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# THE MEDIAEVAL *CONTRACTUM TRINIUS*<sup>1</sup> AND THE LAW OF PARTNERSHIP

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## 1 Introduction

Partnership law is as old as commerce itself. Its history as a profit-sharing device can be traced from the ancient Near-Eastern civilizations to its present day position as one of the most important forms of business enterprise.<sup>2</sup>

The Roman *societas*, the *lex mercatoria* and the mediaeval *commenda* have been identified as pre-eminent among the main historical influences that shaped the law of partnership.<sup>3</sup> The contribution of Roman law is evident both in so far as the basic concept of partnership as a consensual contract of the utmost good faith as well as the relationship constituted by it between the partners *inter se* are concerned.<sup>4</sup> Developments advanced by the *lex mercatoria* include the doctrine of *mutua praepositio*, the liability *in solidum* of partners to third parties for partnership obligations and the entity theory of the legal nature of partnership.<sup>5</sup> The *commenda* was an arrangement by which an investor (*commendator*) entrusted capital to a merchant (*commendatarius*) for employment in business on the understanding that the *commendator*, while not in name a party to the enterprise and though entitled to a share of the profits, would not be liable for losses beyond his capital. This concept served as the

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1 The term "*contractum trinius*" (vulgar Latin) has been used as a term of art in legal texts since the Middle Ages to designate a so-called triple contract – a set of three contracts devised as a method of circumventing mediaeval edicts prohibiting usury. See also text following on n 55.

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2 Bromberg & Ribstein *Bromberg and Ribstein on Partnership* (1992) 13; Joubert *LAWSA: Partnership. First Reissue* Vol 19 (1997) 186; Goldschmidt *Universal-geschichte des Handelsrechts* (1891) 51-78; Szelechter *Le Contrat de Société en Babylonie en Grèce et à Rome* (1947) 113-122; Burns "Partnership" in *Encyclopedia of the Social Sciences* Vol 12 (1948) 3; Salin "Usury" in *The Encyclopedia of the Social Sciences* Vol 15 (1948) 195; Story *Commentaries on the Law of Partnership* (1841) 2-3; Tyler *The Law of Partnership* (1877) 9; Blackett-Ord *Partnership* (1997) 4-5.

3 Joubert (n 2) 187. Cf Henning & Delpont *Partnership* (1984) par 362; Burdick *Law of Partnership* (1899) 2-3.

4 Buckland *Roman Law and Common Law* (1963) 508; Thomas *Textbook of Roman Law* (1976) 304; Schulz *Classical Roman Law* (1951) 552; Van Oven *Leerboek van Romeinsch Privaatrecht* (1948) 286; Daube "Societas as consensual contract" 1938 *Cambridge LJ* 381; Barrett & Seago *Partners and Partnerships* (1956) 7-10; Goldschmidt (n 2) 255-271; Stein "Mutual agency of partners in the civil law" 1959 *Tulane LR* 595 596; Holdsworth *A History of English Law* (1966) 207; Maine *Lectures on the Early History of Institutions* (1875) 234; Story (n 2) 7.

5 Joubert (n 2) 186; Goldschmidt (n 2) 283, Drake *Law of Partnership* (1995) 610-613.

precursor of the present day Continental (and South African) partnership *en commandite* as well as the Anglo-American limited partnership.<sup>6</sup>

The list is not exhaustive. From the Middle Ages onward in Europe and Britain, partnership served as an important stimulus to commerce by bringing together investor and merchant in relationships specially constructed to escape condemnation as usury.<sup>7</sup> It is to be expected that the usury doctrine of the time, and especially the resulting *contractum trinius*, would influence the development of the law of partnership.<sup>8</sup>

## 2 Loan and partnership

Differentiating between partnership and other legal relationships has often been a matter of some difficulty. Nowhere has this proved to be more so than distinguishing between loan and partnership, especially in the case where money is advanced to a business in return for a share of the profits or a rate of interest varying with the profits of the business.<sup>9</sup>

It is possible that an advance of money to a business may be made on the understanding that interest on the advance is to be calculated with reference to a share in the profits of the business. It is also possible that an agreement is made by which a person's share in the profits of a business is to be calculated with reference to interest charged on capital contributed to the firm. These agreements contain the essential elements of partnership, but the difficulty is to ascertain whether in fact they constitute a partnership agreement or a loan agreement.<sup>10</sup>

In principle a partnership will not be formed unless the participants' contributions to the enterprise are subjected to the risks of the venture. Where capital is advanced to a business on the basis that the full amount plus interest must be returned at a later stage irrespective of the fortunes of the business, the agreement is one of loan and not partnership. However, the fact that a

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6 Lindley *Law of Partnership* (1984) 839; Bromberg & Ribstein (n 2) 15; Bergstedt "Partnerships *in commendam* – Louisiana's limited partnership" 1961 *Tulane LR* 816-817; Bates *Law of Limited Partnership* (1886) 8; Holdsworth (n 4) 195-196; Goldschmidt (n 2) 255-264; Wessels *History of the Roman-Dutch Law* (1951) 650-651; Banks *Lindley and Banks on Partnership* (2002) 841; Blackett-Ord (n 2) 4-5.

7 Bromberg & Ribstein (n 2) 13-14; Crane & Bromberg *Law of Partnership* (1968) 11-13.

8 Endemann *Studien in den romanisch-kanonistischen Wirtschafts- und Rechtslehre* (1874) 399-423; Banks (n 6) 3-4: "On the other hand, it suffered from the laws against usury, from what previous editors called 'unsound views of political economy'."

9 See, eg, *Canada Deposit Insurance Corporation v Canadian Commercial Bank* [1992] 3 SCR 558.

10 Joubert (n 2) 213. Cf Henning & Delpont (n 3) par 371.

party is entitled to the return of the full amount of the principal sum contributed by him is not always conclusive. If a partner contributes the use of capital to the business he remains entitled to the return of the full amount, and only the interest on it will be subjected to the risks of the business. Where both capital and services are contributed, the agreement is not necessarily a loan merely because the capital plus interest is to be repaid in full, because a partner may also lend money to the firm. Modern textbooks on the law of partnership emphasise that in such cases all other surrounding facts must be considered to ascertain the true nature of the agreement.<sup>11</sup>

### 3 The British *Partnership Act* of 1890

#### 3.1 Importance of the British *Partnership Act*<sup>12</sup>

The importance of the British *Partnership Act* of 1890 (the "*Partnership Act*") in the history of the Anglo-American law of partnership is beyond question. This Act, with its "rather limpid prose" and the "clear and elegant expression of its provisions",<sup>13</sup> has been in force in England, Wales and Scotland since 1 January 1891. It has served as an example for partnership legislation of most Commonwealth jurisdictions and has strongly influenced the American *Uniform Partnership Act* of 1914. Provisions similar to those referred to below, currently appear in more than thirty other Partnership Acts and Ordinances with dates of implementation ranging from 1891 to 1981.<sup>14</sup>

Although the *Partnership Act* has often been praised as a model of its kind, not all comment has been so kind. There has been critical comment on the results of the long period of gestation of the Bill, following Sir Frederick Pollock's draft of 1879. In the course of the subsequent decade the Bill was resubmitted at frequent intervals, suffering alterations and deletions, almost amounting to mutilation, and resulting in many obscurities in the *Partnership Act*. Against this backdrop, although the *Partnership Act* which eventually reached the statute book in 1890 was based upon Pollock's original Bill, he is not the only one to blame for its many ambiguities and inaccuracies.<sup>15</sup>

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11 Joubert (n 2) 214.

12 1890 (53 & 54 Vict c 39).

13 Miller *The Law of Partnership in Scotland* (1973) 5; in *Keith Spicer Ltd v Mansell* [1970] 1 All ER 63 it was described as "a model piece of legislation".

14 Henning "Die aanspreeklikheid van 'n beslote korporasie vir die handeling van 'n lid en enkele ander aspekte rakende eksterne verhoudings" 1984 *J for Juridical Science* 155-168.

15 The Law Commission and The Scottish Law Commission *Partnership Law. A Joint Consultation Paper* (2000) par 3.21: "Our own work on the project has confirmed our respect for the 1890 Act as a whole, in particular its simplicity of expression. However, we have also been struck by the lack of clarity on some important concepts." See also

### 3 2 Loan and partnership

Section 2 of the *Partnership Act* contains the rules which have to be considered in determining whether a partnership exists.<sup>16</sup> Section 2(3) is regarded as the most important of these rules. It is therefore significant that paragraph (d) of this subsection provides that a loan of money to a person engaged in a business, on a the basis that the lender will receive either a rate of interest varying with the profits or a share of the profits arising from the carrying on of the business, *does not in itself* make the lender a partner with the person carrying on the business *or liable as such*. It is even more significant that this arrangement is subject to the express proviso *that the contract must be in writing, and signed by or on behalf of all the parties thereto*.<sup>17</sup>

It has been said of this subsection that it is “unfortunate”, that it “could be better”,<sup>18</sup> that it is “not well expressed”, that it “contains a contradiction in terms” and that it “has a lack of clarity”.<sup>19</sup> At first glance the effect of the proviso seems to be that a lender receiving a rate of interest varying with the profits of the business, in terms of a contract *not* reduced to writing or *not* signed by or on behalf of all the contracting parties, is *not* entitled to the benefit of paragraph (d), and the advance of money under such circumstances would therefore *in itself* make the lender a partner *or liable as such*.<sup>20</sup> Indeed, in *Re Fort, ex parte*

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Davis, Steiner & Cohen *Insolvent Partnerships* (1996) par 1.3. Burdick (n 3) 4 remarks that the result of the Act was that “the law of partnership with all its existing incongruities has been codified.”

16 These are: “(1) Joint tenancy, tenancy in common, joint property, common property, or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof. (2) The sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived. (3) The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but the receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business; and in particular- (a) The receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him a partner in the business or liable as such: (b) A contract for the remuneration of a servant or agent of a person engaged in a business by a share of the profits of the business does not of itself make the servant or agent a partner in the business or liable as such: (c) A person being the widow or child of a deceased partner, and receiving by way of annuity a portion of the profits made in the business in which the deceased person was a partner, is not by reason only of such receipt a partner in the business or liable as such: (d) The advance of money by way of loan to a person engaged or about to engage in any business on a contract with that person that the lender shall receive a rate of interest varying with the profits, or shall receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such: (e) A person receiving by way of annuity or otherwise a portion of the profits of a business in consideration of the sale by him of the goodwill of the business is not by reason only of such receipt a partner in the business or liable as such.”

17 My emphasis.

18 Morse *Partnership Law* (2001) 50.

19 Lindley (n 6) 81.

20 *Idem* 108.

*Scofield*<sup>21</sup> the Queens Bench took this very view and decided that if the benefit of section 2(3)(d) is “desired by the lender, then under the proviso the contract must be in writing.” Following this approach, it may be argued that a person who was a creditor, but never a partner, and with regard to whom the only evidence is participation in profits, in the absence of a written and signed contract to the contrary should be regarded as a partner.<sup>22</sup>

Even from a purely practical viewpoint, the usefulness of the proviso in section 2(3)(d) requiring a written contract, signed by or on behalf of the parties, is questionable.<sup>23</sup> Furthermore, section 3 of the Act provides that in the event of the bankruptcy or insolvency of the borrower, the lender is not entitled to recover anything in respect of his loan until all the other claims of the borrower’s creditors have been satisfied.

The Law Commissions of England, Wales and Scotland agreed with the above criticism and suggested that the proviso in section 2(3)(d) should be repealed. In their view “it appears to be a relic of earlier times”.<sup>24</sup>

In this day and age, a proper interpretation of the proviso to section 2(3)(d) is made more difficult by the relative insensitivity of many mercantile lawyers to the reality that few branches of the law today retain as many historical survivals as the law of partnership. The struggle between ancient concepts and modern business practices, characteristic of all commercial law, is particularly apparent in the law of partnership. This is exacerbated by the fact that most modern Anglo-American authors tend to attach more importance to what partnership law presently is than to its historical development.<sup>25</sup>

It should be kept in mind that these provisions of the *Partnership Act* were taken over from the *Act to Amend the Law of Partnership* of 1865 (“*Bovill’s Act*”).<sup>26</sup> *Bovill’s Act* endeavoured to provide some relief to lenders from the approach that a loan of money at a rate of interest varying with the profits of the

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21 [1897] 2 QB 495 at 501.

22 See Ivamy *Underhill’s Principles of the Law of Partnership* (1986) 8-9; Miller (n 13) 87-88; Blackett-Ord (n 2) 32-33.

23 Lindley (n 6) 108 argues that if it is law that a contract not within this sub-section is admissible as evidence to show the terms on which the loan is made, and there appears to be nothing in this Act to exclude such evidence, it is difficult to see the utility of the proviso to the present subsection. Whether the contract is or is not within the sub-section, when its terms are once proved its real effect must be considered, and if on the construction of the contract the relationship between the parties is that of debtor and creditor, there is nothing in this Act or the general law to change this relationship into one of partnership. If this be so, the only advantage of a signed contract appears to be that such a contract is more easily proved than a verbal or unsigned contract.

24 The Law Commission and The Scottish Law Commission (n 15) par 5.40

25 See Cherry “Cases on partnership” 1931 *Harvard LR* 1156.

26 28 & 29 Vict c 86. See Twomey *Law of Partnership* (2000) 8-9.

business automatically and of necessity made the lender a partner in the partnership with all the consequences attendant thereon, for instance liability *in solidum* of the lender as a partner for the debts and obligations of the partnership.<sup>27</sup>

This confusion of lender with partner and loan with partnership may be traced back<sup>28</sup> to the so-called *contractum trinius* inspired by the mediaeval usury doctrine.

## 4 Historical background

### 4.1 Usury doctrine

“Usury” is derived from the word “*usura*” which means, inter alia, “use, enjoyment, interest.”<sup>29</sup> In the course of its history the concept of usury has covered a wide variety of meanings.<sup>30</sup> Originally it referred to all returns derived from the lending of consumables and carried no moral or legal opprobrium. Domat, for instance, states that the term usury is applied to everything that the creditor, who has lent either money or provisions or other things which are consumed by use, may receive over and above the value of the money or thing which he lent.<sup>31</sup>

In the Middle Ages all direct payments for loans were deemed usurious and condemned as sinful and unlawful.<sup>32</sup> This was a sentiment shared by many common people. It was argued that the burden to prove that it was at least socially useful to permit the charging of interest was on the defenders of interest. This was far from clear in feudal economies, where most lending was for consumption and not production. Social costs were more clearly discernible: The mathematics of compound interest increased social inequality, condemned free men to indentured servitude and burdened civil authorities with enforcement, while the only advantage it seemed to bring was to encourage consumption. Thus, interest-bearing debt was not only unnatural, but also a sinful, morally repugnant and socially detrimental institution.<sup>33</sup> Although in

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27 Gower *Modern Company Law* (1979) 50.

28 See Miller (n 13) 88-89.

29 See also *Wikipedia* Latin sv “Usury”: “Demanding a return for a loan greater than that which was borrowed” (10 July 2006).

30 Salin (n 2) 193; Endemann (n 8) 1-9; Nelson *The Idea of Usury: From Tribal Brotherhood to Universal Otherhood* (1969) 20.

31 Domat *The Civil Law in its Natural Order* (1722) 606.

32 Eg Felicius *Tractatus de Societate* (1666) 3 21: “*Usurae prohibita sub omni jure.*” See also Bates (n 6) 20-21; Blitz & Long “The economics of usury regulation” 1965 *J of Political Economy* 608-609.

33 Although clerics had been prohibited from lending at interest at least since the fourth century, the ban was not extended to laymen until much later. In 1139, the Second Lateran Council denied all sacraments to unrepentant usurers and, in an 1142 decree,

modern times the term was again narrowed down to refer only to excessive loan charges, the term usury will be used in this contribution within its restricted mediaeval meaning.

The theory of usury was shaped by the conceptions developed by the ancient Greek and Roman philosophers on the one hand and the Jewish and Christian theologians on the other.<sup>34</sup> Some of the earliest prohibitions of usury are to be found in the Old Testament, for example *Leviticus* 25:36–37: “Take thou no usury of him, or increase: but fear thy God, that thy brother may live with thee. ... Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase”; *Deuteronomy* 23:19: “Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury”<sup>35</sup>; *Deuteronomy* 23:20: “Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury; that the Lord thy God may bless thee in all that thou settest thine hand to in the land whither thou goest to possess it”; *Exodus* 22:25: “If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shalt thou lay upon him usury”; *Ezekiel* 18:13: “Hath given forth upon usury, and hath taken increase: shall he then live? He shall not live: he hath done all these abominations; he shall surely die; his blood shall be upon him”; *Ezekiel* 22:12: “ ... thou hast taken usury and increase, and thou hast greedily gained of thy neighbours by extortion, and hast forgotten me, saith the Lord God”.<sup>36</sup>

The negative attitude toward usury adopted by the ancient philosophers was shaped in part by the naturalistic conception of money and interest in the teachings of Aristotle which influenced the thinking of mediaeval theologians. Aristotle argued that money as an inorganic object could be used only as a medium of exchange and therefore could not breed new coins. Demanding

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condemned any payment greater than the capital that was lent. Jews and Moors (being “strangers” in Christian lands) were initially exempt from the ban, but the Fourth Lateran Council (1215) issued an admonition prohibiting non-Christians from charging excessive usury. In 1311, Clement V at the Council of Vienna prohibited usury outright and condemned as heretical any secular legislation that tolerated it. See Anon “*The ancients and scholastics*” <http://cepa.newschool.edu/het/schools/ancients.htm> (10 July 2006).

34 Salin (n 2) 193; Gamoran “The Biblical law against loan on interest” 1971 *J of Near Eastern Studies* 127-128.

35 See also Nelson (n 30) 135.

36 *Authorised King James Version*. See also *Nehemiah* 5:7; *Nehemiah* 5:10; *Psalms* 15:5; *Proverbs* 28:8; *Jeremiah* 15:10; *Ezekiel* 18:8; *Ezekiel* 18:17. See further Hildesheimer *Das jüdische Gesellschaftsrecht* (1930) 95: “Da das jüdische Recht Zinsnehmen für Darlehen als Wucher verbietet ...”; Waldron “White collar usury” 1994 *Canadian Bar Review* 1; Meislin & Cohen “Backgrounds of the Biblical law against usury” 1964 *Comparative Studies in Society and History* 250-252; Gamoran (n 34) 127-128; Buckley *Teachings on Usury in Judaism, Christianity and Islam* (2000) 41-55.

payment for the lending of money causes money to beget money and is thus an act contrary to the laws of nature.<sup>37</sup>

This anti-chrematistic tone accorded with the teachings of the Christian Church. Although the doctrine of the Christian Church was based primarily on the Scriptural command in *St Luke* 6:35 ("But love ye your enemies, and do good, and lend, hoping for nothing again; and your reward shall be great, and ye shall be the children of the Highest: for He is kind unto the unthankful and to the evil"), theologians drew freely upon the anti-usury arguments of the classical philosophers.<sup>38</sup>

St Thomas Aquinas argued that the charging of interest was wrong because it amounted to "double charging", namely charging for both the thing and the use of the thing. This would be morally wrong in the same way as if one charged for a piece of cake as well as for the eating of the piece of cake. Yet this is what usury does. Money is an exchange-medium. It is used up when it is spent. To charge for the money and for its use by spending is to charge for the money twice as if one were to charge for a piece of cake and then make a further charge for eating it.<sup>39</sup>

Canon lawyers of the thirteenth and fourteenth centuries provided comprehensive and rational legal foundations for the doctrine of the Church. These gained acceptance in the writings of commentators on the revived Roman law in the period immediately after the Glossators. The prohibition on usury was accepted as a rule of positive law since the time of Bartolus de Saxoferrato and Baldus de Ubaldis.<sup>40</sup> Specific legislation in cities and states during the fourteenth and fifteenth centuries completed the assimilation of the usury prohibition in Europe and Britain into the law of the land.<sup>41</sup> Unlike the situation in ancient Greece and Rome, it was then no longer necessary to determine at what rate a charge for money loan became usurious and punishable. All charges above the principal were held to be usurious.<sup>42</sup> As a consequence, whole areas of mediaeval mercantile law came completely under the influence of the usury doctrine.<sup>43</sup>

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37 Salin (n 2) 193-194.

38 *Idem* 194.

39 *Wikipedia* sv "Usury" (10 July 2006).

40 Robinson, Fergus & Gordon *European Legal History* (1985) 100. See also Felicius (n 32) 8 21, 16 23.

41 Salin (n 2) 194.

42 *Idem* 195; Holdsworth (n 4) 101-102.

43 Endemann (n 8) 399-423.

However, at no time were prohibitions of the Church and the State completely successful at stamping out loans at interest. With the revival of trade during the Renaissance, considerable thought and ingenuity went into the development of plans and theories by which compensation could be paid for the use of money without violating prohibitions against usury.<sup>44</sup>

While the charging of interest on loans was prohibited as usury, a person in need of money and willing to shoulder the cost was never completely dispossessed of the possibility of borrowing money. Various constructions were designed to evade the anti-usury laws, for instance the practice of sale and resale whereby the prospective lender fictitiously sold to the borrower a commodity on credit at a high price and simultaneously repurchased it for cash at a lower price. The difference clearly constituted an interest charge for an actual loan.<sup>45</sup>

Another escape device was eventually made available by invoking partnership.<sup>46</sup>

#### **4 2 *Contractum trinius***

By using the mediaeval *commenda*, the investor could limit the risk of personal liability for business debts as well as the risk of sharing in losses beyond that of the capital, but not of the capital itself. The risk of losing the capital had to be borne by the *commendator*, and precisely this risk justified his participation in the profit.<sup>47</sup> By analogy, the distinction between loan and partnership was founded on the placement of the risk. In the case of loan the risk was borne by the lender, while in the case of partnership it was borne by the partner contributing the capital.<sup>48</sup>

After the work of St Thomas Aquinas, the Christian Church had no objection to the investor sharing in the profit of the business as a partner.<sup>49</sup> The practice of investing money in the form of a partnership and drawing a profit was deemed acceptable, provided that the person advancing the capital shared in the losses as well, that is, that at least the capital provided by the investor was subjected to the risks of the business.<sup>50</sup>

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44 Benfield "Money mortgages and migraine – The usury headache" 1968 *Case Western LR* 823.

45 Salin (n 2) 195; Holdsworth (n 4) 103.

46 Endemann (n 8) 360-363.

47 *Idem* 361; Goldschmidt (n 2) 254; Bates (n 6) 20-21.

48 Salin (n 2) 195; Endemann (n 8) 364; Nelson (n 30) 233-234.

49 Robinson, Fergus & Gordon (n 40) 106-107.

50 Salin (n 2) 195.

The requirement of risk-sharing as an essential element of partnership rendered this form of investment unsuitable to the moneylender who was interested primarily in the safety of his principal (constituting the original sum of money lent) and in a fixed return on his capital.<sup>51</sup> Not only was the risk of the loss of both unacceptable but particularly also the liability *in solidum* for partnership debts and obligations attendant on his membership of a commercial partnership.

The *commenda* afforded some protection to investors, but not enough. Another solution had to be found and this was eventually provided.

It was contended that the partner could legally protect his investment by insuring the principal (constituting the original sum of money lent) against loss. There was no reason, it was submitted, why the partnership agreement and the insurance contract, each one legal in itself, should be presumed to be illegal when entered into by the very same two persons. Initially, glossators on the revived Roman law, such as Azo and Accursius, described such an agreement as a *societas leonina*.<sup>52</sup> After intensive and often heated debate, this construction was eventually declared a contravention of the usury prohibition by Sextus V.<sup>53</sup>

This approach was not in accordance with the needs of daily commercial practice. Certain Italian commentators on the revived Roman law, notably Scaccia and Raphael, stepped into the breach and argued for the validity of an agreement whereby a partner could be insured by the other partner against the risk of the loss of his capital. Although initially heavily criticised, this viewpoint gained wider acceptance and eventually prevailed in the civilian legal systems on the Continent as well as the in the common law.<sup>54</sup>

Once this viewpoint had been accepted, the next step was fairly obvious. It was maintained that if a partner could be insured against the loss of his capital, he could just as well be assured of a minimum profit.<sup>55</sup>

This transaction eventually became known as the *contractum trinius* (triple contract), in terms of which an investor could protect his investment by insuring the principal against loss, which was legal, and assured a fixed rate of return by

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51 *Ibid.*

52 Robinson, Fergus & Gordon (n 40) 65-74; Henning "Die leeuvennootskap" 1980 *Moderne Besigheidsreg* 143.

53 Endemann (n 8) 369; Felicius (n 32) 17 20, 18 3.

54 Endemann (n 8) 369-370.

55 Heaton *Economic History of Europe* (1948) 201; Ashley *An Introduction to English Economic History and Theory* (1931) 441.

selling a future uncertain profit for a certain definite return, which was also legal. It was argued that there was no reason why the three contracts, the partnership agreement, the insurance contract and the sale of a future uncertain profit, each one legal in itself, should be considered to be illegal when entered into by the very same two persons.<sup>56</sup>

Stated differently, it was a combination of three separate contracts. Each contract separately was deemed permissible, but together they yielded a fixed rate of return from the outset. For example, the first contract would call for A to contribute R100 to a partnership between himself and B for one year. In the second contract A would then sell back to B the right to any profit over and above R30 for a fee of R15 to be paid by B. Finally, in the third contract, A would insure himself against any loss of wealth at a cost to A of R5, paid to B. The net result of these three simultaneously agreed contracts was an interest payment of R10 (R15 minus R5) on a loan of R100 made by A to B.<sup>57</sup>

Under this construction, the essential element in partnership, participation in risk, had in fact been contracted away. Although the *contractum trinius* (triple contract) became an established practice in the latter part of the fifteenth century<sup>58</sup> and was eventually legally considered as a valid partnership,<sup>59</sup> it was in effect nothing more than an agreement with all the implications of a modern loan transaction.<sup>60</sup>

This was also the conclusion of the French jurist Pothier, in his famous treatise on partnership, *Traité du Contrat de Société*, published in 1765. After discussing the triple contract in some detail he concludes:<sup>61</sup>

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56 Salin (n 2) 196; Endemann (n 8) 384-385.

57 See Ackerman "Interest rates and the law: A history of usury" 1981 *Arizona LJ* 61 77; Noonan *The Scholastic Analysis of Usury* (1957) 202-248; Berger "The inequitable results of New York's usury remedies" 2002 *Fordham Urban LJ* 2202; *Wikipedia* sv "*Contractum trinius*" (10 July 2006). See also Anon "Islamic banking isn't Islamic" at <http://islamic-finance.com/item100-f.htm> (10 July 2006).

58 The idea quickly spread to merchants and bankers across Christendom. It helped in part to improve public perception of the practice of usury by moneylenders, and ultimately the doctrine was rewritten by the School of Salamanca, and the ban overturned in many Protestant countries, starting with England by Henry VIII. See *Wikipedia* sv "*Contractum trinius*" <http://e.wikipedia.org/wiki/Contractum-trinius> (10 July 2006).

59 There is a minority view that the present practice of Islamic banking relies on devices similar to the *contractum trinius* as a means of working around a ban of *riba* (usury) in religious scripture. See *Wikipedia* sv "*Contractum trinius*" at <http://e.wikipedia.org/wiki/Contractum-trinius>. See, too, Anon (n 57).

60 Salin (n 2) 196; Endemann (n 8) 376-378, 384-385.

61 Par 22 as trl by Tudor A *Treatise on the Contract of Partnership* (1845). Pothier *Contrat de Société* (1765) par 22: "*En général toutes les fois qu'un particulier fait un prétendu contrat de société avec un marchand qui l'associe a son commerce pour une certaine somme d'argent qu'il apporte a ce marchand, lequel s'oblige de la lui rendre à la fin de la société, sans que ce particulier supporte aucune part dans la perte si la société ne réussit pas, et à la charge qu'il aura une certaine part dans le gain; quelque modique que soit cette part dans le gain, en consequence de ce qu'il ne porte rien de la perte, et soit que cette part soit assurée a une certaine somme par chacun, ou soit qu'elle ne le soit*

It needs no great acuteness to perceive that such agreement is in truth nothing else than a loan ... which ought ... to be declared usurious. It is very clear that the three pretended contracts comprised in the agreement are only feigned in order to disguise a loan at interest, and that, in truth I had no intention of entering into a partnership with the merchant, but only of getting from him interest on the sum which I lent. And even if, by a misconception, I should have persuaded myself that I really had the intention of entering into three successive contracts with him, this would be an illusion produced by my cupidity, in order to disguise for myself the vice of usury in the loan at interest to which the whole of the agreement resolves itself.<sup>62</sup>

Under the impact of capitalistic development the mediaeval conceptions on usury receded into the background. The advances of economic liberalism wiped the anti-usury laws from the statute books of most countries during the second half of the nineteenth century. In 1545, England established a statutory rate of interest.<sup>63</sup> The question was no longer whether it was permissible to charge a price for capital, but at what rate the charge became excessive and therefore usurious.<sup>64</sup>

Although the strict prohibition on usury thus came to an end, the concept that the person advancing money to a business for a share in the profit should be considered as a partner and not a mere creditor, already in disrepute on the Continent, had by then become firmly enshrined in British jurisprudence and influenced subsequent remedial partnership legislation. This rule was characterised as arbitrary, unjust, and as productive of the greatest confusion.<sup>65</sup>

## 5 Influence

Sections 2 and 3 of the *Partnership Act*<sup>66</sup> originate from *Bovill's Act*.<sup>67</sup> The intent of the latter was to mitigate the harshness of the common-law rule which determined that any person who shared in the profits of the partnership was

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*pas, un tel contrat doit passer pour un contrat de société simulé, qui n'a été fait que pour déguiser un prêt usuraire que ce particulier vouloit faire au marchand de la somme d'argent qu'il lui a remise."*

62 See also Felicius (n 32) 17 20-22, 18 3-4.

63 *A Bill Against Usury* 1545 (37 Hen VIII c 9). See Bender "Rate regulation at the crossroads" 1994 *Houston LR* 725.

64 Salin (n 2) 196.

65 Lindley (n 6) 99.

66 53 & 54 Vict c 39.

67 See also Twomey (n 26) 8.

considered to be a partner, and so liable for any debts of the partnership.<sup>68</sup> Thus in *Grace v Smith*<sup>69</sup> it was accepted that "[e]very man who has a share of the profits of a trade ought also to bear his share of the loss".<sup>70</sup>

The judgement in *Grace v Smith* appears to have been based on the prior case of *Bloxham v Pell*.<sup>71</sup> In this case a contract which, on the ground of usury, was invalid as a contract of loan, was nevertheless upheld by Lord Mansfield as a contract of partnership, although in principle it was not.<sup>72</sup> The viewpoint was confirmed in *Waugh v Carver*<sup>73</sup> and the same principle was applied in numerous other decisions.<sup>74</sup>

By treating as partnership, and therefore legal, what in truth was a loan at usurious interest, and therefore illegal,<sup>75</sup> an amount of confusion was introduced into the common law of partnership which even the repeal of the usury laws and other remedial legislation failed to remove. In *Gilphin v Enderby*<sup>76</sup> and *Fereday v Hordern*<sup>77</sup> it was decided that a loan of money on the terms that the lender should share the profits of the borrower, rendered the lender liable to third persons, as if he were a partner with the borrower. The loan was not usurious by reason of such risk. The borrower and lender were also regarded as partners *inter se*.<sup>78</sup>

Hence there was, in effect, a strong tendency<sup>79</sup> to hold parties to their bargain by regarding what was in reality a loan (but one which was illegal under the laws against usury) as a contract of partnership and accordingly untainted with the illegality which would have attached to it as a contract of loan.<sup>80</sup> In *Bloxham v Pell*<sup>81</sup> a partnership was concluded between Brooke and Pell for seven years. After one year it was agreed to dissolve the partnership. Brooke wished to have

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68 *Canada Deposit Insurance Corporation v Canadian Commercial Bank* [1992] 3 SCR 558; Lindley (n 6) 104.  
 69 (1775) 96 ER 588.  
 70 *Grace v Smith* (1775) 96 ER at 591. See also Lamoreaux & Rosenthal "Legal regime and business's organizational choice: A comparison of France and the United States" (2004) 6 at <http://www.nber.org/papers/W10288> (11 July 2006).  
 71 Quoted in *Grace v Smith* (1775) 96 ER at 591. See Lindley (n 6) 100; Burdick (n 3) 38-39.  
 72 Lindley (n 6) 100; Burdick (n 3) 39.  
 73 (1793) 2 Hy BI 235, 126 ER 525.  
 74 Eg *Hoare v Dawes* (1780) 1 Doug 371, 98 ER 1365. *Jestons v Brooke* (1778) 98 ER 1365; *Morse v Wilson* (1791) 4 Term 353, 100 ER 1060; *Morisset v King* (1759) 2 Burr 891, 97 ER 620. See also Stark *Treatise on the Law of Partnership* (1825) 37-50; Lindley (n 6) 101; Story (n 2) 53.  
 75 Seabourne "Controlling commercial morality in late mediaeval London: The usury trials of 1421" 1998 *Legal History* 116.  
 76 (1824) 106 ER 1441.  
 77 (1821) 37 ER 804.  
 78 Lindley (n 6) 95.  
 79 Bates (n 6) 15-16 refers to this approach as "the rule so long in vogue".  
 80 Miller (n 13) 87; Twomey (n 26) 8-9.  
 81 As quoted in *Grace v Smith* (1775) 96 ER at 591. See Miller (n 13) 88; Drake *Law of Partnership* (1983) 39-40; Twomey (n 26) 9; Bates (n 6) 15-16.

the profits of the business for himself and Pell wished to relinquish his interest in the trade and profits. It was accordingly agreed that Brooke would grant a bond for £2,485 in favour of Pell, the sum which Pell had contributed to the partnership, with interest at five per cent per year. It was further agreed that Brooke would pay Pell £200 per year for six years if Brooke lived so long, in lieu of the profits of the business, Pell having liberty to inspect the books. Brooke became bankrupt before he paid any sum to Pell under the bond or agreement. Pell was then sued in respect of a debt incurred by Brooke in the course of the business. Lord Mansfield held that Pell was a secret partner:

It was a device to make more than legal interest of money and if it was not a partnership it was a crime ... . *And it shall not be in the defendant Pell's mouth to say, 'It is usury, and not a partnership'.*<sup>82</sup>

This approach was first modified in the decision of the House of Lords in *Cox v Hickman*.<sup>83</sup> The company of Smith and Son fell into financial difficulties and was unable to pay its creditors. The Smiths entered into an arrangement with five of its creditors assigning the company to them (as trustees for all of the creditors), for a term of twenty one years. During that period, the trustees were to carry on the business of the company and to pay the net income, after answering all expenses; which net income was always to be deemed the property of the two Smiths, among (all) the creditors of the Smiths. In other words, the creditors were to be paid their debts out of the profits of their debtors' business.

The repayment was to be only to the extent of the debts. When all the debts had been paid, the trustees were to hold the estate in trust for the Smiths. Financial troubles continued under the new management, and the company once again became unable to pay its debts. Since at that time the law was that a person who shared in the profits was liable as a partner, the question in *Cox v Hickman*<sup>84</sup> was not whether those creditors who were being paid out of profits were to be ranked equally with subsequent creditors, but whether the former group were to be themselves liable as partners to subsequent creditors. In deciding that they were not so liable, the House of Lords is considered to have

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82 My emphasis. See Miller (n 13) 88-89; Story (n 2) 53.

83 (1860) 11 ER 431. This decision was extensively analysed *inter alia* in the recent decision of *Canada Deposit Insurance Corporation v Canadian Commercial Bank* [1992] 3 SCR 558.

84 (1860) 11 ER 431.

established, in effect and amongst other things, that receipt of a share of the profits is not *conclusive proof* of a partnership as was previously thought.<sup>85</sup>

This decision notwithstanding, it was deemed appropriate to introduce *Bovill's Act* with the intention to give statutory relief from partnership liability to investors. By *Bovill's Act* it was ultimately provided that sharing of profits should, in the circumstances provided for, not be conclusive evidence of partnership, but that lenders in consideration of a share of the profits should be deferred creditors. At the time it was thought that *Bovill's Act* had effected a substantial advance by legislating something in the nature of a limited partnership. In fact it was held in *Syers v Syers*<sup>86</sup> that it did not. It protected the creditor only where he was not involved in the running of the business. If he in truth was, he became fully liable as a partner, notwithstanding that he was described as a contributor under *Bovill's Act*. It constituted no advance on the decision of *Cox v Hickman* and far from protecting *bona fide* creditors, the *Act* made them deferred creditors in bankruptcy.<sup>87</sup> In fact, *Bovill's Act* expressed only part of the new footing on which partnership law was placed in *Cox v Hickman*. It is clear that the effect of *Cox v Hickman* was not understood at the time by the promoters of *Bovill's Act* and that, although it was intended to produce a substantial amendment of partnership law, Parliament "produced unawares a stray bit of codification".<sup>88</sup>

Although *Bovill's Act* was repealed by the *Partnership Act*, its provisions were substantially re-enacted in the latter Act.

In the event the judicature has proved to be far more reform-minded than the legislature by overruling *Grace v Smith* in *Cox v Hickman* and rightly placing the emphasis on the intention of the parties and the real substance of the agreement rather than on merely the form.<sup>89</sup> Thus in *Badeley v Consolidated Bank*<sup>90</sup> the plaintiff advanced money to a contractor to enable him to carry out his contract to build a railway. The deed provided that the plaintiff should receive ten per cent interest and ten per cent of the profits of the contract, and the contractor assigned to him all his machinery and plant by way of security. It

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85 Cf also the discussion in *Canada Deposit Insurance Corporation v Canadian Commercial Bank* [1992] 3 SCR 558.

86 (1876) 1 AC 174 (HL).

87 Gower (n 27) 50.

88 Pollock *Essays in Jurisprudence and Ethics* (1882) 83.

89 Eg *Pooley v Driver* (1876) 5 Ch D 458; *Badeley v Consolidated Bank* (1888) 38 Ch D 238; *Re Young, ex parte Jones* [1896] 2 QB 484; *Davis v Davis* (1894) 1 Ch D 3. See also Milman & Flanagan *Modern Partnership Law* (1983) 12-14; Burgess & Morse *Partnership Law and Practice* (1980) 4-5; Morse (n 18) 40-41.

90 (1888) 38 Ch D 238.

was held that these provisions were consistent with an intention to secure a loan and insufficient as evidence of partnership.

Hence it should now be clear that, since the abolition of the laws against usury, the tendency to ascribe loans, wherever possible, to partnership in order to avoid the consequences of holding them to be usurious, has disappeared “and the British courts are now free to adopt the pure Gallic logic of Pothier’s approach”.<sup>91</sup>

However, the survival of these statutory provisions in the Britain of the third millennium is evidence of how the lack of vigorous law reform can have the effect of legislatively enshrining outdated doctrine.

## 6 Review of partnership law

The *Partnership Act* now shows the signs of its rather advanced age, especially when compared with the innovative revisions in the United States which resulted in the *Revised Uniform Partnership Act* of 1994.<sup>92</sup> It is rightly perceived as failing to keep up with the reasonable expectations of those running and dealing with the almost seven hundred thousand business partnerships in the United Kingdom.

Following on a recommendation to this effect in 1994, the British Department of Trade and Industry requested the Law Commission of England and Wales and the Scottish Law Commission in 1997 to undertake jointly a review of partnership law.

On 13 September 2000 both Law Commissions released a comprehensive joint consultation paper. The Commissions emphasised that while attention has recently been focussed on the reform of company law it is no less important that partnership law should clearly and sufficiently address the needs and current practices of today’s market. The economic importance of partnership should also not be underestimated. There are almost as many partnerships in the United Kingdom as there are trading companies.

The Law Commissions agreed that the usefulness of the proviso to section 2(3)(d) requiring a written contract, signed by or on behalf of the parties, is

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91 Miller (n 13) 90.

92 See Hillman, Vestal & Weidner *General and Limited Liability Partnerships under the Revised Uniform Partnership Act* (1996) 1-5.

questionable. They suggested that the proviso to section 2(3)(d) should be repealed.<sup>93</sup>

Rounding off their review process, the Law Commissions on 18 November 2003 released a joint final report entitled *Partnership Law. A Joint Report*, accompanied by a Draft Partnerships Bill. The *Report* recommends far-reaching reforms to the *Partnership Act*. It is to be replaced by a modern partnership act capable of standing the test of time and which will respect the unique qualities of partnership as a form of business enterprise.<sup>94</sup> It supports the repeal of the proviso in section 2(3)(d), and recommends that the wording of the subsection should be changed to: "The receipt by a person of a share of the profits of a business does not of itself make him a partner in the business."<sup>95</sup>

## 7 Conclusion

The legacy of the *contractum trinius* has long been laid to rest in the *ius commune* and in Continental legal systems. This only serves to highlight the fact that if the particular recommendation of the Law Commissions of England, Wales and Scotland (for the repeal of the proviso in section 2(3) (d)) does not elicit any reaction from the legislature, it may very well merit an inference that the legacy of the old usury-inspired *contractum trinius* is alive and well, and living on in its own quiet little corner of the British *Partnership Act*.

In fact, the continued survival of these contentious provisions of the *Partnership Act* in Britain today is conclusive evidence of how the lack of vigorous law reform can have the unfortunate effect of legislatively enshrining outdated and discredited doctrine and thus a rule repeatedly characterised as arbitrary, unjust, and as productive of the greatest confusion.

Clearly, the struggle between ancient concepts and modern business practices is still particularly apparent in the English law of partnership. This is exacerbated by the fact that those responsible for keeping the British *Partnership Act* in existence long past its "sell by" date evidently does not attach much importance, if any, to its long, involved and problematical historical background.

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93 The Law Commission and The Scottish Law Commission (n 15) par 5.39.

94 See <http://www.gnn.gov.uk/environmental/detail.asp> (11 July 2006).

95 The Law Commission and The Scottish Law Commission *Partnership Law Report* (2003) par 5 & Draft Bill cl 1(7) & Schedule 1.