Justice Story:

> [T]he very silence of the partners, as to any particular stipulation, might seem fairly to import, either, that there was not, all things considered, any real inequality in the benefits to the partnership in the case, or that the matter was waived upon grounds of good-will, or affection, or liberality, or expediency.[197]

It seems reasonable to use Justice Story's analysis to explain the U.P.A.'s approach, because the U.P.A. codified without commentary the default rules on which Justice Story was commenting. Indeed, the newest American treatise on partnership essentially restates Justice Story's presumption of balance. Writing of "the parties' assumed expectations," Bromberg and Ribstein state: "[E]ven if a partner contributes only capital or only services, the capital or service contribution together with the credit contribution that all partners make probably balance the contributions of the other members."[198]

The English law of partnership also reflects the presumption of balance. As Scamell and Banks state: "[N]or is it unreasonable to infer, in the absence of evidence to the contrary, that the partners have agreed to consider their contributions as of equal value, although they may have brought in unequal sums of money, or be themselves unequal as regards skill, connection or character."[199]

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196. The old cases also contain another rationale that is not directly relevant here. That rationale supports the presumption of equal division because it is simply impractical for a court to evaluate the relative values of partner inputs. *See supra* text accompanying note 65; *see also* Turnipseed v. Goodwin, 9 Ala. 372, 377 (1846) ("How can a just estimate be made of matters so vague and indeterminate, as skill, experience, probity &c.?" A more practical, predictable course is to presume an equal division in the absence of an agreement.). Contrast Scottish law of the same period, which took a more optimistic view of a court's ability to value partner input. In Thompson v. Williamson, 5 Eng. Rep. 833, (1831) (H.L.), Lord Wynford held that a presumption of equality should apply only when no evidence exists of other factors justifying an unequal share. Evidence of a contrary agreement was not necessary to dispel the presumption. Evidence of differing inputs would suffice to raise a jury question. "It is scarcely possible for a case to occur in which there will not be circumstances which it is fit to submit to the consideration of a jury, and which would induce a jury to give in unequal shares." *Id.* at 834.

197. J. STORY, LAW OF PARTNERSHIP § 24, at 34 (6th ed. 1868).

198. 2 A. BROMBERG & L. RIBSTEIN, *supra* note 54, § 6.02(b), at 6:9; *cf.* Wagner v. Wagner, 17 Ill. App. 2d 307, 311-12, 149 N.E.2d 770, 772 (1958) (if partner wished to exclude copartner from an interest in inventory and accounts, partner should have obtained an agreement to that effect).

199. E. SCAMELL & R. BANKS, LINDLEY ON THE LAW OF PARTNERSHIP 470 (14th ed. 1979); *see also* Robinson v. Anderson, 20 Beav. 98, 102-03, 52 Eng. Rep. 539, *aff'd*, 7 De G.M. & G 239, 44 Eng. Rep. 94 (Ch. 1855) (participant who sought unequal share should have said so prior to entering into the enterprise).

Thus, the default rules presuppose a rough equality of input,[200] and so long as that assumption holds true the default rules produce fair results. When fact follows theory and inputs are in balance, each partner receives a return roughly proportional to the value of the partner's input. When, however, the facts undercut the input equality assumption, the default rules apparently forsake the underlying rationales of balance and proportionality. Instead of producing fair results, the default rules produce imbalance, and partners receive returns out of proportion to their inputs.

Precisely in such circumstances, courts tend to commit heresies of capital or of labor. If the imbalance would prejudice the *K* partner, then the courts ignore the metamorphosis of contributed property,[201] ignore the dictates of U.P.A. sectiion 18(d),[202] and allocate all partnership property to the *K* partner. If the imbalance would prejudice the *L* partner, then the courts ignore the command of U.P.A. sections 18(f) and 40,[203] capitalize some or all of *L*'s labor, and allocate that value to *L* as a return of capital.

Thus, behind cases like *Schaefer* and *Thompson* is apparently the laudatory desire to make default rule results comport with default rule assumptions.

C. *The Costs of Well-Intended Heresy*

Although it may be appealing to commit heresy in the service of fairness and proportionality, the heresies of capital and labor are not cost free. When courts eschew the plain meaning of the U.P.A. default rules, they disregard a fundamental tenet of statutory construction. In doing so, they offend the basic democratic notion that courts should not legislate. In doing so in an ad hoc and incomplete way, they undercut the practical interests served when law is coherent and predictable.

It is a basic rule of statutory construction that "where the statute contains no ambiguity, it must be taken literally and given

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200. When death irrevocably rebuts the presumption of balance, the U.P.A. itself changes the default rules. "A surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs." U.P.A. § 18.

201. A partner's contribution of property severs the partner's direct connection to the property. At dissolution, the contributor has no right to a return of the capital in kind and no right to any post-contribution appreciation. *See supra* notes 119-23 and accompanying text.

202. U.P.A. § 18(d) precludes interest on contributed capital. *See supra* note 59 and accompanying text.

203. U.P.A. § 18(f) prohibits remuneration for partner labor. *See supra* notes 55-57, 143-47 and accompanying text. Section 40 establishes the default scenario for distributing partnership property after dissolution. *See supra* notes 76-82 and accompanying text.

effect according to its language."[204] This rule applies even though "the true application of the statute would have a harsh effect."[205]

This deference to statutory language is not merely an empty tradition or a technique of convenience. The rule derives from the constitutional doctrine of separation of powers and from the notion that society ought to be governed by laws promulgated by democratically elected officials. Although our society accomodates judicial legislating through the common law, when the legislative branch does choose to act the judiciary should defer. "While '[i]t is emphatically the province and duty of the judicial department to say what the law is,' . . . it is equally — and emphatically — the exclusive province of the [legislative branch] . . . to formulate legislative policies . . . ."[206] The general policies adopted by the legislature may occasionally produce unpalatable results, but those results do not empower the courts to upset the policies. "Our Constitution vests such responsibilities in the political branches."[207]

Almost every rule of statutory construction has exceptions, and the rule of plain meaning has three. None of the exceptions, however, justifies disregarding the plain meaning of the U.P.A. default rules. One exception allows courts to disregard the plain

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204. Helvering v. New York Trust Co., 292 U.S. 455, 464 (1934).

205. *In re* Shear, 139 F. Supp. 217, 221 (N.D. Cal. 1956); *see also* Commissioner of Immigration v. Gottlieb, 265 U.S. 310, 313 (1924).

206. Tennessee Valley Auth. v. Hill, 437 U.S. 153, 194 (1978) (quoting Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803)). The authority here and in following footnotes is federal, while the U.P.A. is an enactment of state law. The principles expressed in the federal cases, however, are equally applicable to state law. Separation of powers is an important doctrine of state constitutional law, as is the notion that legislation should emanate from a representative branch of government. A number of states provide for election of state judges, either open contests or retention elections, but those elections do not transform a state judiciary into a representative institution. Judges are generally not elected to reflect particular viewpoints. The issue-oriented 1986 elections for the California Supreme Court are the exception that prove the rule. Alpern, *Judiciary Elections—The 1986 Elections for the California Supreme Court*, 9 HARV. J.L. & PUB. POL'Y 751 (1986); Hall & Aspin, *What Twenty Years of Judicial Retention Elections Have Told Us*, 70 JUDICATURE 340, 346 (1987); *cf.* Wold & Culver, *The Defeat of the California Justices: The Campaign, the Electorate, and the Issue of Judicial Accountability*, 70 JUDICATURE 348 (1987). Most retention elections are pro forma, and negative votes have far less to do with a judge's policy positions than with the voters' trust or distrust of political institutions. Hall & Aspin, *supra*, at 347. "[V]oters do not differentiate much between judges." *Id.* at 346. States with open election contests probably present much the same situation. Election contests are rare. Most judges are appointed to fill vacancies and thereafter face only token opposition. *See, e.g.*, THE AMERICAN BENCH: JUDGES OF THE NATION 1331-80 (Hough ed. 1989-1990) (most Minnesota judges took office via appointment).

207. *Tennessee Valley Auth.*, 437 U.S. at 195; *cf.* CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 96-97 (Scalia, J., concurring) ("[A] law can be both economic folly and constitutional.").

language of a statutory provision when that language contradicts the language or meaning of another provision or statute.[208] This exception certainly does not apply to the U.P.A. default rules. All the relevant provisions, especially sections 18 and 40, point in the same direction.

Another exception allows courts to go beyond the statute's plain meaning when "giving the words their natural significance . . . leads to an unreasonable result plainly at variance with the policy of the legislation as a whole."[209] This exception also is inapplicable. The U.P.A. default rules on labor remuneration and post-dissolution property disposition *are* the policy of the legislation. They provide a coherent and internally consistent structure for resolving difficult questions. When a legislature enacts the U.P.A., the legislature is choosing, as a matter of policy, to adopt that structure and to make that structure applicable whenever the partners have not agreed to the contrary. Particular circumstances may reveal the default structure as imperfect, but those imperfections do not make the structure any less the manifestation of legislative policy.[210]

The third exception allows "the reason of the law [to] prevail over its letter" when the letter of the law mandates a nonsensical result.[211] For example:

> [C]ommon sense accepts the ruling . . . that the statute of 1st Edward II, which enacts that a prisoner who breaks prison shall be guilty of felony, does not extend to a prisoner who breaks out when the prison is on fire, "for he is not [sic] be hanged because he would not stay to be burnt."[212]

While the U.P.A. default rules may occasionally produce unpalatable results, the rules stop far short of hanging a prisoner for

208. 82 C.J.S. *Statutes* § 325, at 619 (1953).

209. Helvering v. New York Trust Co., 292 U.S. 455, 464 (1934) (quoting Ozawa v. United States, 260 U.S. 178, 194 (1922)); *see also* North Am. Util. Sec. Corp. v. Posen, 176 F.2d 194, 196-97 (2d Cir. 1949); Arkansas Oak Flooring Co. v. Louisiana & Ark. Ry. Co., 166 F.2d 98, 100-01 (7th Cir.), *cert. denied*, 334 U.S. 828 (1948).

210. Even if the true application of the statute would have a harsh effect, the harsh effect cannot influence the Court's administration of that law . . . .

> Courts are not at liberty to amend or repeal a statute under a guise of construction . . . .
>
> . . . [Therefore] a court must be wary where meaning is sought to be derived from other than specific language, lest what professes to be mere rendering becomes creation.

In re Shear, 139 F. Supp. 217, 221 (N.D. Cal. 1956) (citations omitted). This caution is all the more appropriate when it would be impossible to devise a general rule that does not occasionally create harsh results. Such is the situation with default rules covering the *K* and *L* problem. *See supra* notes 60-65 and accompanying text.

211. Church of the Holy Trinity v. United States, 143 U.S. 457, 461 (1892).

212. *Id.*

escaping a burning building. Indeed, the U.P.A.'s default rules are at least as sensible as any other general structure one might devise to handle disputes when partners have not adequately planned the post-dissolution distribution of property.[213]

On a less ethereal plane, the heresies of capital and labor create serious practical problems for individuals and entities who find themselves subject to the law of partnership. People often become partners inadvertently or at least without having planned their relationship in any detail.[214] When partnerships form in this fashion, sooner or later the partners will find themselves in some sort of disagreement. To encourage calm and prompt resolutions, the default rules that apply to such disagreements must be as coherent and predictable as possible. To the extent that "results oriented justice" muddies the default rules, parties' energies are more likely to be consumed in that most costly of clarifying exercises—litigation.[215]

In sum, while the heresies of capital and labor may do rough justice in the particular case, they arrogate to the courts a policy function which belongs to the legislative branch and they do serious damage to coherence and predictability in the law of partnership.

D. *Seeking Balance and Coherence, Consistent with the Rule of Law*

Fortunately, a court does not have to choose between inequity in the particular or arrogation and confusion in the general. The U.P.A. itself provides a way to deal with gross imbalances between partner input and partner return. When such an imbalance exists, the trial court should address the problem by focusing on two crucial questions of fact.

First, the court should consider what the imbalance implies about the very existence of a partnership. In most *K* and *L* disputes, the party who fears an imbalance argues that no partnership existed. If the default rules on profit sharing and property disposition will produce a substantial imbalance problem, then perhaps the parti-

213. *See supra* notes 60-65 and accompanying text.

214. *See supra* notes 17-18 and accompanying text.

215. The dangers in the domain of partnerships are probably far greater than in the domain of another major set of commercial default rules, Article 2 of the Uniform Commercial Code. In that latter domain, industry customs help define appropriate conduct among enterprises, and a concern for reputation, *i.e.*, the desire for repeat business, helps divert business from litigation. Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIOLOGICAL REV. 55 (1963); *see also* Comment, *The Statute of Frauds and the Business Community: A Re-Appraisal in Light of Prevailing Practices*, 66 YALE L.J. 1038 (1957). These factors do not apply in most disputes among partners.

cipants did not truly intend the community of ownership that characterizes a partnership.[216] Even if the court finds an agreement to share profits, that agreement may reflect merely the payment of wages.[217]

Second, assuming a partnership does exist, the court should consider what the imbalance between input and return may imply about ownership of capital and compensation for labor. If the default rules threaten an imbalance that substantially prejudices *L*, then the court should look carefully for an implied agreement to reimburse *L*.[218] In contrast, if the default rules threaten a substantial imbalance that prejudices *K*, then the court should take special care to determine whether *K* actually contributed the property at issue or merely furnished its use.[219]

A court should not, of course, by fiat convert partners into mere employees or manufacture agreements where none exist. Any court facing issues of partnership existence, compensation for labor, and ownership of capital, however, will inevitably be considering ambiguous situations. If the parties had been able to locate a definitive agreement, the matters would not be in litigation. The court will have to choose between conflicting interpretations of conduct and intent. The court will be in effect looking for implied agreements.

For reasons of philosophy and practicality, this focus on factual issues is far superior to heretical attempts to twist the law. The suggested factual inquiries are quite consistent with the legislated policy. Indeed, all the relevant U.P.A. default rules either presuppose or defer to particular factual findings. The very existence of a partnership is a question of fact.[220] The ownership status of property used by a partnership is a question of fact.[221] The rules on labor remuneration and property disposition apply only in the absence of a contrary agreement, and the existence of such an

216. *See supra* notes 197-99; Doan v. Deyer, 286 F. 339, 341 (9th Cir. 1923); Cyrus v. Cyrus, 242 Minn. 180, 184, 64 N.W.2d 538, 542 (1954); Peterson v. Eppler, 67 N.Y.S.2d 498, 499 (Sup. Ct. 1946).

217. Such a finding would negate any inference of partnership. U.P.A. § 7(4)(b).

218. Schymankski v. Coventz, 674 P.2d 281, 284 n.1 (Alaska 1983), erroneously characterizes Thompson v. Beth, 14 Wis. 2d 271, 111 N.W.2d 171 (1961), as having found such an implied agreement. *Cf.* Steinberg v. Goodman, 317 N.Y.S.2d 342, 345, 265 N.E.2d 758, 761 (1970) (In a limited partnership the principle of no compensation for labor "does not apply . . . where the interests, liabilities and responsibilities of the general partners and the special partners [are] not equal.))

219. *See supra* notes 45-46 and accompanying text.

220. *See supra* note 7.

221. *See supra* note 47 and accompanying text.

agreement is a question of fact.[222] Thus, far from usurping a legislative function, the fact inquiries suggested here are dictated by the statutory scheme.

The focus on facts also serves the value of predictability, albeit imperfectly. If courts stay faithful to the law, parties will be better able to predict which rules apply. Considerable fact uncertainty will remain, however, because the key fact questions all relate to issues of intent. Disputes about intent can easily degenerate into "swearing contests," but even as to fact predictability, the approach suggested here will help. By keeping the law coherent and predictable, the suggested focus makes clear which issues matter and which lines of inquiry should be pursued. Potential litigants will at least know what it is they will be fighting about. Even when this increase in information does not prevent a lawsuit, the information gain should certainly limit the expense of bringing the lawsuit to a conclusion.

To maximize predictability and to keep the fact finding consonant with partnership principles, the court must impose some structure on the fact-finding process. The fact finder must always have in mind the U.P.A.'s hidden presumption of balance and must use that presumption to draw factual inferences from the prospects of imbalance. A venerable guide for construing ambiguous written agreements works equally well for agreements ambiguously implied in fact:

> Where [the] meaning [of an agreement] is doubtful, so that it is susceptible of two constructions, one of which makes it fair, customary, and such as prudent men [sic] would naturally execute, while the other makes it inequitable, unusual, or such as reasonable men [sic] would not be likely to enter into, the interpretation which makes a rationale [sic] and probable agreement must be preferred.[223]

VI. SOLVING THE CHRISTMAS TREE PROBLEM

In the actual Christmas tree case, *Schaefer v. Bork*,[224] the partners initially disputed the existence of a partnership. The evidence of partnership status was overwhelming, however.[225] The evidence on property issues was far more ambiguous, and the

222. U.P.A. §§ 18(f), 40.

223. Percy A. Brown & Co. v. Raub, 357 Pa. 271, 287, 54 A.2d 35, 43 (1947) (quoting 6 R.C.L. § 230 at 841).

224. 413 N.W.2d 873 (Minn. Ct. App. 1987).

225. Schaefer v. Bork, No. CX-85-283 (Minn. Dist. Ct. Jan. 8, 1987) (amended finding) (evidence so strong that judgment n.o.v. might have been warranted if jury had failed to find a partnership).

partners vigorously disputed the distribution of land, trees, and trucks. Each of these three categories of assets included not only property brought to the partnership by the *K* partner as start-up capital but also property purchased during the life of the partnership with partnership funds. The appellate opinion states that Bork, the *K* partner, had agreed to contribute the start-up capital[226] and affirms the trial court decision to return all partnership property, regardless of origin, to Bork.[227]

Neither the trial court nor the appellate opinion actually analyzes the ownership status of the property used by the partnership. As demonstrated in Part III, Section *A*, that analysis presents the threshold issue for resolving disputes over the distribution of property at partnership dissolution.[228] In the Christmas tree case, that threshold analysis would have yielded the following results:

Growing Trees—Start-Up Capital

The trees that Bork, the *K* partner, brought into the business most likely represented a contribution of capital. The trees were the inventory of the business. In the words of U.P.A. section 8(1) they were "brought into the partnership stock." To find otherwise would imply that Bork intended to have the same trees returned to him when the partnership ended. Because, to the contrary, Bork must have expected those particular trees to be harvested and sold, Bork necessarily intended to contribute, rather than furnish, the trees.

At dissolution, Bork had the right to a return of the value of the trees, determined as of the time of contribution.[229]

Growing Trees—Purchased During Life of Partnership

U.P.A. section 8(2) dictates the results here: "Unless a contrary intention appears, property acquired with partnership funds is partnership property." If the trees were partnership property, their value should have been allocated first to pay debts to creditors and to fund the return of Bork's capital.[230] Any remaining value should have been shared by the partners as profit.

Trucks—Start-Up Capital

Bork provided trucks to help the partnership get started, and neither the appellate nor trial court decisions reveal whether Bork expected eventually to regain those specific trucks. Also, nothing

226. *Schaefer*, 413 N.W.2d at 874.
227. *Id.* at 878.
228. *See supra* notes 45-46 and accompanying text.
229. *See supra* notes 43-45 and accompanying text.
230. *See supra* notes 76-82 and accompanying text.

indicates that the partnership paid rent for the trucks, and it seems unlikely that Bork would have allowed the trucks to depreciate from use and age without expecting something in return. Under partnership law, that something might well have been credit in Bork's capital account for property contributed to the partnership. If so, at dissolution, Bork would have been entitled to a return of the value of the trucks, determined as of the date of contribution. The depreciation of the trucks would not have affected Bork's entitlement.[231]

Trucks—Purchased During the Life of the Partnership

The analysis here is the same as for the trees purchased with partnership funds. The trucks were partnership property.

Land—Start-Up Capital

None of the factors used to determine intent to contribute are helpful here. The land was indeed crucial to the partnership business, but such use is by no means dispositive.[232] Neither the trial court decision nor appellate opinion discusses how taxes were paid on the property or how the partnership's books dealt with the land.[233] Partnership efforts improved the trees growing on the land, but neither opinion cites any significant improvements to or maintenance of the land itself.[234]

Nothing indicates that Bork received any direct compensation for use of the land, and the absence of compensation suggests contribution.[235] During the first five years of the partnership's existence, however, Bork did receive all profits from the business, and Schaefer, the *L* partner, was limited to a small salary.[236] That

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231. *See supra* note 128. In contrast, if Bork had merely loaned the trucks, he would have received less. At dissolution the partnership would have been unable to return the trucks because it no longer had them. Bork would therefore have been entitled to damages in the nature of conversion. Those damages would have equaled the fair market value of the property, calculated as of the time of conversion. 18 AM. JUR. 2D *Conversion* § 105 (1985). Bork would have therefore borne the loss caused by depreciation.

232. *See supra* note 51 and accompanying text.

233. *See supra* notes 52-53 and accompanying text. Neither opinion clearly indicates who held formal title to the various parcels of land, although it appears that some land was titled in the name of the partnership, some in Bork's name, and some jointly in the names of Schaefer and Bork. Schaefer v. Bork, No. CX-85-283 (Minn. Dist. Ct. Jan. 8, 1987) (amended finding, conclusion of law 3(a)). Formal title is not a strong indicator on the issue of intent to contribute. *See supra* note 49.

234. The partnership did erect a house on the land acquired later. *See supra* note 193 and accompanying text.

235. *See supra* note 54 and accompanying text.

236. Schaefer v. Bork, 413 N.W.2d 873, 874 (Minn. Ct. App. 1987).

arrangement might have reflected compensation for lending the land.[237]

In this ambiguous situation, it makes sense to inquire whether a reasonable person in Bork's position could have intended to contribute the land. The land was part of a successful pre-existing business that Bork owned and operated. The chance of the land declining in value was slight. To the contrary, the partnership was formed during a period of inflation and thus an increase in the land's value during the life of the partnership was likely.

Would Bork have intended to transfer this prospect of appreciation to the partnership? Was Schaefer bringing anything to the enterprise valuable enough to warrant Bork balancing the bargain by providing not only the use of the land but also any profits from future appreciation?

The trial court opinion suggests that the answer to both questions is no. After detailing how Bork brought to the enterprise substantial assets, experience, contacts, and expertise, the court describes what Schaefer, the *L* partner, had to offer: "Schaefer . . . had personal experience with Bork as a laborer, and outside of the personal relationship between the two, had little to contribute to the partnership other than his labor."[238]

It therefore seems highly unlikely that Bork would have intended to contribute anything but the use of the land. Consequently, at dissolution Bork had the right to the return of all the land he had furnished at the outset of the partnership. This right included the benefits of appreciation.[239]

Land Purchased During the Life of the Partnership

Two parcels came into use during the life of the partnership. Bork "supplied the entire purchase price for one of the two parcels."[240] Analysis of that parcel should follow the analysis stated for the land Bork provided at the outset of the partnership. It seems most likely that Bork intended to provide only the use of the parcel.

The other parcel requires a more complicated analysis. The purchase price was at least $30,000. Bork provided $15,000 and a mortgage covered another $15,000. Whether any partnership funds

237. *See* Sundstrom v. Sundstrom, 75 S.D. 555, 70 N.W.2d 65 (1955) (in apparent compensation for furnishing the newspaper production facilities, partner benefited from a 55/45 split of profits).

238. Schaefer v. Bork, No. CX-85-283 (Minn. Dist. Ct. Jan. 8, 1987) (amended finding).

239. *See supra* notes 45-46 and accompanying text.

240. *Schaefer*, 413 N.W.2d at 875. This parcel was the so-called "Conklin parcel."

went toward the downpayment is unclear.[241] Neither opinion identifies who was personally liable on the mortgage, but the trial court opinion implies that partnership funds were used to make mortgage payments.[242] In addition, the partnership erected a house on the parcel. The house served as a residence for Schaefer and his family.[243]

The partnership used the parcel to operate its business. Partnership funds paid the mortgage. The partnership made a permanent improvement to the property. These three factors suggest that Bork intended to contribute his interest in the parcel to the partnership.[244] If so, at dissolution Bork would have been entitled only to the value of the contributed property at the time of contribution, $15,000. The land itself would have belonged to the partnership. Any increase in the land value would have been for the partnership, not for Bork.[245]

Another possible analysis can, however, be gleaned from the trial court's opinion. The trial court seemed to view the first three years of mortgage payments as actually strengthening Bork's claim to the land. Those payments, from April 1972 until June 1975, occurred during the time that Schaefer had no right to share in the profits. The oral partnership agreement limited Schaefer to a salary of $8,200 per year for the first five years of the partnership. The agreement also put Bork in "control of capital expenditures of the partnership."[246] The court reasoned that, therefore, any acquisitions made with partnership funds during the first five years represented profit to Bork that Bork could have taken directly:

> The Court feels that the acquisition of . . . properties between June 1, 1970 and June 1, 1975 had no effect on Schaefer's interest, as his only expectancy during that period of time was $8,200 per year. Under those circumstances, had Bork not decided to purchase property, but instead had decided to distribute the cash used for those purposes to himself directly, Schaefer would have had no claim against this distribution.[247]

Under this view, the use of partnership funds to make mortgage payments merely reflected a distribution of profits to Bork and

241. *Schaefer*, No. CX-85-283 (amended finding of fact 18). This parcel was the so-called "Harmon farm."

242. *Id.* (amended findings, conclusion of law 5(b)) (awarding Schaefer money on account of the mortgage balance; presumably partnership funds had paid off the balance).

243. *Schaefer*, 413 N.W.2d at 875.

244. *See supra* note 52 and accompanying text.

245. *See supra* notes 121-23 and accompanying text.

246. *Schaefer*, No. CX-85-283 (amended findings memorandum).

247. *Id.*

the use by Bork of those profits to make payments on his land.[248] The mortgage payments therefore did not reflect an intention to contribute the property.[249]

If this view succeeds in rendering ambiguous the status of the second parcel, then the same analysis and outcome applicable to the start-up land should apply to the second parcel. Given the imbalance of benefits brought to the partnership by Schaefer and Bork, it seems unlikely that Bork would have intended to contribute more than the use of the second parcel. At dissolution, therefore, Bork would have been entitled to the return of the second parcel.

VII. CONCLUSION

The Christmas tree problem arises when a partnership dissolves and the partners disagree on how to divide the property used in the partnership business. To resolve such disagreements, the U.P.A. provides a coherent structure of default rules. In the absence of contrary agreement, courts should apply the default rules as written.

In some instances, the default rules seem to dictate a result that would produce a gross imbalance between the benefits the partners respectively brought to the enterprise and the return the partners respectively will receive. In such cases, the courts should resist the temptation to overstep their bounds and twist the law. Instead, courts should focus attention on two crucial factual questions—the existence *vel non* of a partnership and the existence *vel non* of agreements displacing the default rules. This factual focus will allow courts to address problems of imbalance without destroying the primacy and the coherence of the legislative design.

248. Although the trial court cited no authority on this point, the court's view resembles the approach of Baum v. McBride, 152 Neb. 152, 40 N.W.2d 649 (1950).

249. Consistent with this view, the court held that Bork, the landowner, should compensate Schaefer for one-half of the cost of the house, which the partnership had erected as a permanent improvement to Bork's land. *Schaefer*, No. CX-85-283 (amended finding of fact 5(c)). The court also required Bork to compensate Schaefer for one-half of the mortgage payments made in the period when Schaefer was entitled to share in the profits. *Id.* (amended finding of fact 5(b)).