TRUSTEE-PARTNERSHIPS. AN OLD REMEDY FOR A NEW NEED. 1720-1960 (TWO HUNDRED AND FORTY YEARS OF PROGRESS).

In the Victorian Legislative Council, on 13th April, 1965, the Hon. J. W. Galbally compared the present situation of trading companies in Australia to that which existed in England in the mid-1720's. Debating proposed amendments to the Companies Act 1961, he said:[1]

> "I wish to quote a precedent. During the Government of Walpole, London and indeed England, was almost brought to its knees by the scandal of 'The South Sea Bubble.' It took many years for England to regain its commercial enterprise."

Some few minutes later, he again drew the same analogy.[2]

> "We realize that the community is highly sensitive to the world of commerce and business. No matter how well established a company may be, as soon as the annual report is published showing increased profits for the year, down goes the value of the shares. What is the reason? It is the same as occurred during the time of the South Sea Bubble—the people were not going to be bitten by the same dog twice."

There is some considerable basis for comparing the last two decades of company development in Australia with those which immediately preceded the bursting of the South Sea Bubble. Just as Australian companies expanded in the warmth of a buoyant economy from the end of World War II until 1960, so the "first and second decades of the eighteenth century were marked by an almost frenetic boom in company flotations which led to the famous South Sea Bubble."[3]

The bursting of that bubble retarded the development of corporations.

> "The law officers of the Crown, mindful of [the Bubble Act's] provisions, hesitated to approve of applications for charters which contemplated the creation of large stocks of transferable shares. Consequently, not only were the operations of unincorporated joint stock companies restricted by the Act, but the Act was used

1 [1965] VICTORIAN PARLIAMENTARY DEBATES 3110.

2 *Ibid.*, at 3111.

3 GOWER, MODERN COMPANY LAW (2nd ed.), 27.

as an expression of policy to restrain the formation of business corporations."[4]

The restrictions on the development of corporations led to an increase in the activity of partnerships and eventually to a resurgence of unincorporated joint stock trading in a new form. The climate in Australia today is right for another similar resurgence, and for similar reasons.

Five years ago, Professor Ford said, "the development of unincorporated business enterprises in the form of unit trusts provides an interesting example of a throwback in the evolution of legal institutions."[5]

A much more dramatic reversal (if not actually a "throwback")[6] is the trend towards partnerships rather than incorporation which has begun in Australia since the credit squeeze of 1960.

It is the thesis of this article, that there is considerable reason for the increased use of the partnership as a form of business organization, and that its use can be extended considerably by the proper use of the trust device.

Today, the position is very similar to that which existed when the South Sea Bubble burst. Incorporation confers many advantages: a corporation is capable of existing in perpetuity; its acts are not easily confused with the acts of its members; the shareholders' liability is limited;[7] shares can be easily transferred; new members can be admitted without a change in the nature of the company.

4 Du Bois, The English Business Company After the Bubble Act, 1720-1800, 12.

5 *Unit Trusts,* (1960) 23 Mod. L. Rev. 130.

6 The form of these partnerships does, however, appear to be a throwback. After the Bubble burst "Great legal ingenuity was brought to bear to confer on these unincorporated associations nearly all the advantages of incorporation, and for this purpose use was made of the trust. The company would be formed under a deed of settlement (approximating closely to a cross between the modern articles of association and debenture trust deed) under which the subscribers would agree to be associated in an enterprise with a prescribed joint stock divided into a specified number of shares: the provisions of the deed would be variable with the consent of a specified majority of the proprietors: management would be delegated to a committee of directors; and the property would be vested in trustees, who would usually be persons other than the directors. Often it would be provided that these trustees should sue or be sued on behalf of the company, and although the legal efficacy of such a provision was by no means clear, suit by the trustees in a court of equity seems to have been generally permitted. As for the right to be sued, it will be appreciated that obscurity on this point was by no means an unmixed disadvantage from the point of view of the company." (Gower, Modern Company Law (2nd ed.), 32-3.).

7 In some of the Australian states it is, of course, possible to create partner-

At the present time, it has also numerous disadvantages. These include the current attitude of the investor, the prospectus provisions of the Companies Act, company tax, the liability presently imposed on directors and promoters and the impossibility of a corporation carrying on certain professional activities.

Public Opinion.

The credit squeeze of 1960 ended an era of "boom" in the Australian economy. Companies had become accustomed to entering into profitable ventures without worrying about the limitations of their own capital structure. A bouyant economy led to quick turn-over on speculative land deals and (with steady inflation a strong factor) profitable trading on readily available loan money.

In 1960 money became short, purchasing power dropped, and companies found they were paying high interest rates on money from which they were unable to derive any profit. Many companies crashed. In certain cases, shareholders, unsecured note-holders, and even debenture-holders discovered that most (if not all) of their money had been lost.

Public confidence has not yet recovered from this sudden change of pace. The investor has become much more cautious with his money. It is very hard to persuade him to invest in a new enterprise, the assets of which only come into existence when his shares are allotted to him.

In certain areas of business, he is much happier to contribute money to a partnership—to pay out money not for a share certificate giving him rights which may in the event prove valueless, but for a tenth share of the bricks and mortar of a motel or for a twentieth share of 1,000 acres of grazing land. So long as things are organized on a local scale, he is much happier to become a partner (with all the liabilities which this may impose upon him) than to pay money for a piece of paper which does not represent anything tangible which he can call "his."

Prospectus Requirements and Share-Hawking.

The Uniform Companies Act contains many provisions designed for the protection of the investor. Among these are the requirements which in substance prevent a company obtaining money from the public without the issue of a prospectus.

ships, the liability of some members of which is limited. See Mercantile Act 1867 (Qld.); Limited Partnership Act 1908 (Tas.); Limited Partnership Act 1909 (W.A.).

"A person shall not issue, circulate or distribute any form of application for shares in or debentures of a corporation unless the form is issued, circulated or distributed together with a prospectus, a copy of which has been registered by the Registrar."[8]

Canvassing by means of written documents other than an application for shares or debentures is also prevented:

"An invitation to the public to deposit money with or lend money to a corporation or proposed corporation shall not be issued, circulated or distributed by the corporation or by any other person" unless a prospectus containing certain specified matters has been registered by the Registrar.[9]

Advertisements "offering or calling attention to an offer or intended offer of shares in or debentures of a corporation or proposed corporation to the public for subscription or purchase, shall be deemed to be a prospectus" if they contain more than a bare minimum of information and unless they state "that applications for shares or debentures will proceed" only on a form of application attached to a printed prospectus.[10]

Similarly, "where a corporation allots or agrees to allot to any person, any shares in or debentures of the corporation with a view to any of them being offered for sale to the public, any document by which the offer for sale to the public is made shall for all purposes be deemed to be a prospectus."[11]

This section prevents an indirect transfer of shares to the public without complying with the requirements of issuing a prospectus in statutory form.

None of these requirements, of course, applies to the sale or offer for sale of interests in a partnership.

Likewise, the Act contains provisions limiting the circumstances in which an "interest" can be issued or offered to the public or in which the public may be invited to subscribe for or purchase[12] an

8 Uniform Companies Act, sec. 37.

9 *Ibid.,* sec. 38. This section in its present form appears to be confined to Victoria and South Australia.

10 *Ibid.,* sec. 40.

11 *Ibid.,* sec. 43 (1). Note that in certain circumstances the onus is on the person offering shares or debentures to the public to prove that they were not originally allotted with a view to such an offer. (Sec. 43 (2).).

12 Note, as to the difference between subscription and purchase at common law, Peek v. Gurney, (1873) L.R. 6 H.L. 377; Andrews v. Mockford, [1896] 1 Q.B. 372. The common law remedies of interest-holders probably depend upon this distinction, but their statutory rights are unaffected by it.

"interest."[13] In relation to such issue, offer or invitation, there must be issued a statement in writing which is deemed to be a prospectus.[14]

For this purpose, an "interest" is defined very widely. It means:[15] "any right to participate or interest whether enforceable or not and whether actual prospective or contingent—

(a) in any profits assets or realization of any financial or business undertaking or scheme, whether in the State or elsewhere;

(b) in any common enterprise whether in the State or elsewhere in which the holder of the right or interest is led to expect profits rent or interest from the efforts of the promoter of the enterprise or a third party;

or

(c) in any investment contract—

whether or not the right or interest is evidenced by a formal document and whether or not the right or interest relates to a physical asset."

It does not, however, include:[16] "any share in or debenture of a corporation" (these are, of course, specifically dealt with elsewhere in the Act); "any interest in or arising out of a policy of life insurance; or any interest in a partnership agreement."

The provisions relating to the sale, etc., of "interests" do not, therefore, apply to a partnership.

The scope for selling shares to the public without the use of any written document is also considerably circumscribed by the Act:[17]

> "A person shall not, whether by appointment or otherwise, go from place to place offering shares for subscription or purchase to the public or any member of the public."

In that provision the word "shares" is given a wide meaning. It relates, however, only to shares of a *corporation* and to debentures, units or documents conferring or purporting to confer a claim *against a corporation*.[18] It has no application to the hawking of a partnership interest.

13 Uniform Companies Act, secs. 81, 82.

14 *Ibid.,* sec. 82.

15 *Ibid.,* sec. 76.

16 *Ibid.*

17 *Ibid.,* sec. 374 (1). Note also that this section prohibits offers in writing to the public of any shares for *purchase* subject to certain limited rights granted in relation to shares quoted on the Stock Exchange of the relevant State (sub-sec. (3)). This provision is, of course, subject to sec. 43.

18. *Ibid.,* sec. 374 (11).

The sections of the Companies Act which deal with prospectuses are designed to protect the public from the confidence man who seeks to float a bogus company. They also embarrass the honest company promoter operating on a shoe-string. He can avoid the difficulties created by these sections if he floats a partnership rather than a corporation.

Ability to Borrow Money.

Apart from the prospectus requirements of the Uniform Companies Act the raising of funds other than by the issuing of shares has become increasingly difficult for the small, ambitious but under-capitalised corporation.

There has, in the last few years, been a considerable tightening of the rules relating to the borrowing of money by bodies corporate. The present strict requirements as to the issue of debentures[19] make the raising of capital in this way a far less attractive proposition than it was four years ago.

Company Tax.

It is not proposed to discuss here the complicated structure of the Income Tax and Social Services Contribution Assessment Act 1936-1964, insofar as it applied to companies. Suffice it to point out that a company is a taxpayer and assessable as such.

Originally rebates of tax were given to shareholders in relation to tax paid by the company. The situation today, however, is quite different.[20] The company is liable to a primary rate of tax calculated

19 *Ibid.*, secs. 70-75, noting especially the various State amendments to those sections. Of course, a partnership may, by reason of the relevant bills of sale legislation, also have difficulty in creating a floating charge over its assets.

20 "From the inception of the Act in 1915 until 1922, a company was taxed on its undistributed profits only, and shareholders were taxed on the dividends received by them without rebate. If the company consequently distributed taxed profits the shareholders were also taxed on the dividends, but rebates were allowed to them in recognition of the tax which had been paid by the company. By the Amending Act of 1923, an important alteration was made in the assessment of companies. Since then, companies have been assessed on the whole of their taxable income, without any deduction of profits distributed to shareholders. Dividends are taxable in the hands of the recipients but shareholders were at first allowed a rebate in recognition of the primary tax paid by the company. This rebate was denied to non-resident companies from income year ended 30 June, 1939. The rebate was also denied to all individuals, whether resident or non-resident from income year ended 30 June, 1940. Thus, only resident companies are now entitled to the dividend rebate." (GUNN'S COMMONWEALTH INCOME TAX LAW AND PRACTICE (6th ed.), 494).

at between 5/6 and 8/- in the £, depending on the net profits of the company and whether or not it has a small or large controlling shareholding.[21] The dividends which the shareholder receives are also taxed.

So long as the bulk of shareholders' income from the company is genuinely received in the way of directors' fees, this aspect is not very significant;[22] but with a wide-spread shareholding the total incidence of tax would normally be greatly increased over that of a comparable partnership. In addition, note the provisions of section 104 *et seq.* of the Income Tax and Social Services Contribution Assessment Act in relation to companies the control of which lies with a small number of shareholders or of which not less than three-quarters of the dividends are payable to persons no more than twenty in number.[23]

A partnership is not a company[24] nor, it is submitted, is any association created by the use of the trust device as contemplated in this article, within the broad definition of company contained in the Act.[25]

Note that, although a partnership is required to "furnish a return of the income of the partnership," it is "not liable to pay tax thereon."[26]

Liability of Directors and Promoters.

If a prospectus (the issue of which is a prerequisite to raising money from the public) contains any false representation, there may exist against the directors and promoters responsible, a right of action for damages for fraud. This depends on the ordinary common law rules as to deceit.[27]

Apart altogether from common law liability, however, there has been evidenced in recent company law legislation a general tendency to fix upon the directors of companies fresh duties, obligations and liabilities.

That the director's burden is a growing one becomes apparent when it is realized that there are currently approximately 175 offences created by the Companies Act and that most of them are offences of which a director can be guilty. It is not only in respect of criminal

21 Income Tax and Social Services Contribution Act 1964, sec. 9, and 6th Schedule.

22 See Income Tax and Social Services Contribution Assessment Act 1936-1964, sec. 109.

23 *Ibid.,* sec. 103A.

24 *Ibid.,* sec. 6.

25 *Ibid.*

26 *Ibid.,* sec. 91.

27 See Derry v. Peek, (1889) 14 App. Cas. 337; R. v. Lord Kylsant, [1932] 1 K.B. 442.

liability, however, that the director's lot is becoming a less happy one. His civil liability is also increasing.

The Uniform Companies Act[28] renders directors and promoters liable to compensate persons who subscribe for or purchase any shares or debentures on the faith of a prospectus, to the extent that such persons suffer loss or damages by reason of any untrue statement or wilful non-disclosure in such prospectus.

This provision is not a new one. It was first introduced in Australia in somewhat different form in the 1890's. Its purpose is to add to the director's common law civil liability for misstatements made in the prospectus. In view of the decision of the House of Lords in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*,[29] it is doubtful whether the director's common law liability in this respect is in fact extended by this statutory provision.

There is also provision for the imposition of criminal liability in respect of any untrue statement or wilful non-disclosure.[30]

Section 124 (1) of the Uniform Act provides that "a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office."

Of this section, Paterson & Ednie[31] say: "So far as is known this section has no counterpart in the English-speaking world." The application of this precise provision has, however, been judicially interpreted at least once. In *Byrne v. Baker*[32] the Victorian Supreme Court held that: "The language used is appropriate and was designed, we think, to introduce one aspect of negligence, as known and acted upon for many years by the courts on misfeasance summonses against directors."

Their Honours went on to hold that the section referred to specific acts of negligence, and that it did not apply to the general "conduct of a director over a selected period."

Clearly to fall within the section a director must be guilty of specific acts or omissions of a negligent nature.

28 Sec. 46. It should be noted that sec. 46 is not absolute in its terms; it enables a director or promoter to escape liability if the prospectus was issued without his knowledge, or if he withdrew his consent before allotment or sale and on becoming aware of any untrue statement, or if he believed and had reasonable grounds to believe any untrue statement, or if any untrue statement purporting to be that of an expert or official person was reasonably based as set out in sec. 46 (3) (d).

29 [1963] 3 W.L.R. 101.

30 Uniform Companies Act, sec. 47.

31 AUSTRALIAN COMPANY LAW, 346.

32 [1964] V.R. 443, at 453 *per* Herring C.J., Smith and Adam JJ.

The section which is now section 304 (1) of the Uniform Companies Act was first enacted in Australia in the 1930's.[33] In its present form that section provides that any person knowingly a party to the carrying on of any business of the company, which business "has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose" may be made personally responsible for "all or any of the debts or other liabilities of the company as the Court directs."

The person party to the fraud is thereby made responsible to meet any liabilities incurred by the company in the course of its fraudulent activities or which, by reason of the fraud, it was unable to meet. This section, though it purports to impose the liabilities of the company on such persons, does not really affect substantive rights, for even at common law such a person would appear to be liable in damages. The section operates primarily to make available to the creditors an easier means of redress rather than to increase their rights.

Section 303 (3) of the Uniform Companies Act first appeared in Australia with the enactment of that Act. That sub-section provides:

> "If in the course of the winding up of a company it appears that an officer of the company who was knowingly a party to the contracting of a debt provable in the winding up had, at the time the debt was contracted, no reasonable or probable ground of expectation, after taking into consideration the other liabilities, if any, of the company at the time, of the company being able to pay the debt, the officer shall be guilty of an offence against this Act."

Of itself that sub-section imposes criminal liability on any officer of a company who is a party to the irresponsible obtaining of credit. Thus, it may be a criminal offence for a company director to act irresponsibly.

A Local Addition Since 1961-2.

The Victorian Companies (Public Borrowings) Act 1963 came into operation on 1st February, 1964; the N.S.W. Companies (Amendment) Act 1964 came into operation on 1st July, 1964. Among the amendments which those Acts made was the addition of sub-section (1A) to section 304. Under the new subsection:

> "(1A) Where a person has been convicted of an offence under sub-section (3) of section three hundred and three in relation to the contracting of such a debt as is referred to in that

[33] Qld. 1931; S.A. 1935; N.S.W. 1936; Vic. 1938; W.A. 1943; Tas. 1959.

sub-section the Court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks proper to do so, declare that the person shall be personally responsible without any limitation of liability for the payment of the whole or any part of that debt."

In one sense the imposition of civil liability does not seem a very strong measure in view of the fact that it is premised on the existence of criminal liability under sec. 303 (3). What makes sec. 304 (1A) of particular importance is that it, more than any other section in the Companies Act, recognizes that, though the shield of incorporation may protect shareholders from direct liability, that shield does not protect the directors or management.

Section 304 (1A) makes the officer in question responsible, not to pay compensation for his own wrongful act, but "for the payment of the whole or any part of" a debt contracted by the company. It permits the Court, if it thinks fit, to attribute to an officer of a corporation a liability incurred by the company. In this sense the new sub-section is an important departure. Civil liability of directors is not new; but civil liability of directors for the debts of the company *as such* involves the tacit adoption of a type of organic theory of corporate personality.

At this stage in the development of company law, it is hard to conceive that liability for the acts of the company can be imposed on the shareholders. To impose such liability on management, the *alter ego* of the company, involves fewer difficulties. Section 304 (1A) may have introduced a new era in the concept of the corporation—an era in which the law equates management with the company, and in which the shield which incorporation gives to the shareholders is used to deflect liability onto the directors.

I am not arguing that the liabilities of directors should be decreased. In a recent article[34] I have advocated the contrary.

It is unfortunate, however, that the legislation in this respect is so piecemeal and also that it is inclined to confuse failure with dishonesty. Not all company failures are due to dishonesty, or even to negligence. Punishment may deter the dishonest. It does not bring back the investors' money, nor does it affect the accumulated earnings of the honest (though overpaid) director. The legislature appears too concerned with shutting the stable door and crying "Thief," rather than with recovering the horse.

34 *Protecting The Small Investor,* (1965) 35 AUSTRALIAN ACCOUNTANT 179.

Many of the sections which impose liability on directors and promoters affect even the director or promoter whose *intentions* are honest. Negligence is sufficient to impose both civil and criminal liability on promoter and director. These statutory provisions do not relate to the activities of partnership promoters.

Professional Qualifications.

Although a company suffers in law from few limitations of a general nature, there are certain qualifications which a company cannot attain. It cannot pass examinations, and thus, for example, it cannot be admitted to practise as a barrister or solicitor; it cannot be a legally qualified medical practitioner; it cannot become a chartered accountant.

As legislation at present exists throughout Australia, there is no possibility of these and other like occupations being carried on by a body corporate. They are, of necessity, the province of the sole practitioner and of the partnership.

Numbers.

Where a large number of people desire to carry on business in partnership, they strike difficulty by reason of section 14 (3) of the Uniform Companies Act. That sub-section provides:

> "No association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any business which has for its object the acquisition of gain by the association or partnership or by the individual members thereof unless it is incorporated under this Act or is formed in pursuance of some other Act or letters patent."

In the majority of cases this presents no difficulty. The problem can be solved by incorporation.

In the case of professional partnerships or partnerships formed to carry on certain types of activity regulated by statute difficulties do arise since they cannot incorporate.[35] Similarly, where a partnership

[35] Recently an Act was passed in Victoria which was designed to permit an increased membership in the case of professional partnerships. By the Companies (Amendment) Act 1965 (Act No. 7281), sec. 14 (3) was replaced by: "(3) An association or partnership consisting—(a) in the case of an association or partnership formed for the purpose of carrying on any profession or calling declared by Proclamation of the Governor-in-Council published in the Government Gazette to be a profession or calling which is not customarily carried on in the Commonwealth by a corporation—of more than fifty persons or (b) in any other case of more than twenty persons—which has for its object the acquisition of gain by the association or partnership or

is (for any of the reasons already referred to) preferred to a corporation there is a problem to be solved.

Trustee-Partners.

One of the methods referred to in evidence before the Jenkins Committee, and which is used for the purpose of overcoming this dilemma in the case of professional partnerships, involves the use of trustee partners.

> "When the existing restriction causes inconvenience, the difficulty can be solved by the constitution of a number of separate firms under a common name, often with certain common partners, each firm observing the restriction to 20 partners."[36]

A similar statement was made by the Institute of Chartered Accountants in England and Wales: "Practical difficulties are created by the limitation and it becomes necessary to form separate partnerships having some partners who are partners in other partnerships and some who are not."[37]

Unfortunately, the Jenkins Committee made no comment on the use of this device during evidence, nor did it mention it in its report. It does not appear that in the actual examples given the partners actually contract as trustees, rather do the partnerships consist of several interlocking partnerships.

It is the purpose of this article to analyse the nature of partnership, and to do this in the light of an examination of the relationship between the beneficiaries of the type of situation here contemplated and the ostensible members of this sort of partnership.

An Association.

It will be noted that the prohibition imposed by section 14 (3) of the Uniform Companies Act relates not only to partnerships but also to "associations" formed for the purpose of carrying on any business which has for its object the acquisition of gain.

In *Smith v. Anderson*,[38] Brett L.J., had "some difficulty in seeing how there could be an association for the purpose of carrying on a

individual members thereof shall not be formed unless it is incorporated under this Act or is formed in pursuance of some other Act or letters patent." Even so, a limit on membership still remains.

36 Memorandum to the Jenkins Committee from the Council of the Institute of Chartered Accountants of Scotland. Jenkins Report, Minutes of Evidence, 1236.

37 *Ibid.*, at 1401.

38 (1880) 15 Ch.D. 247, at 277.

business which would be neither a company nor a partnership . . . But according to all ordinary rules of construction, if the association mentioned in [section 14 (3)] is not, strictly speaking, a company or a partnership, it must be something of a similar kind."

Cotton L.J.[39] in the same case was of opinion that if the term "association" was intended to mean something other than a company or a partnership "it must denote something where the associates are in the nature of partners."

James L.J.[40] took the terms "company" and "association" to be synonymous. He said that it was "the result of an arrangement by which parties intend to form a partnership which is constantly changing, a partnership today consisting of certain members and tomorrow consisting of some only of those members along with others who have come in, so that there will be a constant shifting of the partnership . . ."

From these statements of the law and the precise words of the section, it is clear that the term "association" is somewhat wider than the term "partnership," but that it is probably used to refer to a relationship which, if it had been created with a view to profit, would have been a partnership.[41]

This was the view taken by the Tasmanian Full Court in *In re The Tasmanian Forests & Milling Co. Pty. Ltd.*[42] where Clark J. (with the concurrence of Nicholls C.J. and Crisp J.) said:[43]

> "It would, therefore, seem that the term "association" as used in [section 14 (3)] means an association consisting of more than 20 persons formed for the purpose of carrying on a business having for its object the acquisition of gain, and which is so much in the nature of a partnership that, if it had been formed to

39 *Ibid.,* at 282.

40 *Ibid.,* at 273-4. This view appears to have been adopted by BUCKLEY ON THE COMPANIES ACTS (13th ed.), 761.

41 Thus in In re Commonwealth Homes & Investment Co., [1943] S.A.S.R. 211, Mayo J. said of an association: "To establish an association, a legal relation must be created between the members giving rise to joint rights or obligations or mutual rights or duties . . . . These rights inter socios if not of statutory origin may ordinarily be expected to be contractual . . . or if related to property may be equitable, in which case a holder will in proper circumstances have the right to follow property into the hands of other holders (Re Hallett's Estate). There was I apprehend no direct intercourse between applicants for bonds or bond holders as such, but by joining in and becoming privy to, a common project without any direct communication, persons may sometimes find themselves in contractual relationships."

42 (1932) 27 Tas. L.R. 15.

43 *Ibid.,* at 26-7.

carry on business with a view to profit, it would have been a partnership."

The element which distinguishes an association from a partnership, therefore, is that the latter must exist with a view to profit; the former need only exist for the acquisition of gain. Sir George Jessel[44] interpreted the word "gain" as follows:—

> "Gain is something obtained or acquired. It is not limited to pecuniary gain. We shall have to add the word "pecuniary" so to limit it. And still less is it limited to commercial profits. . . . Commercial profits, no doubt, are gain, but I cannot find anything limiting gain simply to commercial profit."

His Lordship took the view that any association formed for the purpose of acquisition, as opposed to one which was formed with the object of spending, fell within the words of the section.

This interpretation of "gain" has since been generally adopted[45] and it would, therefore, seem beyond doubt that to fall within section 14 (3) an association must be in the nature of a partnership and must exist for the purpose of acquisition. An association existing for charitable purposes would not be within the section.

From this it follows that association and partnership are nearly synonymous. An association need not exist for "profit" as such; it may have changing members; in all other respects it closely resembles a partnership.

Whether those represented by trustee-partners are members of an association can best be answered after we have considered the nature of partnership.

A Partnership.

The Partnership Acts of the various Australian States[46] define partnership as "the relation which subsists between persons carrying on a business in common with a view of profit," but as not including the relationship between the members of a registered company or of a company or association "formed or incorporated by or in pursuance of any act or letters patent or Royal Charter."

44 In re Arthur Average Association for British Foreign and Colonial Ships, (1875) 10 Ch. App. 542, at 546-7.

45 See In re Padstow Total Loss and Collision Assurance Association, (1882) 20 Ch.D. 137; Jennings v. Hammond, (1882) 9 Q.B.D. 225; POLLOCK, THE LAW OF PARTNERSHIP, (15th ed.), 13; PATERSON & EDNIE, AUSTRALIAN COMPANY LAW 155; See also HIGGINS, THE LAW OF PARTNERSHIP IN AUSTRALIA AND NEW ZEALAND 38-9.

46 N.S.W. Sec. 1; Qld. Sec. 5; S.A. Sec. 1; Tas. Sec. 6; Vic. Sec. 5; W.A. Sec. 7 (1) (4).

The type of organization here contemplated is not within either of the specific exceptions in the section. We are left with the question whether persons, on whose behalf representative partners act, are carrying on business in common with a view of profit.

The Partnership Acts define business as including every trade occupation or profession.[47] It is, however, the 'carrying on' of a business which is referred to both in the definition of partnership and in the prohibition in section 14 (3) of the Uniform Companies Act.

> "The expression 'carrying on' implies a repetition of acts and excludes the case of an association formed for doing one particular act which is never to be repeated."[48]

If, however, there are intended to be a series of acts, as for example, the purchase, subdivision and sale over a period of time of a number of blocks of land, a single isolated transaction at the beginning (i.e. the purchase of the first block of land) will constitute carrying on a business.[49]

It is clear, therefore, that if a number of persons give money to a trustee for him to invest that money on trust, the mere fact that the beneficiaries join together to give the money to the trustee will not

47 N.S.W. Sec. 45; Qld. Sec. 48; S.A. Sec. 46; Tas. Sec. 5; Vic. Sec. 4; W.A. Sec. 6. Of the word "business" Jessel M.R., in Smith v. Anderson, said (at 258-9): "Now 'business' itself is a word of large and indefinite import. I have before me the last edition of Johnson's Dictionary, edited by Dr. Latham, and there the first meaning given of it is, 'Employment, transaction of affairs'; the second, 'an affair'; the third, 'subject of business, affair, or object which engages the care.' Then there are some other meanings and the sixth is; 'something to be transacted.' The seventh is, 'something required to be done,' Then taking the last edition of the Imperial Dictionary, which is a very good dictionary, we find it a little more definite, but with a remark which is worth reading: 'Business, employment; that which occupies the time and attention and labour of men for the purpose of profit or improvement.' That is to say, anything which occupies the time and attention and labour of a man for the purpose of profit is business. It is a word of extensive use and indefinite signification. Then, 'Business is a particular occupation, as agriculture, trade, mechanics, art or profession, and when used in connexion with particular employments it admits of the plural, that is, businesses.' Therefore, the Legislature could not well have used a larger word."

48 Smith v. Anderson, (1880) 15 Ch.D. 247, at 277 *per* Brett L.J. Note that the (Victorian) Companies Act, sec. 14(3) in its amended form no longer refers to the "carrying on" of business.

49 See Re Griffin; ex parte Board of Trade, (1890) 60 L.J. Q.B. 235, at 237; Ballantyne v. Raphael, (1889) 15 V.L.R. 538. It would appear to be to this sort of "single adventure" that the Partnership Acts (N.S.W. sec. 32; Qld. sec. 35; S.A. sec. 32; Tas. sec 37; Vic. sec. 36; W.A. sec. 43) refer when they speak of a partnership entered into for a single adventure. A "single adventure" requires more than a single act.

constitute them partners. By doing that single thing they do not "carry on a business."

In the case of trustee-partners, the position will usually, however, be more complex than this. The normal "sleeping" partner may do no more than contribute money and then wait for the profits to roll in, but this does not necessarily prevent his being a partner.

> "A man who allows another to carry on trade, whether in his own name or not, to buy and sell, and to pay over all the profits, to him, is undoubtedly the principal, and the person so employed is the agent, and the principal is liable for the agent's contracts in the course of his employment. So if two or more agree that they should carry on a trade, and share the profits of it, each is a principal and each is an agent for the other, and each is bound by the other's contract in carrying on the trade, as much as a single principal would be by the act of an agent, who was to give the whole of the profits to his employer."[50]

The beneficiary may likewise be carrying on business by means of his agent, the trustee partner.

This line of argument has, it is true, been rejected in the Unit Trust cases,[51] but not without strong opposition from one of England's greatest judges.

In both *Sykes v. Beadon*[52] and *Smith v. Anderson*,[53] Jessel M.R. held that Management Trusts, the 19th century ancestor of the Unit Trust, were illegal as associations contrary to the then equivalent of section 14 (3).

His Lordship's views were, however, overruled by the Court of Appeal in *Smith v. Anderson.*

50 Cox v. Hickman, (1860) 8 H.L.C. 268, at 312 *per* Lord Wensleydale, 11 E.R. 431, at 449. See also Badely v. Consolidated Bank, (1888) 38 Ch.D. 238, at 247 *per* Cotton L.J.

51 Ford describes Unit Trusts as follows: "Basically a unit trust is an arrangement whereby property is held on trust for a large number of investors. It is constituted by a deed regulating the rights, powers and duties of the parties to the arrangement. These parties are usually a manager, a trustee and investors, the last being commonly known as unit holders. The manager purchases property and vests the title to it in the trustee who, at the outset, holds on trust for the manager. Sometimes the property is an estate in land or a mortgage thereof but most unit trusts are in respect of a portfolio of shares. In the ensuing discussion the former will be called a land-unit trust and the latter a share-unit trust. The beneficial interest is divided into a large number of units which are sold by the manager to investors." (*Unit Trusts,* (1960) 23 MOD. L. REV. 129).

52 (1879) 11 Ch.D. 170.

53 (1880) 15 Ch.D. 247.

James L.J.[54] could not find "that this deed constitutes any association whatever between the persons who are supposed to be *socii.* One man goes with £90 in his hands and buys from the trustees a £100 certificate with all the chance of profit attaching to it. Another man goes the next day and takes his £90 to the same people and gets from them another certificate, by which he gets a right to share in the funds which they have in their hands. The first man knows nothing of the second, and the second knows nothing of the first; they have never come into any arrangement whatever as between themselves. There never has been anything creating any mutual rights or obligations between those persons. They are from the first entire strangers who have entered into no contract whatever with each other, nor has either of them entered into any contract with the trustees or any trustees on behalf of the other, there being nothing in the deed pointing to any mandate or delegation of authority to anybody to act for the certificate holders as between themselves, and nothing, as it appears to me, by which any liability could ever be cast upon the certificate holders either as between themselves or as between themselves and anybody else. Therefore, I cannot arrive at the conclusion that the certificate holders form an association within the meaning of this Act of Parliament, any more than the persons who subscribe for debentures in a railway, or the Bolivian bondholders (whose case was before us in *Wilson v. Church*) or the creditors in *Cox v. Hickman.*"

In the opinion of Cotton L.J.[55] "what must be shown is that the association by themselves or by their agents carry on a business. Now, here, how can that be said? That the certificate holders do it by themselves can, I think, hardly be contended. All the power which the subscribers of this money had was to attend sometimes at meetings, and the meetings which were held most usually are those mentioned in clause 26. The only business done at them was to receive and consider a report from the trustees on the condition and affairs of the trust, to appoint auditors to audit the accounts, and to elect new trustees to fill up vacancies. It is impossible, in my opinion, to say that the certificate holders are by themselves in any way carrying on any business by reason of what is done at these meetings. . . . Then, can it be said that they carry on a business by their agents? In my opinion that cannot be maintained. The trustees here are the only persons who are dealing with the investments, and they are dealing, not as agents for some principal, but as trustees in whom the property and the manage-

54 *Ibid.,* at 274-5.
55 *Ibid.,* at 284.

ment of it are vested, and who have the power of changing the investments and securities."

He went on to say, that the mere fact that the trustees are to account to others for the profits made is a matter utterly immaterial as between them and those with whom they deal. They deal with those persons as the only persons contracting, and hold themselves out as personally liable. Those persons have no right whatever as against the persons beneficially entitled, nor, except possibly in the case of a testator having directed a part of his assets to be employed in the trade, have they any claim whatever against the assets of the testator.

As Professor Ford points out,[56] this decision of the Court of Appeal is clear authority for the proposition that the holders of interests in Unit Trusts are not members of an association or partnership within section 14 (3) of the Companies Act.

Such a conclusion, however, turns upon the fact that the trustees in those cases do not contract as agents of the certificate holders. Brett L.J.[57] in *Smith v. Anderson* specifically premised his judgment on the fact that "the persons called trustees in the deed are clearly trustees as distinguished from agents and from directors." In the case of persons who enter into a partnership agreement as trustees for others the position may well be different.

Will such a trustee be an agent for his beneficiaries, such as to make those beneficiaries partners? "A trustee is a man who is owner of the property and deals with it as principal, as owner, and as master, subject only to equitable obligations to account to some persons to whom he stands in the relation of trustee, and who are his cestue-que-trust."[58] Whereas an "ordinary partnership is a partnership composed of definite individuals bound together by contract between themselves to continue combined for some joint object, either during pleasure or during a limited time, and is essentially composed of the persons originally entering into the contract with one another."[59]

Although a trustee is not, generally speaking, an agent, there is nothing to prevent a trustee from becoming an agent. The main argument against there being a partnership in the Unit Trust cases stems from the absence of a contractual relationship between the

56 *Unit Trusts,* (1960) 23 MOD. L. REV. 133. See also Charles v. Federal Commissioner of Taxation, (1953-54) 90 C.L.R. 598, at 608-9, 611-2.

57 (1880) 15 Ch.D. 247, at 280.

58 *Ibid., per* James L.J. at 275.

59 *Ibid., per* James L.J. at 273.

certificate-holders *inter se*. If there were such a contractual relationship then it might lead to a quite different result.[60]

No distinction is drawn in any of the decisions between a trustee who enters into a partnership agreement and a person who enters into a partnership agreement as trustee. In one case it is quite clear that, although the beneficiaries can enforce their personal and proprietary rights against the trustee, they have no rights against the partnership as such. In the second case, the contracting party, i.e., the ostensible partner, contracts as trustee. If that contract can be enforced by the beneficiaries, it would seem inevitable that they are, to a large extent at least, in the same situation as partners.

It is true that "no stranger to the consideration can sue upon a contract though made for his benefit."[61] Moreover, "in the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it. Our law knows nothing of a *jus quaesitium tertio* arising by way of contract. Such a right may be conferred by way of property, as, for example, under a trust, but it cannot be conferred on a stranger to a contract as a right to enforce the contract in personam."[62]

It is equally clear, however, that when one person contracts as trustee for another, the trustee can enforce the contract on behalf of his beneficiary[63] and, if the trustee refuses to do so the beneficiary

60 The whole basis of Smith v. Anderson is that there is no contractual relationship between the beneficiaries. If there were (and such a relationship could arise by their each agreeing with the trustee that he should act as agent for all unit holders) they would appear to be members of an "association." In adopting this view Ford (*Unit Trusts* (1960) 23 Mod. L. Rev. at 134) relied on Clarke v. Earl of Dunraven [1897] A.C. 59. Since then such a line of reasoning has been confirmed by Rysfield v. Hands, [1960] 1 Ch. 1.

61 National Phonograph Company Limited v. Edison Bell Consolidated Phonograph Company Limited, [1908] 1 Ch. 335, at 346 *per* Joyce J.

62 Dunlop Pneumatic Tyre Company Ltd. v. Selfridge and Company Ltd.,[1915] A.C. 847, at 853 *per* Viscount Haldane L.C. See also Tweddle v. Atkinson, (1861) 1 B. & S. 393, 121 E.R. 762; Bourne v. Mason, (1669) 1 Vent. 6, 86 E.R. 5; Dutton and Wife v. Poole, (1678) 2 Lev. 210, 83 E.R. 523; Price v. Easton, (1833) 4 B. & Ad. 433, 110 E.R. 518; McGuther v. Pitcher, [1904] 2 Ch. 306.

63 Robertson v. Wait, (1853) 8 Ex. 299, 155 E.R. 1360; Les Affretèurs Rèunis Sociètè Anonyme v. Leopold Walford (London) Limited, [1919] A.C. 801; Lloyd's v. Harper, (1880) 16 Ch.D. 290. In this last-mentioned case Lush L.J. (at 321) said, "I consider it to be an established rule of law that where a contract is made with A. for the benefit of B., A. can sue on the contract for the benefit of B., and recover all that B. could have recovered if the contract had been made with B. himself. The books afford innumerable instances of the application of this doctrine." In Gandy v. Gandy, (1885)

may himself enforce the contract. The opinion of the Judicial Committee of the Privy Council in *Vandepitte v. Preferred Accident Insurance Corporation*[64] makes this clear beyond any possibility of doubt.

> "No doubt at common law no one can sue on a contract except those who are contracting parties and (if the contract is not under seal) from and between whom consideration proceeds. . . . but . . . a party to a contract can constitute himself a trustee for a third party of a right under the contract and thus confer such rights enforceable in equity on the third party. The trustee then can take steps to enforce performance to the beneficiary by the other contracting party as in the case of other equitable rights. The action should be in the name of the trustee; if, however, he refuses to sue, the beneficiary can sue, joining the trustee as a defendant."

In such circumstances the beneficiary, therefore, would be a party to the partnership contract and the person entitled in equity to enforce the terms of that contract against the other parties.

Apart from the cases where one person enters into a contract as trustee for a third party, there appears to be at least one other way in which persons can enter into a contractual relationship without either having actual cognizance of the other. *Clarke v. Earl of Dunraven*[65] involved in a situation very similar to that contemplated by James L.J. in *Smith v. Anderson*[66] when he said of the certificate holders, "The first man knows nothing of the second, and the second knows nothing of the first; they have never come into any arrangement whatever as between themselves."

In *Clarke v. Earl of Dunraven* the owner of a yacht entered it in a regatta, the rules of which provided that the owner of any yacht disobeying the rules should be "liable for all damages arising therefrom." The yacht committed a breach of the rules and as a consequence

30 Ch.D. 57, Cotton L.J. (at 66-7) said: "Now, of course, as a general rule, a contract cannot be enforced except by a party to the contract; and either of two persons contracting together can sue the other, if the other is guilty of a breach of or does not perform the obligations of that contract. But a third person—a person who is not a party to the contract—cannot do so. That rule, however, is subject to this exception: if the contract, although in form it is with A., is intended to secure a benefit to B., so that B. is entitled to say he has a beneficial right as cestui-que-trust under that contract; then B. would, in a Court of Equity, be allowed to insist upon and enforce the contract. That, in my opinion, is the way in which the law may be stated."

64 [1933] A.C. 70, at 79 *per* Lord Wright.

65 [1897] A.C. 59.

66 (1880) 15 Ch.D. 247, at 274.

fouled and sank another yacht. The owner of the sunken yacht recovered damages.

Lord Herschell[67] could not "entertain any doubt that there was a contractual relation between the parties to this litigation. The effect of their entering for the race, and undertaking to be bound by these rules to the knowledge of each other, is sufficient, I think, where those rules indicate a liability on the part of the one to the other, to create a contractual obligation to discharge that liability."

The fact that each yacht owner consented to be bound by a set of rules created an implied contract between the yacht owners *inter se*. Their Lordships do not make it clear whether the contracting parties must have knowledge of each other contracting party as an individual or merely knowledge that all those who have entered into the venture have agreed to be bound by the rules.

Applying the decision in *Clarke v. Earl of Dunraven* to the partnership situation, it would appear at least arguable that, if the persons who are formally partners know that one of their number is acting as trustee for other persons undisclosed and at whose behest he has become a partner, there may be a contractual relationship between the beneficiaries and the partners based on the partnership contract.[68]

Criteria for Partnership.

According to the Partnership Acts of the Australian States:[69]

"In determining whether a partnership does or does not exist regard shall be had to the following rules:—

(1) Joint tenancy, tenancy in common, joint property, common property or part ownership does not of itself create a partnership as to anything so held or owned whether the tenants or owners do or do not share any profits made by the use thereof.

(2) The sharing of gross returns does not of itself create a partnership whether the persons sharing such returns

67 [1897] A.C. 59, at 63.

68 Note the right to indemnity of a trustee-partner in such circumstances. "I take it to be a general rule that where persons accept a trust at the request of another, and that other is a cestui-que-trust, he is personally liable to indemnify the trustees for any loss occurring in the due execution of the trust." *per* Jessel M.R. in Jervis v. Wolferstan, (1874) L.R. 18 Eq. 18, at 24. See also Hardoon v. Belilios, [1901] A.C. 118; Matthews v. Ruggles-Brise, [1911] 1 Ch. 194; Fraser v. Murdoch, (1881) 6 App. Cas. 855. Strangely, however, the doctrine of subrogation does not appear in such cases to avail the creditors of the trustees.

69 N.S.W. sec. 2; Qld. sec. 6; S.A. sec. 2; Tas. sec. 7; Vic. sec. 6; W.A. sec. 8.

have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived.

(3) The 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 the receipt of such a share or of a payment contingent on or varying with the profits of a business does not of itself make him a partner in the business."

The sections then go on to state a number of particular circumstances in which receipt of a share of the profits does not of itself make a person a partner.

This provision does not help us very much, for it defines partnership in a purely negative way. It leaves very many questions unanswered. This is particularly true of sub-section (3) which, although its precise terms are explicable, is, in the absence of abnormally sophisticated reasoning, inherently self-contradictory in its application.

North J. in *Davis v. Davis*[70] explained it in this way:

"These phrases appear somewhat conflicting but I do not think there is any real difficulty in understanding them . . . . the receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in it, and if the matter stops there, it is evidence upon which the court must act. But, if there are circumstances to be considered, they ought to be considered fairly together; not holding that a partnership is proved by the receipt of a share of profits unless it is rebutted by something else, but taking all the circumstances together, not attaching undue weight to any of them, but drawing an inference from the whole."

This, it is respectfully submitted, is a way out of the dilemma. It does not, however, appear to be what the Legislature has actually said. Even if it is a correct interpretation of the Legislature's intention, it does not really help in deciding whether a particular relationship is a partnership.

What ingredients are essential to categorize persons as members of a partnership?

The classic statement of the law on this point (and by this I mean the statement from which most judgments and most text writers

70 [1894] 1 Ch. 393, at 399.

start)[71] is contained in *Cox v. Hickman.*[72]

> "It is often said that the test, or one of the tests, whether a person not ostensibly a partner, is nevertheless in contemplation of the law, a partner, is whether he is entitled to participate in the profits. This no doubt, is, in general, a sufficiently accurate test; for a right to participate in profits affords cogent, often conclusive evidence, that the trade in which the profits have been made, was carried on in part for or on behalf of the person setting up such a claim. But the real ground of the liability is, that the trade has been carried on by persons acting on his behalf. When that is the case, he is liable to the trade obligations, and entitled to its profits or to a share of them. It is not strictly correct to say that his right to share in the profits makes him liable for the debts of the trade. The correct mode of stating the proposition is to say that the same thing which entitles him to the one makes him liable to the other, namely the fact that the trade has been carried on on his behalf, i.e., that he stood in the relation of principal towards the persons acting ostensibly as the traders, by whom the liabilities had been incurred and under whose management the profits have been made."

It is clear that mere receipt of a share of net profits does not *of itself* constitute partnership nor does joint ownership of property *of itself* create a partnership. Something more is needed. The existence of mutual rights and obligations combined with a share of the profits appears to be widely accepted as *the* test to be applied.

In *Smith v. Anderson*[73] James L.J. said that: "Persons who have no mutual rights and obligations do not, according to my view, constitute an association because they happen to have a common interest or several interests in what is to be divided between them." "Such mutuality" says Higgins,[74] "can only arise if the parties have the power to enforce their rights against their associates, and are under a legal duty to perform their obligations to those associates."

Is this sufficient to constitute the beneficiary a partner?

> "The real test of partnership seems to be whether the parties

71 See for example, LINDLEY ON PARTNERSHIP, (12th ed.) 79; HIGGINS, THE LAW OF PARTNERSHIP IN AUSTRALIA AND NEW ZEALAND, 67; Badeley v. Consolidated Bank, (1888) 38 Ch.D. 238, at 258-9, 261-2; POLLOCK ON PARTNERSHIP, (15th ed.) 19-20.

72 (1860) 8 H.L.C. 268, at 306 *per* Lord Cranworth, 11 E.R. 431, at 446.

73 (1880) 15 Ch.D., at 275.

74 THE LAW OF PARTNERSHIP IN AUSTRALIA AND NEW ZEALAND, 56.

are carrying on the business as principals and agents for each other."[75]

The principal-agent test is accepted in a number of other cases also, but in view of the precise provisions of the legislation, appears to be somewhat circular.[76]

In *Badeley v. Consolidated Bank*[77] Bowen L.J. said rather optimistically:

> "The real test is that which is decided by a catena of cases beginning with *Cox v. Hickman* and ending, I hope, with this case, though I am not sure of that. The question is whether there is a joint business or whether the parties are carrying on business as principals and agents for each other. . . . You have a group of facts—A, B, C, D, E and F, and you want the right conclusion to draw from them. The right way is to weigh the facts separately and together, and to draw your conclusion. It is not to take A, and say that if A stood alone it would shift the onus of proof, and then to look over B, C, D, E and F and see if the remainder of the proof is sufficient to rebut the presumption supposed to be raised."

Looking at all the facts in the present case and applying any criteria which can be derived either from the Acts or from the cases can it be said, either where the trustee contracts as trustee or where *Clarke v. Earl of Dunraven*[78] applies, that the beneficiaries are not partners?

In such circumstances, not only have the beneficiaries a right in equity to a share of the net profits, a right in equity to a share of any

75 Ballans v. Kleinig, [1925] S.A.S.R. 227, at 231 *per* Richards A.J.

76 Note that the Partnership Acts (N.S.W. sec. 5; Qld. sec. 8; S.A. sec. 5; Tas. sec. 10; Vic. sec. 9; W.A. sec. 26) specifically provide that "Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership, and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter and the person with whom he is dealing either knows that he has no authority or does not know or believe him to be a partner." Hence partners are agents for each other. Which comes first the agency as a test of partnership or the partnership as proof of agency?

77 (1888) 38 Ch.D. 238, at 261-2.

78 [1897] A.C. 59. It is not proposed to canvass in detail the implications of this case or how narrowly it should be construed. Whatever its ambit, it is possible for it to apply to a situation where the other partners know that the trustee has entered into the partnership contract at the behest of others who are in equity entitled to his share of the profits and of surplus on dissolution. See further note 68 (*supra*).

surplus on dissolution and a right to enforce the contract in equity. They have also, it is submitted, an equitable interest in any partnership property.

If there is partnership property in which they can claim an interest the beneficiaries have an equitable interest in specific assets. Although the doctrine of conversion (and now the Partnership Acts) turns all interest in partnership property into personalty as between the partners on the basis that the partners' only rights are to share profits and, on dissolution, to share any surplus of assets over liabilities—all partnership property must have both a legal and an equitable owner (or owners) during the continuance of the partnership. If A is trustee for B, any estate or interest properly obtained by A with the trust funds belongs in equity to B. Therefore, the equitable estate in the partnership property, whether it be realty or personalty, will belong in equity not to the ostensible partners but to the "beneficiaries" and those partners who are partners on their own behalf.[79]

Applying any of the accepted tests to such a situation, surely the beneficiaries are partners? Strangely, the text-books tend to indicate the opposite.

On the question of receipt of profits, Lindley[80] states that "the character in which a portion of the profits was received did not affect the results. For a person who as executor or trustee merely employed money in trade or business, and shared the profits arising from it, incurred all the liabilities of a partner, although he in fact had no interest whatever in the matter. On the other hand, the *cestuis-que-trust* were also liable; the creditors having an option against which of two they would proceed."

79 It is true that it was held in England (prior to 1925), in In re Kipping, [1914] 1 Ch. 12, that, where an estate consisted of realty a person was not entitled to have his undivided share handed over to him upon becoming absolutely entitled because it was notorious that such a course was less advantageous than retaining the whole of the real property. But as Harman J. points out in In re Weiner, [1956] 1 W.L.R. 579 at 582-3; "However that may be, in the case of In re Marshall, [1914] 1 Ch. 192, it was said quite clearly, in the Court of Appeal that the principle of In re Kipping has no application to personal estate. In re Marshall, I may say, was a case of the dividing of shares in a public company. Lord Cozens-Hardy M.R. said: 'Speaking generally, the right of a person, who is entitled indefeasibly in possession to an aliquot share of property, to have that share transferred to him is one which is plainly established by law.' Then he said that that was not true in the case of real estate if the person were to take an undivided share. He continued: 'But that doctrine, it seems to me, has no application, apart from special circumstances, to personal property'."

80 LINDLEY ON PARTNERSHIP, (12th ed.) 77.

This might indicate that the beneficiary is a partner, but in a footnote to this paragraph Lindley refers to *Goddard v. Hodges,*[81] where the Court of Exchequer, in a case where one person became a partner as trustee for another, held that the beneficiary was the real partner and that the incidents of partnership devolved upon him. Of this decision, Lindley says "In this case the court held that the *cestui-que-trust* was liable to creditors, and that *therefore*[82] he could not sue the co-partners of his own trustee. But surely this was wrong. There was no partnership between the plaintiff and defendants, no contract between them."

If this be the basis, and the sole basis of Lindley's criticism of *Goddard v. Hodges,* it appears to beg the whole question.

In putting forward the proposition that "the *cesui-que-trust* clearly does not become a partner with the partners of his trustee," Lindley[83] rejects *Goddard v. Hodges* and relies on *Jefferys v. Smith,*[84] *Newry Rly Co. v. Moss,*[85] and *Bugg's Case.*[86]

None of these cases can be described as exactly modern and their validity in the context of the present question must be rather doubtful.

Jefferys v. Smith certainly does not bear out Lindley's view. The question there in issue was whether persons to whom an interest in a partnership had been assigned were partners and whether the assignor was still a partner. The Court refused to take cognizance of any equitable rights *inter se* of a person who acted as a partner under an executory contract which never became executed and his assignor but in relation to a second assignment Copley M.R. said:[87]

> "It is said that the assignment was colourable; that is, that it was made for the sake of securing the assignor from future liability. Suppose he made it with that view, he had a right so to protect himself from future liability. It is alleged that the assignee was not a responsible person. Let it be so; Guppy, for the purpose of securing himself, had a right to assign to a person not responsible. The only ground of objection would be, that, though there was an assignment in form, there was an understanding between the parties that the assignee should be a trustee

81 (1832) 1 Cr. & M. 33, 149 E.R. 303.
82 A partner could not recover from his co-partners except on a taking of accounts.
83 LINDLEY ON PARTNERSHIP, (12th ed.) 597.
84 (1826) 3 Russ. 158, 38 E.R. 535.
85 (1851) 14 Beav. 64, 51 E.R. 211.
86 (1865) 2 Dr. & Sm. 452, 62 E.R. 692.
87 (1826) 3 Russ. 158, at 167, 38 E.R. 535, at 539.

for the assignor. Here there is no pretence for such a supposition."

It is implicit that if the assignee held on an express trust for the assignor, the assignor-beneficiary would be a partner.

Bugg's Case was concerned with the proposition (now embodied in section 156 (4) of the Companies Act)[88] that a company is not affected by notice of trusts. It is clear authority only for the proposition that a beneficiary is not a contributory in the winding-up of a company in which his trustee holds shares.

In *Newry Railway Co. v. Moss* a bill by a railway company seeking to compel payment of calls by a mortgagee of shares not standing in his own name, was held not to be sustainable. The learned Master of the Rolls (Sir John Romilly) said:[89]

> "It is said that this Court will enforce the relation between trustee and *cestui-que-trust*. Of that I have no doubt; but trusts are only enforced in this Court at the instance of the parties to the trust—that is, either of a trustee who comes to have the property administered, or of the *cestui-que-trust,* to enforce the benefit of it. If any trust existed in this case, Mr. Sudlow was the trustee and Moss & Co. were the *cestuis-que-trust;* and I have no doubt, that if Mr. Sudlow had been living and solvent, and had paid up the calls to the company, he would have a right, in this Court, to compel Moss & Co. to reimburse him the calls which he had paid. Neither do I doubt that if Sudlow had claimed the shares for his own benefit, Moss & Co. (assuming them to be the equitable owners of the shares) might have enforced the beneficial use of the shares against Sudlow, although they could not, as against the company, either have voted, or have enforced the payment of the dividends. But what relation of trustee and *cestui-que-trust* is there between the railway company and Moss & Co.? I am unable to see any."

There also, however, his Lordship was dealing with a situation to which the Companies Clauses Consolidation Act[90] applied, not with a mere partnership. Secondly, of course, the trustee (if he be such) had not contracted as trustee.

Bunn's Case[91] (which was relied on by counsel in *Bugg's Case*)

88 At that time embodied in sec. 20 of the Companies Clauses Consolidation Act, 8-9 Vict. c. 16.

89 (1851) 14 Beav. 64, at 69-70, 51 E.R. 211, at 213.

90 8-9 Vict. c. 16. Under that Act a company was not affected by notice of a trust (sec. 20), calls could be made on *shareholders* (sec. 22) and production of the register was *prima facie* evidence of proprietorship (sec. 28).

91 (1860) 2 De G. F. & J. 275, 45 E.R. 627.

was also concerned with the question of who were contributories in the winding-up of a registered company. Once again it was held that a beneficial owner who was not registered as a shareholder could not be treated as a contributory.

Turner L.J. said[92] that "a *cestui-que-trust* may be liable to indemnify the trustee, but he is not liable to the company," but such a statement bears no necessary relevance whatsoever to the problem here in question.[93]

These cases carry very little weight as authority for the proposition that a beneficiary, whose trustee, in his capacity as trustee, is a member of a partnership, cannot thereby become a member of that partnership.

The true test, surely, is what rights are given to the beneficiary as regards the other partners? Higgins,[94] however, also appears to take the view that a beneficiary is not a partner. He says that "although the beneficiaries under a will or trust may derive a benefit from a business carried on by the trustee, that business is not carried on by the trustee in partnership with the beneficiaries." This statement would, of course, be much more accurate if it read "not necessarily carried on."

Higgins then goes on to support this proposition by pointing out the differences between an agency or partnership relationship and the trustee-beneficiary relationship.

The difference between these relationships cannot be denied. What is, however, rather dubious is the argument that because a trust relationship differs from a partnership relationship, therefore, a trustee is not in partnership with his beneficiaries, nor are the beneficiaries in partnership with each other, nor are the beneficiaries in partnership with the partners of the trustee. Whether the beneficiaries are in partnership with any, and if so, what person, depends not on the name that is given to the relationship but on the precise legal rights and duties flowing from the situation in which the beneficiaries find themselves.

Despite the broad statements to the contrary in the text-books, it is submitted that, if a trustee enters into a partnership contract as trustee, all the criteria necessary to constitute the beneficiaries members of the partnership are present.[95] Even where the trustee does not

92 *Ibid.*, at 300.
93 See note 68 (*supra*).
94 THE LAW OF PARTNERSHIP IN AUSTRALIA AND NEW ZEALAND, 55.
95 They can enforce the partnership contract; they are entitled to a share of

specifically contract as trustee, if the other partners know that in entering into the contract he is acting as trustee and is specifically authorized by the beneficiaries to do so, the same criteria would appear to be present.[96]

Hence, beneficiaries of trustee-partners will normally be members of the partnership and, a fortiori, will, at least, be members of an "association" such as is contemplated by sec. 14 (3) of the Uniform Companies Act. This does not mean that, as a device to increase the number of people participating in the control and profits of an unincorporated business enterprise, the trustee-partnership concept is necessarily abortive.

It is merely essential that the relevant trust deed be drafted in such a way as to remove the criteria of partnership or association.

The Trust Deed.

In order that the trustee-partnership concept can be used to provide a solution to some of the problems presently confronting the promoters of small or localised business ventures, it is necessary that the trust deed, by which the relationship of trustee and beneficiary is created, be so framed as to exclude many of the equitable rights which would otherwise accrue to the beneficiaries.

To achieve this result it is necessary to draw a clear distinction between the partnership rights which the trustee possesses and the money which the trustee receives from the partnership.

If the trust does not attach to any monies or other property until such monies or property is actually received by the trustee, whether by way of distribution of income or distribution of surplus assets on dissolution, and if the beneficiaries are not able to enforce the partnership contract, the beneficiaries, it is submitted, are neither partners nor members of an "association."

Both this proposition and the way in which it can be implemented are better explained by illustration than elaboration.

The Trust deed should contain clauses to the following effect:—

> "1. The Trustee declares that he holds all profits which he shall derive from the said partnership in each and every year in trust for the beneficiaries respectively in proportion to the amount which each beneficiary has or shall at the com-

the net profits; they are entitled to a share of the surplus on dissolution; they have an equitable interest in any partnership property.

96 See Clarke v. Earl of Dunraven, [1897] A.C. 59.

mencement of such year have contributed for investment which amount shall be conclusively determined by the several amounts which shall at the commencement of such year be set out after the respective names of the beneficiaries in the second schedule hereto.

2. The trustee further declares that he shall hold in trust for the beneficiaries in the proportions referred to in Clause 1 hereof any sums which the trustee may receive from the partnership or from the proceeds of the partnership assets on the dissolution of the said partnership.

3. The trust herein created does not attach to the income of the partnership or any part thereof as such nor does it attach to any surplus of assets over liabilities as such in the event of the dissolution of the partnership. It attaches only to such monies as are actually received by the trustee.

4. The beneficiaries neither have nor shall have any interest whatsoever equitable or legal in the property of the partnership and no rights arising out of or in connection with the partnership its assets or its business save as hereinbefore set out.

5. The beneficiaries may not in any manner whatsoever interfere whether directly or indirectly in the conduct of the said partnership or of the said business.

6. The trustee's rights as a partner in the said partnership shall be unaffected by the trust hereby created. The trustee may exercise or refrain from exercising his rights as partner or any such rights entirely at his own discretion. The full legal and beneficial interest in the said partnership is vested in the trustee absolutely."

If this is done the beneficiaries will be neither partners nor *socii*. Whatever the number of beneficiaries, sec. 14 (3) of the Uniform Companies Act will have no relevance except as regards the number of ostensible partners.

Transferability of Interest.

One other factor which must be borne in mind is that, in order to possess the maximum degree of usefulness, the device should allow for the transfer of the beneficial interests.

It will be remembered that one of the criteria by which James L.J. in *Smith v. Anderson*[97] distinguished an "association" from a

[97] (1880) 15 Ch.D. 247, at 273. See note 40, (*supra*).

partnership was that an association's membership could be in a state of constant change with the intention that these changing partnerships should, so far as possible, have rights of succession one to the other.

The transfer by a partner of his partnership rights creates certain difficulties. It appears, however, that, even in the case of an orthodox partnership it can be done. A partnership deed may permit of the introduction of new partners.[98] Lindley[99] says:

> "If partners choose to agree that any of them shall be at liberty to introduce any other person into the partnership, there is no reason why they should not; nor why, having so agreed, they should not be bound by the agreement. Persons who enter into such an agreement consent prospectively and once for all to admit into partnership any person who is ready to take advantage of their agreement, and to observe those stipulations, if any, which may be made conditions to his admission."

Clearly, this statement of the law involves the proposition that a partnership agreement can give to a third party rights against the partnership, rights in fact to become a partner. If the partners themselves contract as trustee for these future "partners" then the future "partners" may, in fact, enforce the partnership agreement even though they are not parties to the partnership deed.

Lindley continues:[1]

> "If therefore the other partners refuse to admit the new partner, or to do and execute the acts and deeds necessary for conferring upon him the rights of a partner, he is entitled as against them to such relief as the courts are in the habit of granting to partners and as may be appropriate to the circumstances of the case, as, for example, to an injunction to prevent his exclusion from the business, or to an account, or to an order for the execution of the proper deeds, or even to a dissolution—subject to his fulfilling on his part such conditions of his admission as may be contained in the agreement under which he is introduced."[2]

Halsbury makes a similar statement of the law:[3]

98 Technically at each change of membership there will be created a new partnership, but these partnerships may have total succession one to the other.

99 LINDLEY ON PARTNERSHIP, (12th ed.) 395-6.

1 *Ibid.*, at 396.

2 As authority for this proposition—LINDLEY cites Byrne v. Reid, [1902] 2 Ch. 735 and Ehrmann v. Ehrmann, (1894) 72 L.T. 17.

3 28 HALSBURY'S LAWS OF ENGLAND (3rd ed.), 535.

> "Recognition by the other partners may, however, confer the rights of a partner on the assignee, and a partnership may be so constituted that the assigning of a share places the assignee in the position of the assignor."

In the case of a Trustee-Partnership, set up in the way suggested in this article, there is no difficulty whatsoever in authorising a transfer of beneficial interest. Transferability can be achieved by inserting in the Trust Deed such clauses as:

> "7. Any person desiring to contribute money to be invested pursuant to the provisions of this trust deed after the date of execution hereof may do so with the consent of the trustee and shall become a beneficiary hereunder and a party hereto upon contributing such money and executing a copy of this trust deed by signing in the second schedule hereto.
>
> 8. The names of persons shall be added to or removed from the second schedule hereto and the amount of any contribution inserted or deleted after such names as and when such persons become or cease to be beneficiaries hereunder.
>
> 9. The execution by a new contributor of a copy of this trust deed and the receipt by the trustee of the money contributed by the new contributor shall be sufficient authority to the trustee to add such new contributor's name to the second schedule hereto and to insert after such name the amount of the contribution so received.
>
> 10. The interest or interests of any beneficiary hereunder shall be assignable without the consent of the trustee and shall be effected by the giving of notice to the trustee in the form in the first schedule hereto signed by the beneficiary.
>
> 11. The receipt by the trustee of a notice in the form in the first schedule hereto signed by a beneficiary or payment by the trustee pursuant to clause 12 hereof shall be sufficient authority to the trustee to delete the name of a beneficiary from the second schedule hereto.
>
> 12. A beneficiary requiring repayment of his contribution shall give to the trustee six months' notice in writing and on the expiration of the said six months the trustee shall [subject to any limitations on return of beneficiaries' money which it is otherwise desired to impose] pay to such beneficiary the amount of the contribution set out after the name of such beneficiary in the second schedule.

Conclusion.

In addition to these clauses and those relating to the nature of the beneficiary's interest, care should be taken to give the beneficiaries power to appoint a new trustee. The trustee should be given an indemnity by the beneficiaries; and he in turn should undertake (i) not to transfer sell or otherwise dispose of his interest in the partnership without the consent of the beneficiaries, (ii) to distribute the proceeds of any such sale etc. amongst the beneficiaries, (iii) pending such distribution to hold such proceeds on trust, and (iv) on the appointment of a new trustee, to transfer his partnership interest to such new trustee. The other partners should be parties to the trust deed for the purpose of consenting prospectively to such transfer, or alternatively, the partnership deed should contain the necessary provision for the introduction of new partners.

The detailed provisions of such a deed depend on the precise agreement reached between the parties. Properly drafted, however, and with some expansion of the matters referred to herein, a trust deed creating a trustee-partnership relationship has at the present time considerable advantages as a means of floating a small or localised[4] business venture.

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[4] It may be that it even gives to the beneficiaries some degree of limited liability, so long as the Courts continued to refuse to subrogate the creditors to the trustee's rights of indemnity against the beneficiaries.

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