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FIDUCIARY DUTY OF PARTNERS*

Partnership

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I. INTRODUCTORY

Familiar among lawyers and students of law is the principle that partners have fiduciary responsibilities to each other. Similar fiduciary duty is owed by an agent to his principal, a trustee to his **cestui que** trust, a guardian to his ward, an attorney to his client, an executor or administrator to the next of kin of the decedent, directors and corporate officers to the corporation.[1]

To say that a man is a fiduciary only provokes analysis; it implores us to further inquiry. What obligations does a fiduciary owe, and to whom? In what respects has he breached this fiduciary obligation? When does this fiduciary duty begin and when does it terminate?

This article seeks to answer these questions with regard to a partner's fiduciary duty to his copartners, when he clandestinely renews or buys the property leased to the partnership and when he secretly engages in business on his own. Although this study is based primarily on Anglo-American jurisprudence, the writer has fallen into the irresistible temptation of making occasional references to the Philippine law on the subject for purposes of comparison because

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[1] Scot, *The Fiduciary Principle,* 37 CALIF. L. REV. 539, 541 (1949).

the latter law commingles provisions of the Uniform Partnership Act and Civil law principles on the subject.[1a]

II. GENERAL STATEMENT

Undoubtedly, while fiduciaries are subject to the same principle of loyalty, which has been described as the "duty of the finest loyalty," and the trustee is held to "something stricter than the morals of the market place,"[2] some fiduciary relationships like that existing between a trustee and a **cestui que** trust, are more intense than others, for instance, the fiduciary duty of a partner to his co-partner or an agent to his principal. A writer suggested that, "The greater the independent authority to be exercised by the fiduciary, the greater the scope of his fiduciary duty."[3]

A. *The Law:*

The principles governing the fiduciary duty of a partner were captured by, and were succintly written into, Section 21 of the Uniform Partnership Act.

"1. Every partner must account to the partnership for any benefit, and hold for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

2. This section applies also to the representatives of a deceased partner engaged in the liquidation of the affairs of the partnership as the personal representatives of the last surviving partner."[4]

B. *Case Law:*

The United States Supreme Court enumerated the principles governing the fiduciary duty of a partner as follows:

"The general principles on which the court proceeded admit of no question, it being well settled that one partner cannot, directly or indirectly, use partnership assets for his own benefit; that he cannot in conducting the business of a partnership, take any profit clandestinely for himself;

[1a] The Code Commission on the Civil Code of the Philippines listed in its report of 1950 the following as the sources of the Civil Code provisions on partnership:
a. Title IX of the Civil Code of Spain.
b. Rules adapted from the Uniform Partnership Act.
c. Opinions of civilians.
d. Code of Commerce of Spain.
e. New rules formulated by the Commission.

[2] Meinhard v. Salmon, 249 N.Y. 548, 164 N.E. 545 (1928).

[3] See footnote 1, *supra*.

[4] This section of the UPA with the exception of the second paragraph is produced in Art. 1807 of the Civil Code of the Philippines.

that he cannot carry on the business of the partnership for his personal advantage; that he cannot carry another business in competition or rivalry with that of the firm, thereby depriving it of the benefit of his time, skill, and fidelity, without being accountable to his copartners for any profit that may accrue to him therefrom; that he cannot be permitted to secure for himself that which it is his duty to obtain, if at all, for the firm of which he is a member, nor can he avail himself of knowledge or information which may be properly regarded as the property of the partnership, in the sense that it is available or useful to the firm for any purpose within the scope of the partnership business."[5]

III. COMMENCEMENT OF A PARTNER'S FIDUCIARY DUTY

When does a partner's fiduciary duty begin? Is there a fiduciary duty on the part of partners negotiating for the formation of a partnership?

In **Haugen v. Neiswonger,**[6] the defendant, owner of a sawmill business, entered into negotiations with the plaintiff for the purpose of forming a partnership in the operation of said sawmill, and in connection with such proposed partnership, the plaintiff and defendant negotiated for the sale to, and the purchase by, plaintiff of one-half interest in and to the aforesaid sawmill business. Upon discovering that the sawmill was previously encumbered under a duly recorded chattel mortgage, plaintiff brought an action to rescind the partnership agreement, on the ground that defendant failed to disclose the existence of the chattel mortgage. The Supreme Court of Washington in refusing to rescind the partnership contract held that no fiduciary relationship existed between the parties while they were negotiating a contract for partnership and, although defendant did not disclose the existence of the encumbrance, he did not misrepresent that it was free from any encumbrance.

Similarly, it was held by the Supreme Court of Minnesota in **Walker v. Patterson,**[7] that, "Unless they are limited by something other than the nature of the intended contract, persons negotiating a contract for a partnership deal at arm's length. There is no fidu-

[5] Latta v. Kilbourn, 150 U.S. 524 (1893). The Philippine Supreme Court has also an occasion to describe this fiduciary duty of a partner. Said the court, "Above all other persons in business relations, partners are required to exhibit toward each other the highest degree of good faith. In fact, the relation between partners is essentially fiduciary each being considered in law as he is in fact, the confidential agent of the other. It is therefore accepted as fundamental in equity jurisprudence that one partner cannot, to the detriment of another, apply exclusively to his own benefit the results of the knowledge and information gained in the character of partner." Pang Lim and Galvez v. Lo Sing. 42 Phil. 282 (1921).

[6] 34 Wash. 2d 422 (1949).

[7] Walker v. Patterson, 166 Minn. 215, 208 N.W. 3 (1926).

ciary relationship because alone of the fact that one will result if they become partners." The court refused to apply Sec. 21 of the Uniform Partnership Act because, "it has no application to any question arising from the formation of this partnership."[8]

Thirty years earlier, however, the same Minnesota court laid down in **Bloom v. Lofgren**[9] the dictum that, "the fiduciary duty is not confined to persons who are actually copartners, but it extends to those negotiating for a partnership not yet formed," a dictum supported and followed in other cases,[10] but rejected by the same court in **Walker v. Patterson, supra.** The findings in the **Bloom** case disclosed that plaintiffs and defendants formed a partnership for the purpose of buying and owning a certain stallion; that one of the defendants (Lofgren) was entrusted with the purchase of said stallion; that he previously bought the horse for $1200, but that the partners, with one exception, were ignorant of this fact; that the partnership gave Lofgren $1800 with which to pay for the horse, and that he reported that he had bought the horse for the partnership for that sum and produced a receipt for $1800, purporting to be from the pretended owner. In ordering defendant Lofgren to pay the difference of $600, the court said he was guilty of fraud and misrepresentation and ruled that fiduciary relationship extends to those negotiating for a partnership not yet formed.

It is believed the said ruling is absurd and untenable and was evidently not necessary to the decision of the case, fraud and misrepresentation having been shown to be present. Fraud, not breach of the alleged fiduciary duty as a partner, made Lofgren liable. Assuming that Lofgren owed some fiduciary duty, did it not arise from the fact that he was in fact and in effect an agent when he was entrusted with the purchase of the stallion? Agency, not the future relationship of partners, spawned his fiduciary duty.

Consider the following situation. "A," "B," and "C" agreed to form a partnership, each to contribute $1800. It was further agreed that instead of contributing $1800 in cash, "C" will contribute a horse, the value of which was fixed at $1800, although "C" paid only $1200 for it, a fact not disclosed by "C" to his future partners. Will "C" be liable to account for the balance of $600? It would be safe to venture that even the Minnesota court will not hold "C"

[8] See also Withooder v. Elmore, 106 Kan. 448, 188 Pac. 428 (1920); Zogg v. Hodges, 126 W.Va. 523.; 52 A.L.R. 991 (1944).

[9] 64 Minn. 1 (1896).

[10] "The obligation of good faith imposed upon partners is not even confined to persons who are actually partners, but extends to persons negotiating for a partnership." Van Hooser v. Keenoa, 271 S.W. 2d 270 (1954); see also Hollowell v. Sotterfield, 185 Ky. 397, 215 S.W. 63 (1919); George v. Sahns, 191 Ky. 428, 230 S.W. 904 (1921); England adopts this view, see LINDBY, PARTNERSHIP, p. 339 11th Ed. (1950).

liable. Yet that would be the result if its ruling in the case of **Bloom v. Lofgren, supra,** that fiduciary relationship extends to persons negotiating for a partnership, is carried to its logical conclusion.

That no fiduciary duty arises between persons negotiating for the formation of a partnership is supported by Mr. Justice Sharswood's statement in **Densmore Oil Co. v. Densmore.**[11] He said, "any man or number of men, who are owners of any kind of property, real or personal, may form a partnership or association with others and sell that property to the association at any price which may be agreed upon between them no matter what it might have originally cost; provided there be no fraudulent misrepresentation made by the vendors to their associates. They are not bound to disclose the profit which they may realize by the transaction. They were in no sense agents or trustees in the original purchase, and it follows that there is no confidential relation between the parties, which affects them with any trust. It is like any other case of vendor and vendee. They deal at arm's length."

The fiduciary duty of a partner arises largely from the fact that he is an agent of the partnership for the purpose of its business.[12] Indeed, each partner acts as to himself, as a principal, having a joint interest in the partnership property, and as to each other partner, as a general agent.[13] When persons are still in the process of negotiating for the creation of a partnership, they are not yet partners; they are not yet agents as to each other. Consequently, no fiduciary duty exists between them.

It is of course possible that a party to a partnership yet to be formed may be authorized by his future partners to perform acts preliminary to the creation of the partnership, from which a fiduciary duty may arise, not because of any partnership relation, but because of the agency entrusted to him by his future partners.

The fiduciary responsibility of a partner as such, therefore, commences from the time the partnership begins. In this connection, the Uniform Partnership Act, unlike Philippine partnership law,[14] is silent as to when a partnership begins to exist. There should be no doubt, however, that it begins from the moment of the execution of the partnership contract or agreement, unless it is otherwise stipulated.

[11] 64 Pa. 43 (1870).

[12] Section 9, UPA

[13] First Nat. Bank of Ann Arbor v. Farson, 226 N.Y. 218, 123 N.E. 490 (1919); Caswell v. Maplewood Garage, 84 N.H. 241 (1930).

[14] "A partnership begins from the moment of the execution of the contract, unless it is otherwise stipulated." Art. 1784 CIVIL CODE OF THE PHILIPPINES "(hereafter cited as NEW CIVIL CODE)."

IV. APPLICATION OF FIDUCIARY DUTY OF PARTNERS IN PARTICULAR INSTANCES

It is an essential feature of a system of free enterprise that a person should be free, within the limits of the law, to pursue any business, profession, or occupation, and to enjoy the fruits of his labor and capital. When he enters into a partnership, however, the law imposes certain duties which restrict this right because of his fiduciary responsibility to his copartners. As the late Justice (then Judge) Cardozo once declared in an oft-quoted statement:

> "Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[15]

When a transaction is fair and ethical, is a partner still duty bound to account to his copartners profits which he secretly earned through his own capital, industry and ingenuity? The same Justice Cardozo refused to accept such a standard. "The law does not stop to inquire whether the contract or transaction is fair or unfair. It stops the inquiry when the relation is disclosed."[16]

We will now examine the application of this fiduciary duty of a partner, the standard of which is frank and honest disclosure, according to Justice Cardozo, as applied in particular instances.

A. *Disability of a Partner to take a lease of a property leased to the partnership:*

Fiduciaries have been disqualified by courts from taking a renewal in their own names leases in which they were interested in their fiduciary capacity.[17] Lord Chancellor King in **Keech v. Sanford,**[18] the leading case on the general subject, stated:

> "This may seem hard, that the trustee is the only person of all mankind who might not have the lease; but it is very proper that the rule should be strictly construed, and not in the least relaxed; for it is very obvious what would be the consequences of letting trustees have the lease, on refusal to renew to cestui que use."

[15] Meinhard v. Salmon, *supra* note 2, at 106.

[16] Wendt v. Fisher, 243 N.Y. 439, 443, 154 N.E. 303, 304 (1926).

[17] 1) B., during the partnership, took a lease of the store in which the business was transacted, for a term extending beyond the term of the partnership. Held, that he was accountable to A's representative for the profits of this lease. Leach v. Leach, 35 Mass. 68 (1826).

2) One member of a copartnership cannot, during its existence, without the knowledge of his copartners, take a renewal lease for his own benefit of premises leased by the firm, on which it has made valuable improvements, and by the joint efforts of the members made the good will valuable and enhanced the rental value of the premises; and this, although the term of the renewal lease does not begin until after the copartnership has expired by its own limitations. Mitchell v. Reed, 61 N.Y. 123 (1874).

3) Where partnership operated hotel under lease not providing for renewal and one of the partners illegally excluded the other from participation and thereafter obtained a renewal of the lease in his own name, which he was evidently enabled to obtain because of his control of the business, the excluded partner was entitled to participate in the profits of the business under the new base until a legal dissolution. Drummond v. Batson, 162 Ark. 407, 258 S.W. 616 (1924).

4) Where defendant, with knowledge that his partner, plaintiff, desired to continue a lease of mineral rights, permitted it to lapse and took a new lease in his own name, evincing a desire to get rid of his partner, it was not error to adjudge that defendant held the new lease in trust for the firm, and to require him to convey a half-interest to the plaintiff. Hollowell v. Satterfield, 185 Ky. 397, 215 S.W. 63 (1919).

5) A partner cannot appropriate to his own use a renewal of lease beginning at the expiration of partnership. Meinhard v. Salmon, *supra* note 2, at 106; (MacDonald v. Follet, 142 Tex. 6 16, 180 S.W. 2d 334 (1944).

6) A partner securing extension of renewal lease in individual name will be deemed to have held lease in trust for partnership. Waller v. Henderson, 275 P. 323, 1350 Lt. 231 (1929). Mullens v. Wolfe, 120 W. Va. 672, 200 S.E. 37 (1939).

7) Where partner notified copartner on April 2 that he desired to dissolve the partnership, and copartner acknowledged notice in writing on April 3, a charge of bad faith on partner's part in procuring in his own name renewal of lease to old quarters on April 12 to commence on May 1 for one year, was not sustained. Thursby v. Kirby, 12 N.Y. S. 2d 279, 171 Misc. 310 (1939).

[18] Select cases in Chancery 61, 25 Eng. Rep. 223 (1726).

[19] 17 Ves. 298 (1810).

[20] See Mitchel v. Reed, 61 N.Y. 123 (1874); Phyffe v. Wardell and Wealey, 5 Paige 268 (1835).

[21] See Lacy v. Hill, 37 Pa. 360 (1860); Mitchel v. Reed, *supra* note 20; Featherstonehaugh v. Fenwich, *supra* note 19.

[22] Fine v. Lawless, 139 Tenn. 160, 201 S.W. 160 (1917).

As early as 1810, the applicability of this principle to partners was definitely decided in the celebrated case of **Featherstonehaugh v. Fenwick**[19] where the court impressed a trust on a lease secretly renewed by a partner of a property leased to the partnership, and subsequently, the partner exercised his power of dissolving the partnership by notice. Cases adopting this ruling are legion. The reasons given by the court, are however, far from uniform. Thus, in some cases,[20] the reason given is that the probability that the partnership in possession of the land will be preferred over others desiring to secure a lease is a valuable interest which one lessee may not pre-empt for himself to the exclusion of his co-lessees. Some courts[21] fear that if a partner is allowed to renew in his name a partnership leasehold, he may demand a hold-up price for allowing the firm to keep the premises after termination of the partnership lease. Another reason given in a Tennessee case[22] for this disqualification to renew a partnership lease by a partner is that the partnership-lessee's normal expectancy of, what the court called, a "pre-emptive opportunity" for renewal is a valuable partnership right and that a partner, like any other trustee, should not acquire a personal interest likely to conflict with his trust.[23]

1. *Renewal after expiration of lease or dissolution of partnership:*

The prescription to renew a partnership lease is so strict that it is extended to a lease taken by a partner which will begin after the term of the partnership fixed in its articles[24] and to a renewal taken by a partner in his own name after the dissolution of the partnership.[25]

In a Pennsylvania case, J and L were partners in the plumbing business. They leased certain premises from the City of Philadelphia. The lease expired October 1, 1883; the firm was dissolved July 12, 1883, and the new lease was obtained by L on September 29, 1883, two days before the expiration of the lease to the partnership. Quoting with approval the opinion of Sedgwich C.J. in **Speiss v. Rosswog,**[27] the court held, "This dissolution did not annul or change those relations between the parties which are the basis of the obligation in such cases. After the dissolution, the original leases remained partnership property for the purpose of liquidation. The obligation of each partner to deal with them, not for his individual benefit, but for the common or joint interest, remained. Accordingly, the court directed L to account for the value of the renewal, in a settlement of the partnership business.

It is important to note that the court used the word, "dissolution," a technical term, and is not to be confused with the "terminaion" of the partnership. The Uniform Partnership Act recognizes the distinction between these two terms when it provided:

"Section 30 (Partnership not Terminated By Dissolution).
"On dissolution, the partnership is not terminated but continues until the winding up of partnership affairs is completed."

As explained by the Commissioners on Uniform State laws, "The terms 'dissolution,' 'winding up,, and 'termination' are often confused. As the terms are used in the Uniform Partnership Act, dissolution designates the point of time when the partners cease to carry on the business together; termination is the point in time when

[23] Ladar v. Psiharis, 241 Mich. 101, 216 N.W. 458 (1927).
[24] Mitchel v. Reed, 61 N.Y. 1231 (1874).
[25] Johnson's Appeal, 115 Pa. 129, 8 Atl. 36 (1886); Speiss v. Rosswag, 63 How. Pr. 401 (1882); aff'd, 96 N.Y. 651 (1884).
[26] Johnson's Appeal, 115 Pa. 129, 8 Atl. 36 (1886).
[27] 63 How. Pr. 401, 48 N.Y. Supper. Ct. 135. Aff'd, 96 N.Y. 651 (1884).

all partnership affairs are wound up; winding up the process of settling partnership affairs after dissolution."[28]

With these distinctions in mind, it is understandable that a partner who renews a partnership lease in his own name after dissolution and during the winding up of the partnership affairs should account for the value of the renewal because this partnership asset is subject to liquidation and distribution, like any other assets of the partnership. Supposing, however, a partner obtains a lease of the property leased to the partnership **after** the **termination** of the partnership and the lease, will the same principle apply so that he will still be liable to hold the lease in trust for his other partners? The Supreme Court of the Philippines indicated an answer to this question in the following words:

"After the termination of the partnership the party who stood in fiduciary relation to the other is free to act in his own interest with respect to the same subject-matter provided he has done nothing during the continuance of the relation to lay a foundation for an undue advantage to himself. To act as a fiduciary of another does not necessarily imply the creation of a permanent disability in the fiduciary to act for himself in regard to the same subject-matter."[29]

This subject will be further discussed under the title, "Termination of Fiduciary Duty."

2. *Effect on the Landlord:*

The right of the firm to a lease renewed by a partner clandestinely is not defeated by a covenant in the agreement between the renewing partner and the landlord against assignment without the latter's consent or a declaration by the landlord that he is not willing to renew the lease to the partnership. A lessor, therefore, must bow to the occupancy of his premises by persons not of his own choosing when the facts bring the case within the rule. However, the landlord is entitled to question on his own account whether a renewal lease was taken by a partner surreptitiously and without the consent of his copartners, and accordingly, is a necessary party to a suit to require a partner to assign the lease to the firm to the end that a full and final adjudication of all the rights of the partners may be had.[29a]

[28] Commissioner's Notes to UPA Sec.29; CRANE ON PARTNERSHIP, 320 (1938 Ed.)
[29] Hanlon v. Hausserman and Beam, 40 Phil. 796 (1920).
[29a] Ladas v. Psiharis, 241 Mich. 101, 216 N.W. 458 (1297).

3. *Effect of Full Disclosure:*

Will a full disclosure by a partner of an intent to renew a partnership lease in his name remove his disability to renew the lease? An English case[30] seems to give a negative answer. In that case the managing partners of a mining partnership at will[31] gave notice of dissolution, to apply for a new lease for their exclusive benefit and did so and obtained a lease, and carried on the business. It was held that, "mere communication of the intention on the part of the managing partners to apply for the new lease for their own benefit would not prevent the renewal from being impressed with a trust." Although the court ruled that the excluded partners were precluded by laches from obtaining any relief due to their failure to take active steps to enforce their rights for nine years, it felt that, despite the notification, the excluded partners were not on an equal footing as to the opportunity of taking advantage of the possibility of renewal. The dictum in this case has been criticized by a text writer[31a] on partnership as carrying the rule too far.

It is most appropriate to recall in this connection the words of the great jurist, Justice Cardozo, who refused to accept a standard of behavior on the part of a fiduciary less rigid than a frank disclosure. "The law does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed. . ."[32]

Even an English court implied that a full disclosure by a partner will remove the disability when it held: "They ought first to have given him notice and to have placed him on equal terms with them; and then, if Mr. W. had thought proper to give them the preference, the case might admit of a different construction."[33]

B. *Disability of a Partner to Purchase the Reversion of a Partnership Leasehold:*

"A" leased to a partnership composed of "B" and "C" a property where the partnership carried its business for a period of ten (10) years. During the life of the lease, "B," in the absence of actual fraud, but without informing "C," purchased the reversion in fee

[30] Clegg v. Edmondson, 8 De G.M. & G. 787, 38 YALE L. R. 785 (1929).

[31] Partnership at will is one where no time is specified for the continuance of the partnership, and it is not formed for a particular transaction or the completion of a particular enterprise and which is to last during the mutual consent of partners. 40 Am. Jur. 139.

[31a] ROWLEY, I MODERN LAW ON PARTNERSHIP, 467 (1916).

[32] *Supra* note 16.

[33] Featherstonhaugh v. Fenwick, 17 Ves. 298 (1810).

from "A." Is "B" legally obliged to hold the property in trust for the benefit of the partnership?

English courts have answered this question negatively. In the leading case of **Bevan v. Webb**,[34] it was held, "The doctrine that wherever the reversion on a lease which forms part of a trust estate is purchased by the trustees of the lease, the purchase is for the benefit of the trust estate, applies only to leaseholds which are renewable by custom or contract. Therefore, if a trustee of a lease which is not thus renewable buys the reversion on the lease, he may, in the absence of fraud, hold it for his own benefit."[35] It has been said that although the **cestui que** trust will be deprived of all the claim of renewal, it has been thought impossible to consider the purchase of the inheritance as a "graft" upon leasehold, or life interest.[36]

In Illinois it was held that the mere fact that the lease on a building and the right of a partnership to renew the lease were partnership assets did not affect the right of one partner to secure and hold as his individual property the fee to the leased premises.[37]

Other state courts[38] have followed this rule on the ground that, although a lease held by a partnership and the right to renew it are partnership assets, the title of the landlord is not so adverse to that of his tenant as to prevent a partner from purchasing the fee to the premises which the partnership leased, provided he practices no fraud or deception upon his copartners and holds his fee subject to the lease for the duration thereof.

Leading the contrary view in the United States is the New York case of **Maas v. Goldman**[39] where it was held that, "partners who secretly purchased one-half of the reversionary interest in fee of premises leased by the partnership must account to the other partner, though there was no affirmative fraud." This case is significant because the defendant directly raised the issue when he relied upon a statement in a case[40] decided about seventy years earlier by the New York court, that a partner may make such a purchase "under circumstances free from deception and fraud."

[34] 1 Ch. 620 (1905).

[35] In Accord: Lloyd Jones v. Clark Lloyd, 1 Ch. 424 (1919).
Randall v. Russell (1817 Ch.) 3 MER. 190, 17 R.R. 56.
Longton v. Wilsby, 76 L.T. 770 (1897).

[36] *Supra* note 33, at 114.

[37] Thomas v. Thomas, 313 Ill. 499, 145 N.E. 250 (1924).

[38] Lipinski v. Lipinski, 227 Minn. 511, 35 N.W. 2d 708 (1949).
Sonek v. Hill Bldg. & Loan Ass'n., 140 N.W. 108 (1946).

[39] 203 N.Y. Supp. 524 (1924).

[40] Anderson v. Lemon, 8 N.Y. 236 (1853).

Rejecting this principle, the court said:

"That language when read in the light of the context and of the cases referred to by Gardiner, J., who wrote for the court, is seen to have referred to active or affirmative fraud, and was intended to declare the proposition that mere secrecy of purchase is not enough to make the purchasing partner a trustee for the firm. The statement was, however, merely a dictum, as the purchasing partner in that case was guilty of the grossest affirmative fraud upon his complaining partner. In this opinion in the case of Mitchell v. Reed, 61 NY. 123, 19 Am. Rep. 252, Dwight C., in commenting upon the dictum in Anderson v. Lemon, said: 'This decision can scarcely be considered a decision in favor of a partner's right to purchase, since he was under the circumstances a trustee. There is great cogency in the remarks of Sir William Grant that the partner may in this way intercept and cut off the chance of future renewals, and consequently make use of his situation to prejudice the interest of his associates.' "

The doctrine in **Mass v. Goldman, supra,** is not lacking in support from other courts. Justice Cardozo backs up this proposition in **Meinhard v. Salmon,**[41] where he said that a purchase as well as a lease will "succumb to the infection of secrecy and silence."

In the face of these conflicting decisions, one will naturally ask: which is the better view? In the search for an answer to this question, an analysis of the reasons which led the courts to arrive at conclusions diametrically opposed to each other would be enlightening, if not necessary.

The strongest case holding the view that, while a partner is disqualified to renew a partnership lease in his own name, he may purchase the reversion in fee of the partnership leasehold is **Bevan v. Webb, supra.** The English court based the distinction between reversion and renewal on the ground that a renewal is a "graft upon the old stock," so much so that the renewal is partnership property just as much as the increase of livestock belonging to the partnership; so that when a partner renews a partnership lease, he is appropriating a partnership asset. This argument is specious because the asset of the partnership consists not of the renewal itself, but the expectancy of such renewal. Certainly, it cannot be argued that the partnership-lessee, can, in the absence of a stipulation to the contrary, legally demand from the landlord, a renewal of the partnership lease. If it cannot legally demand such renewal, how could the renewal be considered as a partnership asset? The only valid reason for the disability of a partner to obtain in his own name a renewal of a partnership lease is that in so doing he will

[41] In accord: Stove v. Serner (1948), 195 P. 2d 9; Saffan v. Nagilee, 960 Cal. (1858), 960.

be depriving the partnership of a "pre-emptive opportunity,"[42] and that like any other trustee, a partner should not acquire a personal interest likely to conflict with his trust.[43] Such conflict of interest is equally present when a partner purchases the reversion in fee of the partnership leasehold, because in either case, he will be in a position to cut off the partnership's normal expectancy of renewal, or to deprive the partnership of a pre-emptive opportunity. Indeed, every reason for requiring the utmost good faith in the case of a lease is present in a purchase. One should be greatly shocked by a clandestine purchase as by a clandestine renewal. In the words of Mullan, J. in **Maas v. Goldman,**[44] "Unless equity is to concern itself with forms rather than with realities, the technical name that is to be given to the legal basis of the privilege of occupying premises is of no moment. Upon principle alone, I can see no valid reason why, in the case of a secret purchase of a fee interest, the courts should insist upon showing of active or affirmative fraud as an essential to holding the purchasing partner as a trustee of the firm."

The distinction between a renewal and a purchase of the reversion observed by the English court in **Bevan v. Webb, supra,** and which led the court to adopt a different rule in the case of a purchase is tenuous and has been criticized by many legal writers.[45]

C. *Duty of Partners to Account For Secret Profits:*

The fiduciary responsibility of partners finds its most frequent application in his duty of holding as trustee for his copartners profits which he may secretly earn. For a proper understanding of the doctrines laid down by the courts, the discussion of this aspect of the fiduciary duty is divided into four different fact situations, namely: (1) secret profits earned by a partner individually out of partnership business, (2) secret profits earned by a partner using his **own funds** and resources in **another business** which is **similar** to the business of the partnership, (3) secret profits earned by a partner using his **own funds** and resources in a **separate business** entirely **different** from that of the partnership, and (4) secret profits earned by a partner in a **separate** and **different** business but using **partnership funds** and **property.**

[42] Fine v. Lawless, 139 Tenn. 160, 201 S.W. 160.
[43] Ladar v. Psiharis, 241 Mich. 101 (1927), 216 N.W. 458.
[44] *Supra* note 39, at 115.
[45] Hart *The Development of the Rule in Keech v. Sandford* 21 L.Q. Rev. 258, 264 (1905). See Comments 38 YALE L.R. 785 (1929).

(1) Cases[46] holding a partner accountable as trustee for secret profits which he may earn out of the partnership business are legion. The different means and methods that may be utilized by a partner to make such profits in violation of his fiduciary duty are numerous and varied. The courts upon discovery of the violation of the fiduciary duty would not hesitate to impress a trust on the secret profits so earned for the benefit of his copartners. Thus, in **Dean v. Dyer,**[47] A, a partner in whose name the stocks owned by the partnership were listed, took in his own name additional stocks offered by the corporation to existing stockholders in the exercise of the stockholders' pre-emptive right. The Supreme Court of the United States declared that A should hold the additional stocks taken by him in trust for the benefit of his copartners.

This duty to account equally applies where profits were made from transactions within the scope of partnership business even if a partner uses his own money and in case of loss, he alone should bear the loss.[48] To relieve himself of this trust obligation, he should make a full disclosure of the transaction and the secret profits.[49]

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[46] Doan v. Dyer 286 Fed. 339 (1923) (partner to hold as trustee additional stock taken by him in the exercise of pre-emptive right for stocks owned by partnership but held in one partner's name) Stenian v. Tashjian, 178 Cal. 623, 174 P. 883 (1918). Partner held accountable for secret separate profits made out of business of partnership. To the same effect, Linn v. Clark, 295 Ill. 69, 128 N.E. 824, (1920); More v. Burroughs, 205 P. 1029, 111 Kan. 28 (1922); Chambers v. Johnston, 180 Ky. 201 S.W. 488, (1918). (Where partner enters into transaction which is within scope of partnership business, he must account to firm although he uses his own money and is liable for losses; Lawson v. Davis, 194 Ky. 67, 238 S.W. 402 (1922) where one partner was not held liable to contribute on the basis of a payment in full of a firm obligation when his copartner selected it for less); Lindsay v. Swift, 280 mass. 407, 119 N.E. 787 (1918); Farady v. Ferlanger, App. Div. 728, 177 N.Y. Supp. 301, 188 (1919); Brown v. Leach, 189 App. Div. 178 N.Y. Supp. 319 (1919); Giannio v. Weis, 195 N.Y. Supp. 279 (1922); Paggi v. Skhris, 54 Retsh 88, 179 P. 739 (1919); Marshall v. Bennett, 214 Ky. 328, 283 S.W. 115 (1926) (Partner, selling property, on which partnership had option, cannot profit at expense of copartners by concealing sale through transfer to kinsmen without proof. Shelley v. Smith, 271 Mass 106, 170 N.E. 826 (1930) (Partner must make full disclosure to relieve himself of trust obligations): same principle in Johnson v. Ironside, 249 Mich. 5, 227 N.W. 732 (1930); Hammonh Oil Co. v. Standard Oil Co. of New Jersey, 259 N.Y. 312, 181 N.E. 583 (1932); Seligson v. Weiss, 222 App. Div. 634, 227 N.Y. Supp. 338 (1928); Schneider v. Brenner, 235 N. Y.Supp. 55, 134 Misc. 449 (1929); Cole v. Whitney, 124 Okl. 193, 255 P. 577 (1927); Anderson v. Whitener, 127 Akl. 284, 261 P. 156 (1927); Edlin v. Moser, 176 Ark. 1107, 5 S.W. 2d 923 (1928); Davis v. McKidden, 50 Ga. App. 608, 179 S.E. 107 (1935); Holmes v. Keats, 58 Fed. Supp. 660 (1945); Stephen v. Stephens, 298 Ky 638, 183 S.W. 2d 822 (1945). (In determining whether partner has received secret profits for which he must make an accounting, the criterion is not actual evil motive, since court looks to the result of any secret action regardless of the intent and if action results in profits or advantage, accounting will be required).

[47] 286 Fed. 339 (1923).

[48] Chambers v. Johnston, 180 Ky. 73, 201 S.W. 448 (1918).

[49] Shelley v. Smith, 271 Mass. 106, 170 N.E. 726 (1930).

(2) Profits made clandestinely by a partner in a business **separate** but **not different** from the partnership business are also held to belong to the partnership. The leading case of **Manufacturers National Bank v. Cox**[50] illustrates the application of this doctrine.

In that case the plaintiff claimed from the defendant's intestate certain moneys received by him from one Brown which, it is insisted, belonged to the copartnership of which the deceased was a member. It appeared that Brown had an agreement with the partnership under the terms of which the firm shall have the exclusive use of an invention of Brown which obviated certain difficulties in the manufacture of stoves and was given the exclusive authority to sell the right to its use to stove manufacturers in Troy, New York, and its vicinity. In return, Brown was to receive one dollar royalty upon each stove manufactured. This agreement was made by the intestate on behalf of the firm. At a later period of the interview, a further agreement was made between the intestate and Brown without the knowledge of the other partners under which, in consideration of the promise of the intestate to use his influence for Brown to introduce the invention to the stove trade generally outside of the district over which the partnership had control, he was to receive, and in fact did receive, fifty percent of the net proceeds for the use of said improvement and patent. The New York Supreme Court, although conceding that there was no evidence that defendant used his influence for Brown or rendered him any service whatsoever and that no actual injury resulted to the firm, sustained the plaintiff's claim because, in its words, "...the intestate, by his secret arrangement with Brown, by which he has to reap an advantage, was engaged in a business which necessarily conflicted with the interest which he held in common with his associate, and which, if the agreement had been fulfilied, might have seriously affected their profits; and although he did no act which produced any such results, as he had violated his obligation and duty, the business upon which he had thus entered became part and parcel of the business of the firm, and that he was liable to account to his copartners for the proportionate share of the profits he realized."[51]

(3) On the third fact situation, a study of decisions on this matter will disclose that courts are in agreement that in the absence of a stipulation to the contrary, profits earned by a partner, using his own funds and resources in a separate business **different** from, and not in competition with, the business of the partnership, need not be accounted for by a partner. The difficulty encountered by courts,

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[50] N.Y. Sup. Ct., 2 Hun 572 (1874) Aff'd, 59 N.Y. 659.

[51] *In accord*: Holmes v. Darling, 213 Mass. 303, 100 N.E. 611 (1913). Numerous other cases are collected in 52 L.R.A. (N.S.) 389.

however, is in determining when a separate business is not in competition with that of the partnership.

In the case of **Shrader v. Downing,**[52] plaintiff and defendant were partners engaged in the business of buying and selling real estate of others for a commission. During the existence of the partnership, defendant purchased a tract of land, improved and subdivided it, and placed it in the hands of the firm to be sold on a ten percent commission. The venture proved profitable and plaintiff claimed an interest in the profits. Denying the claim of the plaintiff, the Supreme Court of Washington declared, "One partner may not make a profit for himself individually out of the partnership business, or out of the transactions which he conducts privately which in justice and equity ought to have been conducted in the partnership name; but he may, without laying himself liable to account, buy and sell real estate or other property with his individual means, if the transaction is disconnected from the partnership business, is not conducted in competition or rivalry therewith, and he is under no duty to conduct the transaction on behalf of the firm. Any other rule would prevent a member of a partnership from investing his private funds."

In effect, the court ruled that the business of buying, improving, subdividing, and then selling real estate is not in competition with the partnership business of selling real estate of others for a commission especially in this case, where the defendant placed the property in the hands of the partnership for sale and the firm was paid the usual commission.

The Supreme Court of the United States[53] adhered to this view when it held that a member of a firm engaged in buying and selling real estate on commission need not account for profits made in another partnership investing in real estate. The court went further to rule that an agreement between the members of the brokerage firm that each partner shall furnish to the partnership information as to bargains in real estate, and give it the option of taking advantage thereof, before acting upon the information for his own benefit,

[52] 79 Wash. 476, 140 Pac. 558, 52 L.R.A. N.E. 389 (1914).

[53] Latta v. Kilbourn, 150 U.S. 524 (1893) reversing 5 Mackey 304.

In Accord: Ahs. v. Benham, 2 Ch. 244, 65 L.T.N.S. 25, 19 Eng Rul Caw. 582 (1891) (A member of a firm of ship brokers cannot be compelled to account for profits realized in a ship building company; Dean v. MacDowell, 8 Ch. Div. 345, 38 L.T.N.S. 862, 20 Week Rep. 456 (1878). (Although the members of a salt brokerage partnership agree not to engage in any other business, one of them, who engaged in manufacturing salt, cannot be compelled to account for his profits in the absense of showing of neglect of the business is not conflicting, where no loss results, nor can result, therefrom.)

does not enlarge the scope of the partnership business so as to make it include purchases and sales of real estate.

Likewise, a member of a law partnership engages in no business or enterprise which can be regarded in competition with his firm, by acting as executor or administrator of an estate, and he cannot be compelled to account for his commissions provided in so doing he does not deprive the law firm of his services, since the court held that the execution of trusts does not constitute a part of what is ordinarily understood as the practice of law.[54]

As to what is the scope of the business of a partnership depends on the articles of copartnership as interpreted by the conduct of the parties.[55] It may be shown that the parties agreed to limit their joint undertakings to those mutually approved, leaving each free to undertake others privately.[55*]

(4) The fourth and last fact situation, when a partner secretly makes profits from a separate and entirely different business but uses partnership funds, presents a difficult problem as to the liability of the partner.

To illustrate: "A" and "B" are partners engaged in the business of buying and selling used cars, each contributing $100,000. "A," the managing partner, without the knowledge of "B," took $50,000 from the partnership coffers and speculated in the stock market. "A's" venture was highly successful so that in a period of three months, he made a profit of $500,000. Must "A" account to the partnership the $500,000 profits or must he only account for the amount of $50,000 he took plus interest and damages that may have been suffered by the firm for its inability to use the $50,000?

1. *Rule In The United States*:

A strict and literal interpretation of the provisions of paragraph 1 of Section 21 of the Uniform Partnership Act will make "A" accountable for all the profits he made. "Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any **use by him of its property."**

[54] Metcalfe v. Bradshaw, 145 Ill. 124 33 N.E. 1116 (1893).

[55] CRANE, PARTNERSHIP, p. 368 (22d Ed.)

[55a] Meyer v. Sharp 341 Ill. App. 431, 94 N.E. 2d 510 (1950).

The prevailing weight of authority in the United States is to hold "A" in the hypothetical situation liable not only for the amount so taken from the partnership, but also as the profits he made from the use of partnership funds. Illustrative of this principle is **Love v. Carpenter**[56] where the plaintiff L and defendant C were partners doing business as railroad contractors under the firm name and style, "Carpenter and Co." C subsequently joined another partnership, a mercantile firm, and used for the benefit of the latter firm bonds of the Carpenter and Co., nominally $74,270.91, but only of the cash value of $34,740, besides using, also, without authority, the name and credit of the firm of Carpenter and Co. in purchasing goods for the mercantile firm, so that all the purchases of goods for the latter firm were made with either the means or credit of the former; and that the mercantile business made a profit, counting the bonds at their nominal value, of $74,270.90. Holding the defendant partner liable not only for the actual value of the partnership property so used without the consent or knowledge of his copartner, but also the profits realized by him out of the transaction, the court said: "It seems to be well settled by the cases, and to rest upon unquestionable principles of public policy, that if one partner clandestinely uses the partnership funds or property in his own private speculation, he must account, not only for the funds or property so employed, but also the profits realized in the transaction."[56a]

Seemingly opposed to this line of decisions is a Minnesota case[58] where the defendant partner employed partnership funds to buy 3.61 acres of land. The partnership of which defendant was a member was engaged in a fishing enterprise. On the question as to whether this piece of land should be considered partnership property and accounted for in the partnership assets, the Supreme Court of Minnesota affirmed the ruling of the trial court that the relationship between the parties was fiduciary in character and that each owed to the others the highest degree of loyalty and good faith, but that such relationship and its obligations were limited to the enterprise in which they were mutually engaged." In effect, the court refused to treat the piece of land bought by defendant partner as trust property and made him liable only for the partnership funds withdrawn by him.

56 30 Ind. 284 (1868) See also Horn v. Lupton, 182 Ind. 363 (1914).
56a Stoughton v. Lynch, 1 Johns Ch. 467 1802 Crawshay v. Collins 15 Ves. 218 (July, 1808); COLLYER, PARTNERSHIP B. 2, Ch. 2, Sec. 182, 186.
57 Stoughton v. Lynch, 1 Johns Ch. 467 (1802).
58 Lipinski v. Lipinski, 227 Minn. 511, 35 N.W. 2d. 708 (1949).

2. *Rule in the Philippines*:

For purposes of comparison, the Supreme Court of the Philippines[59] laid a dictum to the effect that where one party to a partnership, without any authority, takes and uses the money of the firm in the purchase of property which he acquired and had registered in his own name, in a suit for the dissolution of the partnership, he will be required to account to his partners for the money which he used in such purchase and if the partnership had the use and benefit of such property, it will be required to account to the owner for the reasonable value of its use. This ruling, however, cannot be considered controlling in the solution of the hypothetical problem previously presented because the other partners in this case preferred that the partner who employed partnership funds account for the funds rather than to treat the property as partnership assets. Nevertheless, under the present law on partnership as embodied in the Civil Code of the Philippines[60] which incorporates *in toto* a good number of the provisions of the Uniform Partnership Act of the United States including Section 21 thereof, while retaining a substantial portion of the Spanish law on partnership as found in the Civil Code of Spain and the Spanish Commercial Code, "A," in the hypothetical situation will be held liable only for the funds withdrawn by him plus interests and damages. This is evident from article 1788 of the Civil Code of the Philippines which was reproduced from article 1682 of the Civil Code of Spain:

> "A partner who has undertaken to contribute a sum of money and fails to do so becomes a debtor for the interest and damages from the time he should have complied with his obligation.
>
> *The same rule applies to any amount he may have taken from the partnership coffers, and his liability shall begin from the time he converted the amount to his own use.*" (Italic supplied)

Nevertheless, if an industrial partner[61] engages in business for himself without being expressly permitted in the articles of copartnership or by the other partners, the capitalist partners or partners contributing money or property "may either exclude him from the firm or avail themselves of the benefits which he may have obtained . . . with a right to damages in either case."[62] The Court of Appeals of the Philippines explained the reason for the rule in the following words:

59 Teague v. Martin, 52 Phil. 504 (1929).
60 See *supra* note 1a, at 106
61 "An industrial partner does not contribute either money or property to the common fund but only his industry." 4 PADILLA, CIVIL CODE OF THE PHILIPPINES, 280 (1956 Ed); 5 TOLENTINO, CIVIL CODE OF THE PHILIPPINES, 281 (1959 Ed.).
62 Art. 1789 NEW CIVIL CODE.

"An industrial partner does not contribute money or property to the common fund, but only his industry. The partnership, therefore, is considered the owner of his services, which is his contribution to the common fund. The partnership, which has a distinct juridical personality (art. 1768) has the exclusive right to make use of, and profit by, such services... and if they are allowed to engage in other businesses, the partnership will be prejudiced because of the reduction of time or the effort which they will have for it."[63]

Capitalist partners, on the other hand, are prohibited from engaging for their own account only with regards to the kind of business in which the partnership is engaged.[64] From these provisions of the Civil Code of the Philippines, it could be argued that a capitalist partner who engages for his account in a business different from, and not connected with, partnership business, using funds withdrawn from partnership coffers, is not legally chargeable with the profits he might make from his separate business, but only for the amount taken plus interest and damages from the time he converted the amount to his own use.[65]

As to which is a better rule — the rule developed in American and English jurisprudence or that established by the Civil Code of the Philippines — is largely a matter of policy consideration. A partner who violates his fiduciary duty by converting to his own use partnership funds is penalized to the fullest extent by American and English courts. Philippine law, on the other hand, compels him only to make reparation to the injury done to the partnership by charging him with the funds taken from the partnership, plus interest and damages that it may have suffered from the time he converted the amount to his own use. American and English courts impose a penalty; Philippine law enforces a reparation. In evaluating the merits of these two different views, one should take note of the fact that a partner who contributes money or property to the partnership capital is actually a co-owner of the partnership assets — especially under the Uniform Partnership Act[66] which, as a general rule, does not personify the partnership as a legal unit or entity, unlike the Civil Code of the Philippines.[67]

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[63] Limuco v. Calinao, (CA) G.R. No. 10099-R, Sept. 30, 1953.

[64] Art. 1808 NEW CIVIL CODE.

[65] Art. 1788 NEW CIVIL CODE.

[66] The theory of the UPA that a partnership is not a legal person has been criticized and defended. See Crane, *The Uniform Partnership Act—A Criticism* 28 HARV. L. REV. 762 (June, 1915) Sewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism* 29 HARV. L. REV. 158 (Dec. 1915); Crane, *The Uniform Partnership Act and Legal Persons* 29 HARV. L. REV. 838 (June 1916).

[67] See Art. 1768 NEW CIVIL CODE.

V. TERMINATION OF FIDUCIARY DUTY

We have seen that the fiduciary duty of a partner rests largely on the fact that, for the purposes of the partnership business, a partner acts as an agent for the partnership and his copartners and as a principal for himself.[68] While this agency exists, the fiduciary duty continues, and is not lessened by the fact that during negotiations for the purchase of one partner's share by another the relations between the partners become strained,[69] or a suit for accounting and dissolution had been filed by one partner.[70]

Enunciating a decidedly minority and contrary view is a Washington decision holding that, "whatever fiduciary relation was imposed on the partnership, the relation ceased when they began to negotiate between themselves as to the price to be paid by one for the other's interest. They were then dealing with each other at arm's length in the absence of any circumstance showing that the complaining party was not **sui juris**, or had a right to rely upon the other."[71]

When the partnership, however, is dissolved or terminated, the general agency for his copartner ceases,[72] although the mutual agency to a certain extent is prolonged until the affairs of the partnership are administered and wound up.[73] It is safe, therefore, to state as a general proposition that the fiduciary obligations of a partner remain until the relationship is terminated.[74] After the termination of his membership in the partnership, a partner is freed from this fiduciary obligation and could purchase a property which was originally leased to the partnership.[75]

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[68] *Supra* note 13, at 109.

[69] Wright v. Duke, 91 Hun 409 36 N.Y. Supp. 853 at 109 (1895)

[70] Johnson v. Peckham, 132 Tex. 148 (1938). For add-cases see 120 ACR. 720..

[71] Elmore v. McCousghy, 92 Wash. 263, 159 P. 108 (1916).

[72] Ordinarily, when partnership is dissolved, authority of individual partner is terminated. Pottash v. Burnet, 50 F. 2d 321 (1931); Atlas Insurance Co. v. Cotter, 226 Ky. 554, 11 S.W. 2d 427 (1928); Diversified Fruit Farms v. Johnson, 58 S.W. 2d 73.

[73] The dissolution of a partnership does not destroy authority of a partner to act for his former associates in matters in which they still have a common interest and are under a common liability. Cotton v. Perisable Air Conditioners, 18 Cal 2d, 575, 116 P. 2d 603, 136 A.L.R. 1068 (1941); Atlas Assur. Co. v. Cotten, Ky. 584; 11SW 2d 427 (1928) Webber v. Rosenberg, 318 Mass 768, 64 NE 2d 98 (1945). Bell v. Portern, 261 Mich 97, 246 NW 93 (1932); McKinnis v. Dodge, 103 OR. 9 (1922).

[74] Claude v. Claude, 191 Ore. 308, 228 P. 2d 776, (1951). Sennion v. Wilson, 250 S.W. 2d 638 (1952); Karrick v Hannaman, 168 U.S. 328 (1897); Zimmerman v. Harding, 227 U.S. 489 33 Ct. (1913).

[75] Stone v. Lerner, 118 Colo. 455 (1948).

The Philippine Supreme Court adheres to this rule. In **Hanlon v. Haussermann and Beam,**[76] four contracting parties agreed to promote a joint enterprise for the rehabilitation of a mining plant which had been destroyed by flood. The engagement of three of the parties was limited to an undertaking to raise money within a stated period by subscribing to or selling shares of the mining company. One of the parties who had promised thus to raise money defaulted, and under the express provisions of the contract the two other parties were discharged. At a later date these two, defendants in the case, who were at the same time stockholders and officials of the mining company, procured a contract from the mining company by which they proceeded to restore the mining plant upon their own account. The court, after finding that the defendants did not acquire any special knowledge of the mine or of the feasibility of its reconstruction by reason of their relation with plaintiff, held that they were not liable to share with their former associates the profits they obtained. Rejecting the contention of the plaintiff that being co-adventurers or co-partners, the defendants had the fiduciary duty to account for the profits, the court ruled that after the termination of the partnership, a partner is free to act in his own inerest with respect to the same subject-matter, provided he has done nothing during the continuance of the relation to lay foundation for an undue advantage to himself.

Decisions of American courts have attenuated the applicability of this general proposition and imposed on a retired partner a fiduciary duty to account for profits earned by him even **after the termination** of his association with the partnership, if in making such profits, he availed himself of information obtained by him while still a partner, and the transactions from which he made the profits are within the scope of the firm's business.

In graphic language, the Oregon Supreme Court said: "When a partner wrongfully snatches a seed of opportunity from the granary of his firm, he cannot thereafter, excuse himself from sharing with his copartners the fruits of his planting, even though the harvest occurs after they have terminated their association."[77]

The facts of this Oregon case[78] were as follows: Plaintiffs and defendant, Janicek, were partners engaged in the business of selling war surplus items. The partnership was given an opportunity to increase its profits by becoming party to a joint adventure arrangement by which third parties were to contribute new capital for

[76] 40 Phil. 796 (1920).
[77] Foucheck et al v. Janicek, 190 Ore. 251 (1950).
[78] *Supra* note 77.

the purchase of war supplies materials. Defendant terminated his association with the partnership on November 2, 1946, and ten days thereafter, he was an active joint adventurer with the same third parties who offered to the partnership new capital. After finding that the defendant learned of the offer of the third parties and its bright prospects in the course of his membership in the partnership, the Oregon Supreme Court held him guilty of a breach of his fiduciary relationship with plaintiffs in turning to his personal profit a valuable business opportunity which had properly belonged to the firm in which the parties were copartners.

In answer to the claim of the defendant that the duty of a former partner to share profits with his former associates extends only to earnings accruing before the termination of the partnership, the court ruled that: "If a member of a copartnership avails himself of information obtained by him in the course of the transaction of partnership business which is within the scope of the firm's business, and thereafter applied it to his own account without the consent or knowledge of his associates, he is liable to account to the firm for any benefit he may obtain from the use of such information."

Note the similarity of the rule laid down by the Supreme Court of the Philippines. Expressing it in a different language, the court declared that, after the termination of the partnership, the fiduciary duty ceases "provided he has done nothing during the continuance of the relation to lay a foundation for an undue advantage to himself."[79]

It should be emphasized, however, that a partner is liable to account for profits earned by him from the use of information obtained by him in the course of the transaction of the partnership business, or by reason of his connection with the firm, only if he uses the information for any purpose within the scope of the partnership business, or for any purpose which would compete with the partnership business. As Lord Justice Lindley said in Aas v. Benham[80], "If he uses the information for purposes which are wholly without the scope of the partnership business, and not competing with it, the firm is not entitled to account of such benefit...It is not the source of the information, but the use to which it is applied, which is important. To hold that a partner can never derive any personal benefits from information which he obtains as a partner is manifestly absurd."

[79] *Supra* note 76, at 126.
[80] Ch. D., 244,255 (1891) See also Latta v. Kelbourn, *supra* note 5, at 107.

Courts have also recognized and enforced a partner's fiduciary duty not to compete with the partnership business after the termination of his membership, if there is a valid stipulation to that effect.

An enlightening discussion on this subject is found in **Eldridge v. Johnston.**[81] Plaintiffs in said case sued for an injunction restraining the defendant from carrying on a meat business in certain counties in competition with plaintiffs contrary to a contract between plaintiffs and defendant. The Supreme Court of Oregon upheld the validity and enforced the provisions of the contract, executed contemporaneously with defendant's sale of his interest in the partnership business to plaintiffs, that defendant would not engage in the meat business in Oregon or Wahington for ten years or so long as plaintiffs were engaged in such business in either of such states on the ground that the contract was not so unreasonable as to render it void as against public policy.

Although the court admitted that contracts in general restraint of trade are void and unenforceable, it upheld the validity of the contract in question on the ground that the restraint of trade was "partial or restricted in its operation as to either time or place, supported by good consideration, and reasonable as affording only fair protection to interests of party in whose favor it is made and not so large in its operation as to interfere with public's interests."

VI. CONCLUSION

The foregoing discussion shows that the fiduciary duty of a partner to his copartners is of great elasticity and generality. For this reason courts have given various and different grounds for compelling a partner to account to his copartners profits he may acquire clandestinely. Likewise, the standard of behavior required of partners by courts is far from uniform. Some courts impose the legal duty to account when the transaction is unfair and unjust to the other partners;[82] others consider the fairness of the transaction inconclusive as to his liability and demand full disclosure as a standard of behavior to exempt him from his obligation.[83]

Stripped of legal verbiage, the fiduciary responsibility of a partner consists of his duty of loyalty to his copartners. In all cases where the courts made a partner account for profits for the benefit of his copartners, one could see, amidst the multifarious reasons given by

[81] 195 Ore. 379, 245 P. 2d 239 (1952).
[82] *Supra* notes 21, 22, 23, at 111 and 112.
[83] *Supra* notes 16, 33, at 110 and 114.

the court, one unifying fact — breach of this duty of loyalty. Indeed it can be said that this duty of loyalty is the basis of the law of partnership, so far as it relates to the rights and obligations of partners as between themselves. Loyalty which has been defined as "The willing and practical and thorough-going devotion of a person to a cause"[84] prohibits a partner from serving two masters, and forbids him from preferring his own interests in case it conflicts with those of the partnership. Semper enim non id quod privatim interest unius ex sociis servari solet, sed quod soci-etate expedit.[85]

It is most appropriate to close this paper with the words of that great jurist, Judge Cardozo (later Mr. Justice Cardozo):

> "Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."[86]

[84] ROYCE, THE PHILOSOPHY OF LOYALTY 6, (1930).
[85] Dig. xvii, Tit. 2, pro socio, 1. 65 Sec. 5.
[86] Meinhard v. Salmon, *supra* note 2, at 106. Will such "uncompromising rigidity" with respect to fiduciaries be followed in the case of directors of corporation? Writers suggest that in regard to the fiduciary duty of directors the policy of facilitating business has prevailed over the older policy of removal of temptation. See *BALLANTINE, CORPORATIONS*, 167, 203, 209 (1946); Note (1948) 61 Harv. L. Rev. 335; Scot, *The Fiduciary Principle* 37 CALIF. L. REV. 539, 555 (Footnote 30) (1949).