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## The Corporation as a Partner

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# NOTES

## THE CORPORATION AS A PARTNER

For many years the courts have stated that a corporation does not have the implied power to enter into a partnership agreement;<sup>1</sup> the power must be expressly given either by statutory<sup>2</sup> or charter<sup>3</sup> provision. The purpose of this note is to determine the legal significance of this statement by analyzing the judicial treatment of corporations entering into partnership agreements without the express power to do so.

The power of a corporation to enter into a partnership has been treated differently by the courts from other corporate powers. Generally, all corporate powers emanate from state incorporation laws. These laws, in addition to designating the general powers which all corporations are to have, give each corporation all of the powers necessary to carry out corporate objectives. These powers may be explicitly designated in the corporation charter or they may be implied from corporate purposes.<sup>4</sup> The courts, however, in treating the power to form a partnership differently from other corporate powers, have said that this power cannot be implied from corporate purposes; therefore, any contract of partnership, or agreement entered into pursuant to a contract of partnership, which is not expressly authorized by a statute or the corporate charter, has been said to be *ultra vires* and unenforceable.<sup>5</sup>

The basic objection to implying such a power has been that in a typi-

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1. *Whittenton Mills v. Upton*, 76 Mass. (10 Gray) 582 (1858); *Mallory v. Hananer Oil Works*, 86 Tenn. 598, 8 S.W. 396 (1888); BALLANTINE, CORPORATIONS § 87 (Rev. ed. 1946); 6 FLETCHER, CORPORATIONS § 2520 (Rev. ed. 1950).

2. At least two states by statute have included in the general powers given to a corporation the power to become a partner. ILL. ANN. STAT. tit. 32 § 157.5(G) (1954); MO. REV. STAT. § 351.385 (1949). Section 2 of the Uniform Partnership Act includes corporations in its definition of persons capable of becoming partners. Research has indicated that few courts have specifically passed upon the effect of this section of the Act and have continued to state that a corporation cannot enter into a partnership where there is no provision for such an exercise of power in the charter. One state has interpreted the inclusion of corporations in the definition of persons capable of entering into a partnership as giving the corporation the power to do so. *Memphis Nat. Gas Co. v. Pope*, 178 Tenn. 580, 161 S.W.2d 211 (1941) (alternative holding), *aff'd sub nom.* *Memphis Nat. Gas Co. v. Beeler*, 315 U.S. 649 (1942).

3. See *News-Register Co. v. Rockingham Publishing Co.*, 118 Va. 140, 86 S.E. 874 (1915). Where the issue has arisen on demurrer, some courts have said that it will be presumed that, in the absence of an allegation, the corporate charter expressly confers the power to become a partner. *Universal Pictures Corp. v. Roy Davidge Film Laboratory, Ltd.*, 7 Cal. App. 2d 366, 45 P.2d 1028 (1935); *Morgan v. Child, Cole & Co.*, 61 Utah 448, 213 Pac. 177 (1923).

4. See BALLANTINE, CORPORATIONS § 53 *et seq.* (Rev. ed. 1946) for a more detailed discussion of the creation of powers in a particular corporation by its charter provisions.

5. See note 1 *supra*.

cal partnership any partner has equal power to bind the others, and entry into a partnership would, in effect, yield corporate management to persons who are not within the corporate structure. This would defeat a basic principle of corporation law that management of a corporation should be vested in the board of directors and agents authorized by the board.<sup>6</sup>

The statement that a corporation has no implied power to become a partner, and the reason behind this assertion, have been attacked.<sup>7</sup> It has been argued that even if a corporation joins in a partnership agreement with an individual, still, that individual's power to bind the corporation differs to no appreciable extent from the power of a corporate agent to bind the corporation.<sup>8</sup> This argument postulates that a corporation can act only through human agents,<sup>9</sup> and, since a corporation can make a contract with an individual giving him managerial control, so also, a corporation should be allowed to make a partnership contract giving the other partner equal control over the management of the partnership. In both instances, it is argued, the same amount of control would be delegated; in fact, partners generally exercise joint control while a corporate agent may have what is tantamount to complete control in the management of the corporate business. Also, both a contract of partnership and an employment contract can usually be dissolved at any time.<sup>10</sup>

The position that there is no logical distinction between a corporate agent and a corporate partner has not been accepted by the courts; they have continued to adhere to the position that the power of a corporation to be a partner cannot be implied from the corporate purposes.<sup>11</sup> Judicial decisions reflect implicit dissatisfaction with this

6. See, e.g., *Gunn v. Central R.R.*, 74 Ga. 509 (1885); *Whittenton Mills v. Upton*, 76 Mass. (10 Gray) 582 (1858); *Mallory v. Hananer Oil Works*, 86 Tenn. 598, 8 S.W. 396 (1888). Cf. *Page-Dressler Co. v. Meader*, 118 Ore. 359, 244 Pac. 308 (1926). BALLANTINE, CORPORATIONS § 87 (Rev. ed. 1946).

7. Rowley, *The Corporate Partner*, 14 MINN. L. REV. 769 (1930).

8. *Id.* at 772.

9. *Id.* at 771.

10. In either situation, of course, the breaching party may be liable for damages. Unlike the normal agent, however, in the absence of an agreement as to control, each partner has an equal voice in the management of the business. If there are two partners, an individual and a corporation, neither party could determine the policy without the other's acquiescence. MECHEM, ELEMENTS OF PARTNERSHIP § 282 (2d ed. 1920). In a corporation the majority of the members of the board of directors determine policy; thus, theoretically, no one member of the corporation board would have the amount of power that a partner would have. The partnership, therefore, does create at least some distortion of the normal corporate structure. In *People v. North River Sugar Refining Co.*, 121 N.Y. 582, 625, 24 N.E. 834, 840 (1890), the court said:

As corporate grants are always assumed to have been made for the public benefit, any conduct which destroys their normal functions, and maims and cripples their separate activity, and takes away their free and independent action, must so far disappoint the purpose of their creation as to affect unfavorably the public interest. . . .

11. See note 1 *supra*.

position, however, and the courts have found several methods of evading it.

One method the courts have used has been to apply generally recognized limitations to the ultra vires doctrine which negates corporate liability for acts done outside the scope of its authorized business. While these limitations vary in different jurisdictions, a large majority of the courts will enforce an ultra vires contract executed by both sides,<sup>12</sup> and many courts will enforce an ultra vires contract performed by the complaining party.<sup>13</sup> Thus, if a partnership contract has been executed on both sides, it has been held that one partner may maintain an action for an accounting against the other.<sup>14</sup> Also, the courts have entertained an action on a contract brought by a creditor against a corporation in pursuance of a partnership agreement when the creditor has performed his part of the bargain.<sup>15</sup> The confusion which exists in regard to the ultra vires doctrine itself and the various interpretations given it by different jurisdictions, however, limit the applicability of this device to avoid the general rule that a corporation cannot become a partner.<sup>16</sup>

The method most commonly used by the courts to circumvent the rule prohibiting the recognition of an implied power of a corporation to become a partner has been to classify an agreement as one for a joint enterprise rather than for a partnership. Although the courts have said that there is no implied power to enter into a partnership contract, they have found an implied power of a corporation to enter into a joint adventure.<sup>17</sup> A joint adventure may be generally defined as a special and limited association of two or more legal entities for the purpose of carrying out a single enterprise which can be accomplished within a limited period of time.<sup>18</sup> A contract of partnership, on the other hand, has been considered by the courts a more general type of agreement intended to endure for a relatively long period of time and in which a series of transactions is contemplated.<sup>19</sup> Once the

12. 7 FLETCHER, CORPORATIONS § 3497 (1931).

13. 7 FLETCHER, CORPORATIONS § 3473 (1931). Some jurisdictions permit an action in quasi-contract. *Id.* § 3470, § 3471.

14. Rankin v. Emigh, 218 U.S. 27 (1910); Mervyn Inv. Co. v. Biber, 184 Cal. 637, 194 Pac. 1037 (1921); J. P. Barnett Co. v. Ludeau, 171 La. 121, 129 So. 655 (1930). *Cf.* Page-Dressler Co. v. Meader, 118 Ore. 359, 244 Pac. 308 (1926).

15. Hayes-Thomas Grain Co. v. Wilcox Corp., 144 Ark. 621, 223 S.W. 357 (1920); Cleveland Paper Co. v. Courier, 67 Mich. 152, 34 N.W. 556 (1887); Catskill Bank v. Gray, 14 Barb. (N.Y.) 471 (1851).

16. See 7 FLETCHER, CORPORATIONS § 3411 (1931).

17. Central Lumber Co. v. Schilleci, 227 Ala. 29, 148 So. 614 (1933); Clement A. Evans & Co. v. Waggoner, 30 S.E.2d 915 (Ga. 1944); Nolan v. J. & M. Doyle Co., 338 Pa. 398, 13 A.2d 59 (1940).

18. Kasishke v. Baker, 146 F.2d 113 (10th Cir. 1944); MECHEM, ELEMENTS OF THE LAW OF PARTNERSHIP § 16 (2d ed. 1920); Mechem, *The Law of Joint Adventures*, 15 MINN. L. REV. 644, 658 (1931).

19. See Mechem, *The Law of Joint Adventures*, 15 MINN. L. REV. 644, 657 (1931), where the underlying reason for the courts' distinction between partnership and joint adventure is suggested:

court labels an agreement a joint adventure, however, the corporate joint adventurer is governed by the same legal rules of liability that govern partners.<sup>20</sup>

A study of the cases in which the distinction between joint adventures and partnerships has been drawn reveals that the courts, in an attempt to give effect to an agreement, have given such a broad interpretation to the joint adventure definition that it would be impossible to predict with any reasonable degree of certainty whether any particular agreement is a partnership or a joint adventure.<sup>21</sup> For example,

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"A partnership involves the conception of a business—an entity, in a mercantile sense at least, separate and distinct from the individual affairs of the members. Such an entity cannot be created by the doing of a single act. It is the performance of a series of acts, all done for the same ultimate purpose of profit under the joint agreement so as to be bound together into a unit, that underlies the conception in the minds of mercantile men of an entity quite distinct from their individual affairs; and this entity the law recognizes to a certain extent and to it attaches certain incidents. But if the joint agreement is such that it does not contemplate the creation of such an entity there is no need of turning to the complex law of partnership for a guide, but each problem arising thereunder can be solved by the ordinary law of contracts."

The controlling thought in this analysis is that the concept of partnership has gradually been refined and developed to a point where it is concerned only with an association engaged in business involving continuity—a continuing enterprise—whereas joint adventure is an association which does not have for its purpose the carrying on of a business in the sense of a continuing enterprise.

Mechem then concluded that the distinction, in fact, was not valid since the courts have not only applied the legal results of partnerships to joint adventures, but have also found joint adventures in cases where there was in fact a partnership in the sense of a continuing business. *Id.* at 659.

20. *Fechteler v. Palm Bros. & Co.*, 133 Fed. 462 (6th Cir. 1904); *Central Lumber Co. v. Schilleci*, 227 Ala. 29, 148 So. 614 (1933); *Milton Kaufman, Inc. v. Superior Court*, 94 Cal. App. 2d 8, 210 P.2d 88 (1949); *Mechem, Law of Joint Adventures*, 15 MINN. L. REV. 644, 654 (1931).

21. See, e.g., *Central Lumber Co. v. Schilleci*, 227 Ala. 29, 148 So. 614 (1933); *Nolan v. Doyle*, 338 Pa. 398, 13 A.2d 59 (1940); *Whatley v. Cato Oil Co.*, 115 S.W.2d 1205 (Tex. Civ. App. 1938). In many of the cases holding agreements to have created joint adventures rather than partnerships, the business activities were very general in nature. The finding on this issue alone would appear to be inconsistent with the idea of a single venture; however, these cases were complicated by the fact that the contracts had been partly executed and the parties suing were either creditors or partners asking for an accounting of the profits from the transaction. The equities represented in the claims of these two classes of complainants might very well influence a court in finding a joint adventure. In many jurisdictions the determination as to whether an enterprise is a partnership rather than a joint adventure is unnecessary since liability could be imposed on the basis of the exceptions to the ultra vires rule. See text supported by notes 12-16 *supra*.

Cases involving creditors where joint adventures were found include: *Luhrig Collieries Co. v. Interstate Coal & Dock Co.*, 281 Fed. 265 (S.D.N.Y. 1922); *Becker v. Turpin*, 61 Cal. App. 16, 214 Pac. 255 (1923); *Hobart-Lee Tie Co. v. Grodsky*, 329 Mo. 706, 46 S.W.2d 859 (1931); *Lane v. National Insurance Agency*, 148 Ore. 589, 37 P.2d 365 (1934); *Wyoming-Indiana Oil & Gas Co. v. Weston*, 43 Wyo. 526, 7 P.2d 206 (1932). Partnership suits for accounting of profits where joint adventures were found include: *Kasishke v. Baker*, 146 F.2d 113 (10th Cir. 1944); *Clement A. Evans & Co. v. Waggoner*, 30 S.E.2d 915 (Ga. 1944); *Forina Co. v. Karnheim*, 240 Mass. 574, 134 N.E. 605 (1922). The willingness of courts to "find" joint ventures has led Professor Mechem, in *The Law of Joint Adventures*, 15 MINN. L. REV. 644, 653 (1931), to say:

suppose *A* corporation, a construction company, desires to do some construction work for *X* but has insufficient capital to finance the job. *A* corporation approaches *B*, an individual, who has adequate capital but no possibility of acquiring the contract although *B* also is in the construction business. *A* corporation and *B* enter into an agreement whereby, in return for a share in the profits, *B* is to furnish capital to finance the construction, provide a performance bond, and furnish money necessary to maintain the equipment to be utilized. *A* corporation is to perform the construction work, and other stipulations contemplate joint management of the job which is to last for a limited length of time. In such a situation, is the agreement between *A* corporation and *B* a joint adventure or a partnership? In two cases in which substantially these same facts were involved, one court called the agreement a joint adventure<sup>22</sup> while another called it a partnership.<sup>23</sup> The court which called the contract a partnership, however, did enforce the agreement on the ground that it had been executed by both sides.<sup>24</sup>

The courts have also held that, even if there is a partnership agreement by the corporation, the rationale of the general judicial refusal to imply the power to enter into such an understanding is not applicable if the corporation retains control of the activities of the partnership and the other partner merely contributes capital.<sup>25</sup> They justify their position by saying that the rule was developed to avoid a delegation of management to persons outside the corporate structure and that this possibility is eliminated if the corporation retains managerial control. These courts have not discussed the fact that this possibility is not completely eliminated; according to strict partnership law, a corporation should be held liable to a bona fide third party who enters into a contract in reliance on the apparent authority of an individual partner, even though such partner owes a duty to the corporation not to enter into such a contract.<sup>26</sup> The decisions in this area show, however, that the courts do not believe that all types of partnership con-

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It is submitted that insofar as any of the cases may hold that a corporation has the power and authority to engage in a joint adventure where it would not be permitted to engage in a partnership, the true reason for such a holding is a desire to escape in some way the stringency of the rule making it *ultra vires* for corporations to engage in partnerships.

See Rowley, *The Corporate Partner*, 14 MINN. L. REV. 769, 776 (1930), where this same view is expressed.

22. Nolan v. Doyle, 338 Pa. 398, 13 A.2d 59 (1940).

23. Hayes-Thomas Grain Co. v. Wilcox Corp., 144 Ark. 29, 223 S.W. 359 (1920).

24. *Ibid.*

25. Bates v. Coronado Beach, 109 Cal. 160, 41 Pac. 855 (1895); Rosenblum v. Springfield Produce Brokerage Co., 243 Mass. 111, 137 N.E. 357 (1922); Municipal Paving Co. v. Herring, 50 Okla. 470, 150 Pac. 1067 (1915); Allen & Sons v. Woonsocket County, 11 R.I. 288 (1876).

26. MECHEM, ELEMENTS OF THE LAW OF PARTNERSHIP § 244 (2d ed. 1920); ROWLEY, THE MODERN LAW OF PARTNERSHIP § 418 (1916).

tracts should be denied enforcement; it is only when the agreement delegates to the non-corporate partner managerial control that the courts may feel that the contract is against the best interests of the corporation.

The courts have made another inroad on the rule by excepting cases in which a *mining* partnership is involved.<sup>27</sup> A mining partnership differs from the ordinary partnership in two significant respects: (1) death or bankruptcy of one partner does not terminate a mining partnership while it does terminate an ordinary partnership, and (2) a mining partner may substitute an assignee as a partner in the partnership without the consent of the other partners while this cannot be done by an ordinary partner.<sup>28</sup> In the mining as well as in the general partnership, however, one partner is able to bind the other in respect to contracts made in the name of the partnership. Thus, the main criticism which has led the courts to prohibit corporations from becoming partners, *i.e.*, loss of managerial control, has not been eliminated in the case of the mining partnership agreement. The nature of the business of mining is such that corporations have found it strongly advantageous to enter into a partnership of this nature, and it would seem, therefore, that the grace which has been granted to mining corporations is based more on economic expediency than any other factor.

Thus, the cases disclose that the courts have felt it necessary to place restrictions on their position that there can be no implication of the power of a corporation to enter into a partnership agreement. It would appear that the rule arose in an effort to protect the stockholders of a corporation; however, there has been no need to apply the rule in the cases in which it has been asserted. In all these cases, the rule has been used as a defense either by the corporation when suit is brought against it by a creditor or the other partner, or by a creditor or partner when suit is brought by the corporation. In both situations, the courts have held that neither the corporation nor the other party to the action should be allowed to avoid a contract which has been entered into voluntarily. Where the contract has been performed by both sides, or at least by one side, the courts may enforce the contract by applying the exceptions to the *ultra vires* doctrine. Moreover, even if the contract is unperformed, by calling the partnership contract a joint adventure, or a mining partnership, or by finding that the individual partner has no managerial control, the court may enforce the agreement.

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27. *Sturm v. Ulrich*, 10 F.2d 9 (8th Cir. 1925). This case contains a large compilation of cases which recognized the validity of mining partnerships and other partnerships of that nature.

28. *Ibid.* For the law on these points in regard to an ordinary partnership, see the UNIFORM PARTNERSHIP ACT §§ 27-31 (1949).

The willingness of the courts to find that the contract should be enforced has, indirectly, given the corporation the implied power to enter into a partnership agreement. It is submitted that the courts should openly recognize this implied power and that a contract entered into pursuant to such a power should be enforced. The rule to the contrary arose basically in an effort to protect shareholders; however, their protection is adequate without a rule against the implication of the power of a corporation to enter into a contract of partnership. Dissatisfied shareholders may bring an action for mismanagement against the corporation and the corporate directors in which they may seek to enjoin the performance of the contract.<sup>29</sup> By adopting the position that there is an implied power of a corporation to become a partner, the courts would be doing nothing more than recognizing an accomplished fact.<sup>30</sup>

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29. Although, generally, actions for mismanagement will be enforced only if there is a gross abuse of discretion, a gross abuse may be found more easily here than in the ordinary mismanagement case, since the courts apparently desire to construe strictly contracts which delegate control to parties outside the corporate structure. See FLETCHER, CORPORATIONS § 5821 (1943), for a discussion of the circumstances where a shareholder may enjoin the directors. It is submitted that the following factors should be considered in determining whether the corporate management has abused its discretionary powers. *First*, how much control over the corporate purpose has been given to the other partner or partners? See text supported by notes 25, 26 *supra*. Where complete managerial control is vested in the corporate partner, courts have held that a partnership is permissible even though all of the other attributes of a partnership are present. Even if there is less than complete control by the corporation, however, the corporation should still be allowed to enter into a partnership agreement in the absence of a gross abuse of discretion by the corporate directors. *Second*, what is the nature of the corporate business? The mining business (see text supported by note 27 *supra*) is an example of a business where the economic need for a partnership has been strong enough to cause the court to enforce the agreement. *Third*, how much financial responsibility and business acumen do the other partners possess? *Fourth*, are the directors of the corporation in good faith? Upon consideration of these and any other factors it may consider pertinent the court should then decide whether the contract is so disadvantageous to the shareholders that it should be enjoined.

30. In so far as the cases analyzed by the author reveal, most courts are enforcing corporate agreements by adopting the exceptions to the rule.