Vanderbilt Law Review

Volume 9
Issue 5 *Issue 5 - August 1956*

Article 4

8-1956

# Business Associations -- 1956 Tennessee Survey

F. Hodge O'Neal

# BUSINESS ASSOCIATIONS—1956 TENNESSEE SURVEY

F. HODGE O'NEAL*

Surprisingly few cases were decided in the field of Business Associations during the survey period. Those decisions for the most part merely reaffirmed legal principles already established in Tennessee law. One of the cases, *Wyatt v. Brown*,[1] raised again the interesting old question of what is a partnership and what factual elements are necessary to constitute the partnership relation. This article discusses that question first and then comments rather briefly on the other cases and the principles they enunciate.

*Difficulty of Defining Partnership Relation:* For almost two hundred years Anglo-American courts have struggled to draw a line of demarcation between the partnership and other relations in which the efforts of individuals or legally recognized units are combined and directed toward a mutual benefit. Even in recent years, there has been a considerable amount of litigation[2] to determine whether the partnership relation exists in particular fact situations. The courts, however, have not been able to isolate the minimum factual elements necessary to create a partnership or to evolve satisfactory tests to distinguish the partnership from other relations. No really satisfactory statement can be found in the jurisprudence—and perhaps one cannot be formulated—on the relative weights to be attached to the following factual elements: an associate's sharing in the profits,[3] his undertaking to bear part of possible losses,[4] his power to control the business,[5] and his actual participation in policy formulation and management.

*Professor of Law, Vanderbilt University.

1. 281 S.W.2d 64 (Tenn. 1955).
2. Many of the cases are collected in Annots., 137 A.L.R. 6 (1942), 150 A.L.R. 1003 (1944).
3. Profit-sharing seems to be an unquestioned essential of partnership: a person is not a partner unless he is to share in the profits. DeLong v. Whitlock, 204 Iowa 701, 215 N.W. 954 (1927); Schuster v. Largman, 308 Pa. 520, 162 Atl. 305 (1932); Farmers' Exchange v. Brown, 106 Vt. 65, 169 Atl. 906 (1934). However, as will be seen from the discussion in the text, profit-sharing alone is not sufficient to constitute a partnership. No case has been found in which the court discusses whether the *proportion* of the profits which a person receives is significant in determining whether he is a partner.
4. A large number of decisions throughout the country emphasize loss-bearing between the parties as an important criterion of partnership. See, *e.g.*, Stafford v. Sibley, 106 Ala. 189, 17 So. 324 (1895); L. Baldwin & Co. v. Patrick, 39 Colo. 347, 91 Pac. 828 (1907); Sharpe v. McCreery, 20 Ky. L. Rep. 911, 47 S.W. 1075 (1898); Van Hoose v. Smith, 355 Mo. 799, 198 S.W.2d 23 (1946); Crmer v. Davenport-Bethel Co., 144 Okla. 74, 289 Pac. 742 (1930); Farmers' Co-operative Elevator Co. v. Farmers' Union Co-operative Exchange, 127 Okla. 275, 260 Pac. 755 (1927); Gottlieb Bros. v. Culbertson's, 152 Wash. 205, 277 Pac. 447 (1929). Many courts have indicated at one time or another that an undertaking (it may be express or implied) by each person to share losses is a *sine qua non* of partnership. See, *e.g.*, Germer v. Donaldson, 18 F.2d 697 (3d Cir. 1927); Cunningham v. Staples, 216 Ala. 531, 113 So. 590 (1927); Garber v. Whittaker, 36 Del. (6 W. W. Harr.) 272, 174 Atl. 34 (1934);

*Profit-sharing as Determinative of Partnership:* As early as 1857[6] the Supreme Court of Tennessee rejected the rule, laid down by a number of early English decisions,[7] that sharing in the profits of a business conclusively establishes the partnership relation, at least to the extent of imposing liability to third parties on persons associated with the business receiving a share of the profits. In disapproving the English rule, the pre-civil war Supreme Court of Tennessee argued that "the more just and sensible view, [is] that participation in the profits, affords merely a presumption, which is to prevail only in the absence of proof to the contrary; and that it is a question of fact, open to inquiry and proof, whether the circumstances under which the participation in the profits exist [*sic*], clearly demonstrate that the profits are taken, not in the character of partner, but in a totally different character . . . ."[8]

Many years later when the Uniform Partnership Act was prepared,

---

Butz v. Hahn Paint & Varnish Co., 220 Iowa 995, 263 N.W. 257 (1935); Harmount & Woolf Tie Co. v. Baker, 251 Ky. 795, 66 S.W.2d 45 (1933); National Bank of Commerce v. Francois, 296 Mo. 169, 246 S.W. 326, 332 (1922). The writers, on the other hand, do not attach as much significance to loss-bearing. MECHEM, ELEMENTS OF THE LAW OF PARTNERSHIP §§ 75-85 (2d ed. 1920); Douglas, *Vicarious Liability and Administration of Risk II*, 38 YALE L.J. 720, 726-27 (1929). The writers are supported by a considerable number of cases. See, *e.g.*, Stafford v. First Nat'l Bank, 179 Ark. 997, 13 S.W.2d 21 (1929); Clemens v. Crane, 234 Ill. 215, 84 N.E. 884 (1908); Simons v. Northern Pac. Ry., 94 Mont. 355, 22 P.2d 609 (1933); Clift v. Barrow, 108 N.Y. 187, 15 N.E. 327 (1888). "In the ordinary partnership these four matters are shared: Profits, losses, ownership of capital, and control of administration or management. Only one of these, profit sharing, seems to be absolutely essential." CRANE, PARTNERSHIP 61 (2d ed. 1952).

5. Since World War I, the influence of "control" as a determinant of partnership has gradually increased. Rowley, *The Influence of Control in the Determination of Partnership Liability*, 26 MICH. L. REV. 290 (1928). The Uniform Partnership Act defines a partnership as "an association of two or more persons to carry on *as co-owners* a business for profit." (Emphasis added.) UNIFORM PARTNERSHIP ACT § 6(1); TENN. CODE ANN. § 61-105 (1956). "Ownership involves control. It is impossible to state that this or that power makes the man who possesses it an owner or co-owner of a business." Lewis, *The Uniform Partnership Act*, 29 HARV. L. REV. 158, 167-68 (1915). For cases that have treated the presence or absence of control as a determining factor in the imposition of partnership liability, see Goldwater v. Oltman, 210 Cal. 408, 292 Pac. 624 (1930); Frost v. Thompson, 219 Mass. 360, 106 N.E. 1009 (1914); H. H. Worden Co. v. Beals, 120 Ore. 66, 250 Pac. 375, 378 (1926); Sheldon v. Little, 111 Vt. 301, 15 A.2d 574 (1940). For a Tennessee case in which the question of control by one of the participants was raised and discussed by the court, see H. T. Hackney Co. v. Robert E. Lee Hotel, 156 Tenn. 243, 300 S.W. 1 (1927). For decisions that attempted to dissect control and determine the importance of particular kinds of control, see San Joaquin Light & Power Corp. v. Costaloupes, 96 Cal. App. 322, 274 Pac. 84 (1929); Southern Can Co. v. Hartlove, 152 Md. 303, 136 Atl. 624 (1927). For the position that the only important powers are the power substantially to determine cost items and the power substantially to fix prices, see Douglas, *Vicarious Liability and Administration of Risk II*, 38 YALE L.J. 720, 720-39 (1929).

6. Polk v. Buchanan, 37 Tenn. *721 (1857).

7. Grace v. Smith, 2 W. Bl. 998, 96 Eng. Rep. 587 (C.P. 1775) (dictum); Waugh v. Carver, 2 H. Bl. 235, 126 Eng. Rep. 525 (C.P. 1793). The rule was later repudiated in England. Cox v. Hickman, 8 H.L.C. 268, 11 Eng. Rep. 431 (1860).

8. Polk v. Buchanan, 37 Tenn. *721, 725-26 (1857).

its draftsmen took an approach quite similar to that of the Tennessee court. Section 7(4) of the uniform act[9] provides that 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, but no such inference shall be drawn if such profits were received in payment (a) of a debt by installments or otherwise, (b) as wages of an employee or rent to a landlord, (c) as an annuity to a widow or representative of a deceased partner, (d) as interest on a loan, though the amount of payment vary with the profits of the business, or (e) as the consideration for the sale of the good will of a business or other property by installments or otherwise. In 1917, the Uniform Partnership Act was adopted in Tennessee.[10]

In *Wyatt v. Brown*,[11] the court applied the prima facie evidence part of section 7(4) of the uniform act. In this case, the plaintiff brought suit against A and B, alleged to be partners, for breach of a contract to dig a well. The record showed that A personally conducted the digging operations; that A and B shared equally in the profits and would have shared equally in any losses sustained; that they together supplied pipe used in the operations; that B checked on the operations from time to time and made suggestions; and that A "cleared" important decisions with B. In holding B as well as A liable on the contract, the court pointed out that the facts gave no indication that B's share of the profits was in payment of debt, interest or rent or that A's share was in lieu of wages. The court did not comment on other factors which could have been utilized to bolster its conclusion of partnership, such as the undertaking of the participants to share possible losses and the joint participation in decision making and in the control of the business.

*Intention of the Participants as Determinative of Partnership:* In *Wyatt v. Brown*, one of the defendants, in trying to escape liability, argued that there had been no intention to form a partnership and that a partnership could not come into existence without that intent.[12] The court gave the usual answer to that contention,[13] quoting secondary authorities to the effect that the legal intention, not the actual intention, of the participants controls; that the intention to do acts which in law constitute a partnership determines the relation irrespective of whether the participants understand the legal effect of their acts; and that a disavowal of an intent to form a partnership or even an affirmative stipulation against partnership is ineffective to escape partnership liability.

9. UNIFORM PARTNERSHIP ACT § 7(4); TENN. CODE ANN. § 61-106 (1956).

10. The Uniform Partnership Act is now incorporated in the Tennessee statutes as TENN. CODE ANN. §§ 61-101 to -142 (1956).

11. 281 S.W.2d 64 (Tenn. 1955).

12. *Id.* at 67.

13. *Ibid.*

*Competency of Partner to Testify as to Existence of Partnership:* One of the preliminary points raised in *Wyatt v. Brown* was whether a partner is competent to testify as to partnership existence. One of the participants in the enterprise had testified on cross-examination that he considered his associate and himself to be partners. The court held on this point that a partner is a competent witness "to give direct testimony in court, subject to cross-examination, as to the existence or non-existence of a partnership."[14] The court pointed out that 1840[15] and 1853[16] Tennessee cases holding to the contrary had been abrogated by statute.

*Power of Partner to Bind his Co-Partners in Contract:* In the absence of agreement to the contrary, partners have equal rights in the management and conduct of firm business.[17] Accordingly, each partner ordinarily has the power to enter into contracts and bind the partnership within the scope of partnership business;[18] and, as a partner just as any other agent derives power to bind his principal not only from authority but also from apparent authority, the act of a partner "for apparently carrying on in the usual way the business of the partnership" binds the partnership unless he in fact has no authority to bind the firm and the person dealing with him has knowledge of that fact.[19] Along this line, *Wyatt v. Brown,* in holding that one of the partners had power to bind the partnership to the well digging contract, stated that "each partner has authority to bind the partnership with respect to matters germane to the partnership business."[20]

The converse rule, that an act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners,[21] was applied in *Bole v. Lyle.*[22] There the partnership was engaged in the manufacture of wooden crates and similar products. One of the partners contracted in the firm name to sell timber to the plaintiff, and the plaintiff advanced money under the contract. The evidence showed that, although the partnership had on occasion bought timber for its manufacturing needs, it was not a trading partnership and had never bought timber for sale. In holding that the partnership was not bound on the contract, the court stated that a

14. *Ibid.*
15. Vazant v. Key, 21 Tenn. 106 (1840).
16. Yancey v. Marriott, Frisby & Co., 33 Tenn. 28 (1853).
17. UNIFORM PARTNERSHIP ACT § 18(e); TENN. CODE ANN. § 61-117(e) (1956).
18. UNIFORM PARTNERSHIP ACT § 9(1); TENN. CODE ANN. § 61-108(1) (1956).
19. UNIFORM PARTNERSHIP ACT § 9(1); TENN. CODE ANN. § 61-108(1) (1956). See also Conyers v. Fisher, 4 Tenn. App. 127 (M.S. 1926). However, a partner does not have "implied power" to dispose of the good will of his firm. Young v. Cooper, 30 Tenn. App. 55, 203 S.W.2d 376 (M.S. 1947).
20. 281 S.W.2d at 68.
21. UNIFORM PARTNERSHIP ACT § 9(2); TENN. CODE ANN. § 61-108(2) (1956).
22. 287 S.W.2d 931 (Tenn. 1956).

sale by a partner to be valid must be "in furtherance of the partnership business, within the real scope of the business or such as third persons may reasonably conclude, from all the circumstances, to be embraced within it."[23]

The court commented that in deciding whether a sale was within the scope of partnership business, it looked at the character of the partnership, *i.e.*, whether it was a trading or non-trading firm.[24] In trading firms, the court pointed out, the sales are a usual part of the business, while in non-trading firms sales are exceptional.

*Right of Foreign Corporation to Litigate in State Courts:* In *Seagram Distillers Co. v. Corenswet*,[25] the Supreme Court of Tennessee reaffirmed a principle previously adopted by the court,[26] that a foreign corporation can enforce or defend its rights in the courts of this state unless it has failed to comply with statutes applicable to corporations doing business in this state. In the *Seagram Distillers Co.* case, Seagram brought suit to restrain a dealer from selling its product below prices fixed in a fair trade agreement. The court sustained Seagram's right to prosecute the action. Seagram was not licensed in Tennessee; but, as it was not doing any intra-state business in Tennessee, it could not be said to have disregarded Tennessee statutes applicable to foreign corporations doing business here.

*Applicability of Privilege Tax to Foreign Corporation Servicing Investment Contracts in State:* A decision of considerable importance to foreign investment companies with contracts in Tennessee was *Investors Syndicate, Inc. v. Allen*,[27] which held that the foreign investment companies there involved, although they were not presently accepting investment certificates from Tennessee customers, were nevertheless still subject to the special privilege tax levied against corporations engaged in issuing, servicing or collecting installments on investment contracts within the state.[28] The court concluded that the companies were doing business within the state, basing this conclusion on the following facts: the companies were still authorized to do investment business in Tennessee; they had not withdrawn from the state; their investment contracts within the state were being regularly serviced; and Tennessee holders of investment certificates were paying annually large sums of money to the companies.

23. *Id.* at 933. "If the act is embraced within the partnership business or incident to such business according to the ordinary and usual course of conducting it, the partnership is bound regardless of whether the partner, in performing the act, proceeds in good faith or in bad faith toward his co-partners." *Ibid.*

24. *Ibid.*

25. 281 S.W.2d 657 (Tenn. 1955).

26. Phillips v. Johns-Mannville Sales Corp., 183 Tenn. 266, 191 S.W.2d 554 (1946).

27. 279 S.W.2d 497 (Tenn. 1955).

28. See TENN. CODE ANN. § 67-4401 to -4410 (1956).

Two Minnesota companies, a parent and its subsidiary, were involved in this litigation. In an attempt to avoid the application of the tax, the subsidiary argued that the parent, which was handling the subsidiary's business in Tennessee, was an independent contractor for that business; and the parent in turn argued that it was not doing business in the state but rather that Tennessee divisional managers and salesmen were acting in its behalf as independent contractors. The court, of course, decided that the state is not concluded by the name the parties to a contract give their relationship if the effect of the contract is to foreclose an inquiry into the nature and extent of a foreign corporation's activities in the state. The court incidentally pointed out that deposits with the Commissioner of Banking and Insurance, necessary for retaining authority to conduct investment operations in Tennessee, were the property of the companies and not the property of the divisional managers, and similarly, that deposits in Tennessee banks were in the name of the parent company and not in the names of the managers.[29]

29. The court rather summarily disposed of a number of arguments challenging the constitutionality of the privilege tax, holding (1) that the tax is not arbitrary, confiscatory or violative of the commerce clause of the Federal Constitution, and (2) that an increase in the amount of the levy did not impair an obligation of a contract.