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Individual Liability of Holders of Shares in Business Trusts

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any losses that should occur in the business during a stipulated period.[47]

When the plaintiff's right of recovery arises out of a contract of settlement between the partners, by which the defendant is to pay for his partner's interest in the partnership properties, the suit is not in equity but at law.[48] And where the plaintiff's right to the amount sued for did not grow out of a partnership arrangement between him and the defendants, but out of a contract by which they were to pay him that sum as the purchase price for a sale to them of a part interest in the properties, the suit is not one in equity.[49]

One partner may sue another at law for fraud in inducing the partnership. In the case of *Gilliam v. Loeb,*[50] one of several partners induced the others to contribute a share of money for the purpose of buying property, misrepresenting to them the purchase price so that they paid more than the property cost, and he pocketed the excess. The court held that each of the partners so defrauded could bring a separate suit to recover the excess of his contribution to the purchase price, without any joinder of parties. It was pointed out that where fraud entered into a proposition the latter is thrust onto an independent footing and segregated from all partnership affairs at the option of those defrauded. Furthermore, as Judge Goode intimated, the whole firm was not defrauded, but only the individual partners.

All in all, the cases examined, directly or by way of inference, point to the conclusion that until an accounting is had and a balance struck, the relation of debtor and creditor does not exist between partners so as to permit an action at law between them, (1) unless by their mutual agreement the partners have dealt with each other in such a way that the subject of their agreement is so segregated from partnership affairs that each man deals solely as an individual, or (2) unless there never has been an occasion for accounts to arise, or (3) unless one partner by acts which are wrongful to his co-partners in their individual capacities affects a segregation of any item. Insofar as *Willis v. Barron* is apposite this conclusion, it is hoped that the Missouri courts, which have cited it almost religiously on every question affecting the relations between partners, will reverse themselves and declare the intention of the legislature in passing the joint debtors' statute to give new rights to third persons, but not to joint obligors themselves.

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INDIVIDUAL LIABILITY OF HOLDERS OF SHARES IN BUSINESS TRUSTS

Men are ever seeking means of doing business which involve the least possible financial risk to themselves. The trust, which is of ancient lineage, is now enjoying the favor of many business men, under the

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[47] Whiteheill v. Shickle, 43 Mo. 537; Stone v. Windover, 2 Mo. App. 247.
[48] Bigham v. Tinsley, 149 Mo. App. 467.
[49] Crocker v. Barteau, 212 Mo. 350.
[50] 131 Mo. App. 70; also Nicholas v. Haddock, 180 S. W. 31.

guise of the Massachusetts or business trust. It is called a common law trust "because it finds its basis in the law of contracts and does not depend upon any statutes for its existence." The purpose behind it is the avoidance on the one hand of individual partnership liability and on the other hand of the many corporation taxes and burdens. But the fact that these are its prime objectives does not make it illegal or contrary to public policy, and the great weight of authority has so held.[1] Unfortunately for the organizers, however, several jurisdictions, notably Texas, have failed to recognize the intention of the parties as expressed in the trust agreement, and have held them liable as partners.

A business trust is created by a declaration of trust wherein the legal title to property which is the subject of the trust is transferred to one or more trustees. Certificates are issued to the *cestuis que trustent* which represent the proportionate share of each. The shares are, as a rule, transferable, and the death of a shareholder has no effect upon the life of the trust. Superficially, a trust more nearly resembles a corporation than a partnership. For the charter, there is the declaration of trust; for the board of directors, there are the trustees; for the capital, there is the corpus of the trust; for the stockholders there are the beneficiaries; and for the shares of stock there are the shares representing the beneficial interest of the members.[2] But it must not be forgotten that it is not illegal for a partnership to have transferable shares, and for its business to be conducted by managers chosen for that purpose.[3]

Whether the declaration of trust creates a pure trust or a partnership, with is corresponding personal liability, can be determined only by examining the words used. The intent as gathered from the whole of the instrument is the controlling factor, and that intent is to be ascertained by determining the amount of control the members have. If they have the power to control the trustees and the management of the business, the partnership relation exists; but if the trustees have absolute control over the management the trust relation exists. This is the Massachusetts rule.[4] Where the magic line is to be drawn in cases in which the members have a slight degree of control, or meetings are provided for, is not certain. However, where the declaration of trust strips the members of every vestige of control, there does not seem to be any just reason for holding them liable as partners. They are then in the position of lending money to the trustees for a share of the profits in lieu of interest;[5] and *Cox v. Hickman* exploded the idea that sharing in profits is the test of a partnership.

In Missouri, the liability of members of a business trust has been passed upon for the first time in the recent case of *Darling v. Buddy,*[6] where the precise point decided was that if the members of the trust

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[1] See 46 A. L .R. 178; Baker v. Stern, 216 N. W. 147 (Wis.).
[2] Schumann-Heinck v. Folsom, 159 N. E. 250 (Ill.).
[3] Ashley v. Dowling, 203 Mass. 311, 89 N. E. 434.
[4] Williams v. Milton, 215 Mass. 1, 102 N. E. 355.
[5] Betts v. Hackathorn, 252 S. W. 602 (Ark.).
[6] 1 S. W. (2nd) 163.

have no control over the management of the business, no partnership liability exists. As to what the ruling would be if the members had some control over the trustees or the management, the case is silent; but one may infer from the length the court went to show the absence of control that if there were any, the members would be liable as partners. Thus, Missouri would seem to be in accord with the better and probably greater weight of authority. The facts in the case are simple. A "syndicate" was formed for the purpose of buying a railroad. Title to the entire capital stock of the railroad and to all moneys paid by the subscribers was vested in five persons, designated as "syndicate managers," who were authorized to use the property according to their own judgment for the general purpose outlined in the agreement. They had the power to select their own successors. The subscribers had no power to control the "syndicate managers" in any way, to fill any vacancy, or to remove any manager; nor was there a provision for any meeting of the subscribers, nor any power given them of amending the terms of the agreement. All the subscribers had was "an interest or right, measured by the amount of their advancements to share in the profits, if any, or in the property remaining, if any, upon the closing of the enterprise by the managers." So, the Missouri Supreme Court rightly lays down the rule that the true test to determine whether it is a trust or a partnership is one of control by the trustees and not merely of investment by the subscribers; that participation in profits is not sufficient to create a partnership *inter sese,* but the parties "must also have agreed that they intended to share the losses and become partners." Since, therefore, in a pure trust, the members have no power of control over the trustees and have divested themselves of the legal title, it is obvious that the trustees, with legal title to the property, do not act as the agents of the members, but rather as principals on their own behalf, and hence are personally liable on their contracts. The trust estate is not the principal, for it cannot promise; so the trustee is bound, for otherwise no one would be bound. Viewed in this light, the pure trust cannot be treated as a partnership, for the latter is, in effect, a contract of mutual agency.

As before stated, the Texas courts have almost uniformly held that the members of a business trust are liable as partners, some of the courts going to the extent of intimating that participation in profits creates a partnership. In *Thompson v. Schmitt,*[7] the shareholders reserved no control at all over the trustees, yet the trustees were held to conduct the business as "chosen agents."[8] The Supreme Court said, "We have no difficulty whatever in regarding the parties by whom the business was to be managed and conducted, though denominated trustees, as actual agents of the certificate holders, all authority they possessed was delegated to them by the shareholders, through their joinder in the articles, either when originally executed or when subsequently adopted. Not only did the trustees exercise purely derivative power, but it was exercised for and on behalf of the certificate holders."[9] It was further

[7] 274 S. W. 554.
[8] For a criticism of the court's reasoning in this case see 4 Texas L. Rev. 57.
[9] Another statement of the rule may be found in Wineinger v. F. & S. Loan

held that even though the creditor has knowledge of the terms of the declaration of trust, the members are bound, where there is no express agreement to look only to the assets of the trust.[10] As a logical result of the Texas rule, the members of the trust must all be joined in an action against the trust,[11] in the absence of a statute changing the common law.

In Kentucky, the broad rule has been laid down that the liability of shareholders in a business trust is that of partners. But the rule is broader than the facts in any Kentucky case justify. In *Ing v. Liberty National Bank*,[12] for example, where a so-called unincorporated syndicate (in reality a business trust) was held to be a partnership, there were meetings of shareholders from time to time, and the note sued on was a renewal of one authorized at a meeting of the members. Moreover, the three cases cited and relied upon[13] do not go to the extent the court supposes.

By reason of a constitutional provision similar to the one in force in Missouri,[14] the Kansas courts construe business trusts to be corporations; and having failed to comply with the corporate law, the members are held individually liable.[15] Such at least was the holding in *Weber Engine Co. v. Barley et al.*[16] This case came up on demurrer, and no facts were given, nor did the court do more than state the rule, contenting itself by saying that it was controlled by the earlier decisions of *Weber Engine Co. v. Alter*,[17] and *Linn v. Houston*.[18] Neither of these cases, however, actually decided more than that the trustees were personally liable.

In Indiana, in spite of a recent decision,[19] the question of the liability of members of business trusts still seems an open one. In *McClaren v. Dawes Electric Sign and Mfg. Co.*[20] where the trustees had exclusive

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and Investment Ass'n, 278 S. W. 932 (Tex. Civ. App.), where it is said, "It seems to be well settled in Texas that when two or more parties engage in a business enterprise under what is variously called a trust agreement, articles of association, or declaration of trust, all the members of such association are liable to third parties under the general law of partnership, unless relieved from such liability by express contract with their creditors."

[10] Such a contract for exemption from personal liability was held to exist in Shelton v. Montoya Oil & Gas Co., 292 S. W. 16 (Tex. Com. App.).

[11] Feldman v. Leay, 291 S. W. 350.

[12] 216 Ky. 467, 287 S. W. 960.

[13] 172 Ky. 693, 189 S. W. 914; 203 Ky. 127, 261 S. W. 868; 203 Ky. 599, 262 S. W. 969.

[14] "The term corporations . . . shall include all associations and joint-stock companies having powers and privileges not possessed by individuals or partnerships," Kans. Const. Art. 12, Sec. 6. The Missouri provision is Art. 12, Sec. 11.

[15] But the Missouri case of Darling v. Buddy, *supra*, points out that in a pure trust there is no association among the members, either in the ownership of the property or in its management or control.

[16] 123 Kans. 665, 256 P. 803.

[17] 120 Kans. 557, 245 P. 143.

[18] 123 Kans. 409, 255 P. 1105.

[19] McClaran v. Dawes Elec. Sign & Mfg. Co., 156 N. E. 584.

[20] 156 N. E. 584.

control of the management, the Supreme Court said in emphatic language, "There is no law in this state statutory or otherwise, authorizing or recognizing the right to organize an association for the purpose of conducting a mercantile business under a declaration of trust and thus evade the statutes concerning the organization of corporations or through which the shareholders can escape their liabilities as partners." But the judgment went only against the trustees, and the court did not criticize the action of the lower court in not rendering a judgment against a shareholder who was not a trustee.

Other jurisdictions which apparently decide in favor of partnership liability without making the distinction between the pure trust and those in which the members retain some degree of control include Louisiana and Florida. But the cases so holding are unsatisfactory as authorities. In *American National Bank v. Reclamation Oil Producing Ass'n.,*[21] the terms of the trust are not set out, while in *Willey v. Hoggson,*[22] it was decided that an agreement between two or more persons, joint owners or owners in common of property, by which one or more of such persons are designated as "trustees" to manage, sell, or otherwise trade with such fund constitutes a partnership or joint-stock company "because such a so-called trust . . . is nothing but a veiled and futile effort to avoid the liability of a copartnership and acquire the privileges and immunities of a corporation without complying with the corporations laws of the state."

It would seem that the cases in Texas, Kansas, Kentucky, Louisiana and Florida are wrong on principle, insofar as they assume to impose partnership liability upon the members of a pure trust, and that the well reasoned cases in Massachusetts[23] state the correct rule. Other jurisdictions applying the same test include Arkansas,[24] Rhode Island,[25] New York,[26] Illinois,[27] and England.[28] The recent Illinois case of *Schumann-Heinck v. Folsom, supra,* contains a clear and concise summary of the better line of reasoning.

The difficulty in the past has been to get the courts to realize that business trusts may be separate and distinct from partnerships, joint-stock companies, and corporations and that there is no necessity to attempt to squeeze the trust into one of these categories. The courts have been afraid of being unfair to stockholders in corporations who point to the burdens the limitation of liability entails and to partners whose liability is so great. But it would seem that the surrender of legal title and of control is a sufficient penalty to impose upon members of a business trust.

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[21] American National Bank v. Reclamation Oil Prod. Ass'n., 156 La. 652, 101 So. 10.

[22] Willey v. Hoggson Corp., 90 Fla. 343, 106 So. 408.

[23] Note 4, *supra.* [24] Note 5, *supra.*

[25] R. I. Hospital Trust Co. v. Copeland, 39 R. I. 193, 98 Atl. 273.

[26] Jones v. Gould, 209 N. Y. 419, 102 N. E. 721.

[27] Schumann-Heinck v. Folsom, 159 N. E. 250.

[28] Smith v. Anderson, 15 Ch. Div. 247.