

Partnership

By

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Introduction

A partnership is defined simply as a contract, whereby two or more persons consent to combine assets or labor to realize common profits. Pooling resources to better exploit investment opportunities is so natural that there is evidence of partnerships in the earliest legal codes. For example, partnerships are referenced in the ancient Mesopotamian Code of Hammurabi, as well as in sixth-century Rhodian sea law. Yet, as even these ancient references imply, the simplest partnership can generate problems stemming from conflicting claims. This suggests that the history of the partnership may be best studied through the recognition of, on the one hand, the desire to exploit economies of investment, and on the other, the need to clarify rights and obligations to minimize conflicts not only between the firm and third parties but also between copartners .

In the eleventh century partnerships were introduced into Europe through Italy when Europe was experiencing increased trade. Of primary importance was renewed contact with the Eastern Mediterranean, through which Western merchants became aware of the business practices and commercial legal codes of Byzantium and the Islamic states. From the former, they were familiarized with the commercial laws of Rome as reflected in the Justinian Code, and from both they acquired the merchant law and its institutions. Regarding partnerships, Western merchants borrowed the *commenda*, as reflected in Islamic law, and the Roman *societas*.

The *Commenda*

The *commenda* contract had a sedentary investor, known as the *commendator*, who advanced capital to a traveling associate, known as a *tractator*. Its essential feature was that the

commendator risked only the capital advanced because he was not liable for any other losses. The contract ended when profits were distributed after the merchant returned. As private partnerships carrying limited liability were unknown in classical Rome, the origin of the *commenda* is believed to be either Byzantium or Arabia.

The *commenda* flourished across Europe after its introduction into Italy, but it particularly was used in overseas trade. Its success has been attributed to its being a convenient tool used to circumvent restrictive usury laws, or as a convenience to reduce capital risk. Both explanations are suspect due to the presence of bottomry loans, which were not repayable if goods were damaged or lost. The bottomry loan, dating back to the Rhodian Sea Law, was tolerated under the canon law, which may explain its subsequent use in overland trade as well.

The success of the *commenda* is therefore attributable to its usefulness in combining capital with merchant entrepreneurship. When the merchant added only his own skill and knowledge, the partnership was known as a unilateral *commenda*, in which case the *commendator* received three-fourths of any profit and the *tractator* the rest. Under this type of contract, the *commendator* would be concerned that the merchant might opportunistically pursue his own interests. A more basic threat stemmed from the fact that the merchant was not personally liable for any losses, and therefore they were inclined to incur more risk than optimal. However, the amount of capital risked was limited to that required to purchase merchandise. In addition, merchants and capitalists generally formed lasting relationships, suggesting that merchant reputation played a crucial role.

The simple unilateral *commenda* of the early period eventually became a more efficient bilateral *commenda*, whereby the merchant also advanced some capital. If he invested a quarter of the total capital, he received 50 percent of the profits. In France and Italy during the fifteenth century a larger form of *commenda* developed, where several *commendators* contributed capital to one or more *tractors*, who increasingly operated with more independence. Under this arrangement, which known as a *société en commandite*, its capital suppliers contributed only capital which carried limited liability, and its managers bore unlimited liability.

The Compagna

The *compagna* was introduced into Italy in the same period as the *commenda*. It was loosely based on the Roman *societas*, which included any association formed to exploit capital and labor. Whereas a *societas* partner was unable to bind his copartners for debts or to alienate any property for more than his share, partners belonging to a *compagna* were each responsible individually for the debts of the firm, and each could contractually bind the whole firm.

The *compagna* could own property and act under a common name. It could sue and be sued, and was even liable for any negligent or fraudulent acts committed by its members. It thus acquired a kind of legal personality. Consequently, as a general rule, each partner enjoyed a voice in partnership decision making. Decisions required a simple majority vote (in contrast with the *societas*, where unanimity was required), allowing the *compagna* to fully exploit its pooled resources and enabling it to undertake larger ventures requiring longer time horizons.

Note that the principle that any one partner could bind all partners originally applied only if extended to a partner by procurement. Otherwise, creditors could only make good a claim against the firm if a debt was recognized as a firm debt. Thus, partnership books were often examined. However, by the fifteenth century, the principle of one binding all was generally accepted. Also, in the formative period, individuals often denied to creditors that they were really partners: they claimed that they were really partners in some other partnership, or that they had previously dissolved their association. Consequently, the rule eventually became that agreements listing the partners had to be registered with their guild and city authority. Such deeds also typically noted the duration of the partnership, but if the latter was not mentioned, the partnership could be dissolved at the will of any partner. The deed also specified an agreed division of profits; otherwise, the split was even.

At first the *compagna* was based solely on the family, but increasingly it included outsiders, though in Venice family-based partnerships persisted well into the sixteenth century. Large partnerships were particularly vulnerable to agency and managerial difficulties. Banking partnerships were among the largest, having several distant branches specifically located to best service the financial needs of overland trade. Banks were based on wealthy families and originally, as in the case of the Peruzzi and Bardi partnerships, they were centrally governed by family partners located at home. As the distant branches were managed by agents called *factors*, local managers were unable to contractually bind the firm. Consequently, these banks often could not seize profitable opportunities and were thus eventually eclipsed by the Medici bank, which formed separate partnerships with each local manager and thrived in the fifteenth century. Notably, under the merchant law, each branch was held to be totally separate.

Summary and Extension

In the formative period of the partnership the essential features of both the limited-liability and general partnership evolved to form the basis of modern partnerships in Roman-law and common-law countries. The general partnership of both England and the United States was introduced into the common law of England through the merchant and equity courts. Its essential characteristics were simply those of the Italian *compagna*. Notably, Scottish partnership law was based on the civil law, and was therefore more flexible from an entrepreneur's perspective. However, after the Act of Union (1707), Scottish partnership law began to slowly coalesce with that of England.

The *commenda* was widely used throughout Europe, including in England, where it was discouraged under the common law in the sixteenth century. But in many countries the modern form of limited partnership derives from the French *commandite*, which spread through much of continental Europe with the Napoleonic Code in the early nineteenth century. It was first introduced by statute into U.S. law in New York in 1822, and soon spread to other states. However, limited partnerships were not reintroduced into England until 1907. The end of the twentieth century witnessed somewhat controversial legal innovations in the USA and UK, which permitted managing partners to have limited liability. These limited liability partnerships (LLP) have become common in the legal and accountancy professions

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