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COMMENTS

COMMERCIAL LAW—BANKS AND BANKING—PARTNERSHIPS—RIGHT OF PARTNERS TO DAMAGES FOR WRONGFULLY DISHONORED PARTNERSHIP CHECKS*

The partnership has long defied attempts of the law to place it into a conceptual pigeonhole.[1] It fits neatly within no traditional category[2]; scholars have debated its nature[3]; and the controversy continues: Is the partnership an aggregate or an entity?[4] Or, indeed, is it either? The answer to this conceptual puzzle is by no means of interest only to legal theoreticians. Its ramifications permeate unexpected corners and crevices of the law.[5]

The civil law treats the partnership as a juristic person possessing a distinctive legal personality, much as our present law regards the corporation.[6] It was viewed by the English common law, however, as no more than a convenient way to express the relationship between the partners and their resultant rights and liabilities.[7] The partnership concept in the United States today is far from being well defined. For some purposes, it is dealt with as a separate entity, while for others it is treated as an association of two or more persons, seen as individuals.

A major characteristic of the partnership which is difficult to reconcile with the separate entity theory is the liability of the individual partners for partnership obligations. Their personal assets may be reached by creditors of the partnership, whether the debt has its origin in contract[8] or in tort.[9] The commercial world, however, often looks on a partnership as being in some way distinct from its members, so that it may be termed a commercial entity even

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* Loucks v. Albuquerque National Bank, 76 N.M. 735, 418 P.2d 191 (1966).

1. 1 S. Rowley, Partnershp § 1.3 (2d ed. 1960).

2. *Id.* § 1.3D.

3. *See, e.g.*, Crane, *The Uniform Partnership Act—A Criticism*, 28 Harv. L. Rev. 762 (1915); and Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism*, 29 Harv. L. Rev. 158, 291 (1916).

4. Jensen, *Is a Partnership under the Uniform Partnership Act an Aggregate or an Entity?*, 16 Vand. L. Rev. 377 (1963).

5. J. Crane, Partnership § 3 (2d ed. 1952).

6. *Id.*

7. 1 S. Rowley, Partnership § 1.3 (2d ed. 1960).

8. Wheatley v. Carl M. Halvorson, Inc., 213 Ore. 228, 323 P.2d 49 (1958).

9. Phillips v. Cook, 239 Md. 215, 210 A.2d 743 (1965).

in circumstances where the law does not treat it as a legal entity.[10] The entity concept is employed in various situations to achieve a just result which might not otherwise be possible.[11] Generally, the ultimate aim of such treatment is fairness and convenience; the entity theory cannot be invoked where it would result in the contrary.[12]

Perhaps the most accurate summary of the current conceptual treatment is that a partnership will not generally be regarded as a legal entity entirely separate and distinct from its members, but it may be dealt with as such if the legal fiction of the entity aids in accomplishing a desired end.[13]

The case of *Loucks* v. *Albuquerque National Bank*[14] illustrates some of the problems that can result when an attempt is made to apply the partnership concept to a specific situation. The plaintiffs, who were partners doing business under the name of L & M Paint and Body Shop, opened a checking account in the partnership name with the Albuquerque National Bank. Subsequently, the bank wrongfully charged a delinquent personal indebtedness of one of the partners against the partnership account. As a result, nine or ten partnership checks were dishonored by the bank.[15]

The partners sought recovery on behalf of the partnership for (1) the amount wrongfully charged against the account, (2) damages to credit, good reputation, and business standing in the community, (3) loss of income, and (4) punitive damages. One of the partners sought recovery for damages suffered from an ulcer allegedly caused by the bank's wrongful dishonor of the checks, and each partner individually sought punitive damages and damages to his personal credit, good reputation and business standing.[16] The trial court removed all questions of damages from the jury except the issue involving the sum wrongfully charged against the account. On appeal by plaintiffs to the New Mexico Supreme Court, *held,* Reversed and Remanded for a new trial solely on the question of damages to partnership credit. The court specifically denied the right of

10. J. Crane, Partnership § 3 (2d ed. 1952).
11. Grober v. Kahn, 47 N.J. 135, 219 A.2d 601 (1966).
12. Scott v. United States, 354 F.2d 292 (Ct. Cl. 1965).
13. Close-Smith v. Conley, 230 F. Supp. 411 (D.C. Ore. 1964); 501 DeMers, Inc. v. Fink, 148 N.W.2d 820 (N.D. 1967). *But see In re* Svoboda & Hannah, 180 Neb. 215, 142 N.W.2d 328 (1966).
14. 76 N.M. 735, 418 P.2d 191 (1966).
15. *Id.* at 739, 418 P.2d at 194.
16. *Id.* at 741, 418 P.2d at 195.

the individual partners to recover damages for any personal losses or injuries they may have sustained.

The court's opinion was based on its interpretation of the word "customer" in § 4-402 of the Uniform Commercial Code[17], which provides:

> A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. When the dishonor occurs through mistake liability is limited to actual damages proved. If so proximately caused and proved damages may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

The court reasoned that the "customer" of the bank, as contemplated by the quoted section of the Uniform Commercial Code, was the partnership; therefore, any right of recovery belonged to the partnership as an entity separate and distinct from the two partners.[18] The individual partners, according to the court's reasoning, had no right of action against the bank because they were not the "customers" protected by the statute.[19]

Three major faulty premises provided the foundation for the court's acceptance of the entity concept of a partnership. One is found in the court's reference to the Uniform Partnership Act.[20] A partnership, it is stated, is treated by the act as a legal entity for some purposes. While this is an undeniably true statement of the law, it is not authority for the result reached by the court. A brief review of the history of the act[21] leads to the conclusion that the common law or aggregate theory was largely retained by the draftsmen of the Uniform Partnership Act,[22] subject to only a few modifications. These modifications permit an application of the entity theory for purposes of facilitating transfers of property, marshalling assets, and protecting the operation of the business from the

17. N.M. Stat. Ann. § 50A-4-402 (Repl. 1962). New Mexico has adopted the Uniform Commercial Code as N.M. Stat. Ann. 50A-1-101 to -9-507 (Repl. 1962).

18. 76 N.M. at 742, 418 P.2d at 196. The issue was not raised either at the trial level or in the briefs on appeal. It appeared for the first time in the opinion.

19. 76 N.M. at 742, 418 P.2d at 196.

20. Adopted in New Mexico as N.M. Stat. Ann. 66-1-1 to -43 (Repl. 1960).

21. The history can be found in the Commissioners' prefatory note to the act, 7 U.L.A. 2 (1949). Summaries of interest are also contained in Mazzuchelli v. Silberberg, 29 N.J. 15, 148 A.2d 8 (1959); and Helvering v. Smith, 90 F.2d 590 (2d Cir. 1937).

22. In Helvering v. Smith, 90 F.2d at 591, Judge Learned Hand stated the point quite succinctly: "it would be a palpable perversion to understand the act as creating a new juristic person. . . ."

immediate impact of personal involvements with the partners.[23] Aside from making use of the conceptual tool of the entity for those procedural and conveyancing purposes, which have no application in the *Loucks* case, the act preserves the traditional aggregate concept.[24]

A second faulty premise used by the court in supporting its acceptance of the entity concept is found in its citation of N.M. Stat. Ann. § 21-6-5[25] and § 21-1-1(4)(o)[26] (1953). These statutes, however, merely provide methods by which litigation involving partnerships can be facilitated through more convenient service of process and permitting suit in the firm name. A federal district court in New York, construing similar provisions in the New York Civil Practice Act,[27] found it clear that the procedural treatment "was never intended to make a New York partnership a separate legal entity apart from that of the partners."[28] The statutes have no application beyond the particular matters with which they deal, and do not change the essential features of the partnership.[29]

The third, and most significant, faulty premise, is expressed in the court's unqualified statement: "The Uniform Commercial Code expressly regards a partnership as a legal entity."[30] The court is wrong. No stand is taken by the Uniform Commercial Code as to the legal nature of a partnership. Section 1-201(28),[31] which de-

23. McKinney v. Truck Ins. Exch., 324 S.W.2d 773 (Mo. Ct. App. 1959).

24. Thomas v. Industrial Comm'n, 243 Wis. 231, 10 N.W.2d 206 (1943).

25. "Suits may be brought by or against a partnership as such, or against all or either of the individual members thereof; and a judgment against the firm as such may be enforced against the partnership's property, or that of such members as have appeared or been served with summons; but a new action may be brought against the other members in the original cause of action."

26. "Upon domestic or foreign corporations or upon a partnership or other unincorporated association which is subject to suit under a common name, [service may be made] by delivering a copy of the summons and of the complaint to an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant."

27. N.Y. Civ. Prac. Act § 222-a (1920). The act has been recodified and is now N.Y. Civ. Prac. §§ 310, 5018(a) and 5201(b) (McKinney 1963).

28. Koons v. Kaiser, 91 F. Supp. 511, 512 (S.D.N.Y. 1950).

29. 40 Am. Jur. *Partnership* § 435 (1942); 68 C.J.S. *Partnership* § 67 (1950).

30. 76 N.M. at 742, 418 P.2d at 196.

31. " 'Organization' includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal *or commercial* entity." (emphasis supplied). N.M. Stat. Ann. § 50A-1-201(28) (Repl. 1962).

fines "organization," provided the basis for the court's statement. The partnership is included in the definition of "organization," but then so is an "association," and even "two or more persons having a joint or common interest." Comment 28 to that section explains that subsection 28 "is the definition of every type of entity *or association,* excluding an individual, acting as such." (emphasis supplied). The definition obviously encompasses both those organizations which are normally entities in the view of the law and those which only bear some resemblance to such juristic persons. The Code's definition of "organization" is, therefore, doubtful authority for treating every commercial entity as a legal entity.

Serious implications for a number of areas of partnership law are raised by the decision. For example, what effect does the holding that the Uniform Commercial Code expressly regards a partnership as a legal entity have upon the traditional individual liability of partners for partnership obligations when transactions under the Code are involved? Would the result be the insulation of the partners and their personal assets from the operation of individual liability? Considering the scope of the Code, the potential effects on commercial law would be enormous should the court follow *Loucks* and interpret the Code as treating a partnership as a legal person for the purposes of applying all its provisions.[32]

Another question arises from the provision in § 4-402 giving a right of recovery when an arrest or prosecution of the customer is proximately caused by the dishonor of the checks.[33] An individual can be arrested and prosecuted for committing a crime; a corporation can be prosecuted and fined upon conviction; a partnership cannot be prosecuted or convicted, however, because it cannot commit a crime.[34] The case of *State v. Spears* emphatically stated that guilt attaches to the individual guilty members, but that the partnership is not a person separate from its members in the sense that a corporation is an entity, and by its very nature could not be guilty of a crime.[35] Since the partners as individuals would be arrested and

32. The major areas covered in the articles are sales, commercial paper, bank deposits and collections, bulk transfers, warehouse receipts and bills of lading, investment securities and secured transactions.

33. N.M. Stat. Ann. § 50A-4-402 (Repl. 1962).

34. State v. Spears, 57 N.M. 400, 259 P.2d 356 (1953).

35. *Id.* The opinion adopted the position of the California courts as stated in People v. Schomig, 74 Cal. App. 109, 239 P. 413, 414 (1925):

> "In most respects a partnership is but a relation with no legal being as distinct from the members who comprise it. It is not a person, either natural or artificial."

prosecuted rather than the partnership,[36] who could recover damages if the proximate cause for the criminal proceeding had been the wrongful dishonor of partnership checks? The partnership could not recover because it was not, and could not have been arrested or prosecuted. The individual partners would be denied recovery on the authority of *Loucks* since they were not the "customers," as the court interprets that term, of the bank.

One might think that individual recovery would be possible on a tort theory, regardless of the conceptual treatment of the partnership. Comment 2 to § 4-402 of the Uniform Commercial Code states:

> The liability of the drawee for dishonor has sometimes been stated as one for breach of contract, sometimes as for negligence or other breach of a tort duty, and sometimes as for defamation. This section does not attempt to specify a theory.[37]

The *Loucks* opinion disposes of the tort theory, however, by apparently slipping into a *contractual* concept of duty: "No duty was owed to [the partner] personally by reason of the debtor-creditor relationship between the bank and the partnership."[38] Duty in tort law does not depend on contractual relationships.

The New Mexico court has held in a pre-Code case, *Young v. New Mexico Broadcasting Co.*,[39] that defamation of a partnership name is defamation of the individual partners and gives a right of recovery to the partners for their individual damages. Since *Loucks* denied the partners any personal recovery, the court must interpret § 4-402 as either excluding a defamation theory entirely or, at the least, excluding a defamation theory when no contractual relationship exists between the bank and the injured party. Their holding that the bank was under no contractual relationship with the individual partners denies the partners any personal recovery based on defamation.

Any theory of recovery except contract was effectually excluded by the decision. The result is to give banks an immunity from tort actions in specific situations involving partnerships, no matter how

36. Unless, of course, the court should decide to extend the entity concept to the area of the partnership's criminal liability.

37. U.C.C. § 4-402, Comment 2.

38. 76 N.M. at 744, 418 P.2d at 197.

39. 60 N.M. 475, 292 P.2d 776 (1956).

negligent or willful their conduct may be. As was pointed out in a recent decision of the California Supreme Court, there is "no reason for according to an institution so basic to the contemporary society as a bank a special non-statutory exemption from general tort liability."[40] *Loucks* does just that.

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40. Weaver v. Bank of America Nat. Trust and Sav. Ass'n, 30 Cal. Rptr. 4, 11, 380 P.2d 644, 651 (1963).