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Commercial division update – Implied partnerships and the importance of shared losses

Thomas J. Hall, *New York Law Journal – February 2018*

In his Commercial Division Update, Thomas J. Hall writes: When there is no enforceable partnership agreement, the party seeking to establish an implied partnership must show that a partnership nevertheless exists based on the conduct, intention and relationship between the parties. Although no one factor is determinative, recent Commercial Division decisions have placed a heightened emphasis on the factor of shared losses.

New York courts are frequently called upon to resolve disputes over the nature of a business relationship. The Uniform Partnership Act (UPA) defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit." N.Y. Partnership Law §10(1). When there is no enforceable partnership agreement, the party seeking to establish an implied partnership must show that a partnership nevertheless exists based on the conduct, intention and relationship between the parties. The Appellate Division has set forth varying factors courts may consider, including the sharing of profits and losses. Although no one factor is determinative, recent Commercial Division decisions have placed a heightened emphasis on the factor of shared losses.

Implied Partnerships

Sometimes referred to as a de facto partnership or a partnership-in-fact, the leading New York case on quasi-partnership law is *Martin v. Peyton*, 246 N.Y. 213 (1927). Decided shortly after New York adopted the UPA, the Court of Appeals in *Martin* established that a partnership can be proven through "the production of some written instrument, by testimony as to some conversation, [or] by circumstantial evidence." In *Martin*, a partner at the brokerage firm Knauth, Nachod & Kuhne (K.N.&K.) obtained a loan from the defendants for the purpose of assisting K.N.&K. with a large portion of debt. As part of the loan agreement, defendants and K.N.&K. executed several written contracts, which gave defendants, among other things, a percentage of K.N.&K.'s profits until the loan was repaid. The plaintiff, a creditor of K.N.&K., sued the defendants, arguing that the loan agreement made them partners and therefore liable for K.N.&K.'s debts.

In determining that a partnership did not exist between the defendants and K.N.&K., the court noted that the sharing of profits alone is not conclusive of whether a partnership exists. In some instances, "profits" may "be merely the method adopted to pay a debt or wages, as interest on a loan or for other reasons." Rather, a court must examine the contract as a whole, weighing profits "in connection with all the rest." Thus, looking at the written agreements as a whole, the court determined that the main purpose of the agreements were to ensure that defendants had control over their loan, not to form a partnership.

Appellate Division Precedent

After *Martin*, the Court of Appeals largely remained silent on implied partnerships, leaving the Appellate Division to develop the case law on the issue. The Appellate Division has noted that, when there is no enforceable partnership agreement, a court may find a partnership still exists based on the "conduct, intention, and relationship between the parties." *Brodsky v. Stadlen*, 138 A.D.2d 662, 663 (2d Dep't 1988). Central to this inquiry is the sharing of both profits and losses.

For example, in *Ramirez v. Goldberg*, 82 A.D.2d 850 (2d Dep't 1981), in deciding the issue of whether a joint venture existed, the Second Department stated that "the factors to be considered are the intent of the parties (express or implied), whether there was joint control and management of the business, whether there was a sharing of the profits as well as a sharing of the losses, and whether there was a combination of property, skill or knowledge." Reversing the lower court's decision, the Second Department stated that although the plaintiff established he received a share of the profits, this factor "is not dispositive, since all of the elements of the relationship must be considered."

Seven years later, in *Brodsky v. Stadlen*, 82 A.D.2d at 663, 526 N.Y.S.2d at 479, the Second Department refined the factors enumerated in *Ramirez*, setting forth nine factors for courts to consider in determining whether an implied partnership exists. These factors include "(1) sharing of profits, (2) sharing of losses, (3) ownership of partnership assets, (4) joint management and control, (5) joint liability to creditors, (6) intention of the parties, (7) compensation, (8) contribution of capital, and (9) loans to the organization." Viewing the parties relationship as a whole, the Second Department noted that "no one characteristic of a business relationship is determinative in finding the existence of a partnership in fact." Thus, although the plaintiff in *Brodsky* could show that he was entitled to a percentage of the enterprise's weekly profits, the court upheld the lower court's decision that a partnership did not exist. The court found that the plaintiffs failure to show liability for any losses, advancement of cash to the defendant's business in the form of a loan, and the plaintiffs failure to contribute capital to the enterprise were all strong indications that a partnership did not exist.

Commercial Division Treatment

Following the factors set forth by the Appellate Division, recent Commercial Division decisions have found the sharing of profits to be not dispositive, and have focused on whether the plaintiff can show an agreement also to share losses.

For instance, in *Decristofaro v. Nest Seekers E. £net LLC*, 2017 N.Y. Slip Op. 50074(U) (Suffolk Co. Jan. 11, 2017), Justice Elizabeth H. Emerson of the Suffolk County Commercial Division opined that "[a]n employer-employee relationship providing for the division of profits will not give rise to a fiduciary relationship (in this case a partnership) on the part of the employer absent an agreement to also share losses." In *Decristofaro*, plaintiff sought to establish that he and the defendant had entered into a partnership to own and operate a real estate firm. Justice Emerson held that a de facto partnership did not exist, in part because an agreement between the parties provided only for the sharing of profits and made no provisions for the sharing of losses. Justice Emerson further noted that "[a]n undertaking to share in profits without submitting to the burden of making good the losses renders such an agreement a nullity under partnership law'' and is "fatal to the plaintiffs claim of the existence of a partnership."

Similarly, in *Barone v. Barone*, 2017 N.Y. Slip Op. 50229(U) (Queens Co. Feb. 17, 2017), Justice Timothy J. Dufficy of the Queens County Commercial Division noted that under New York's Partnership Law, "partners mutually promise to share in the profits of the business as well as accepting the burden of carrying the losses." In *Barone*, the plaintiffs brother had willed several properties to his wife and appointed the plaintiff as executor. As executor, plaintiff transferred his deceased brother's properties to a corporation, naming himself as president and the defendant as vice-president and sole owner. Several years later, in an attempt to recover a share of the $40 million estate, plaintiff sought to establish that he and the defendant were partners. Placing considerable emphasis on the lack of evidence that plaintiff shared in the corporation's losses, in a post-trial decision Justice Dufficy stated "there is not one scintilla of evidence to support the conclusion that the plaintiff ever agreed ... to be liable for the losses of the corporation." Finding that the sharing of losses "is an essential element of a partnership," the court held that there was insufficient proof that a partnership existed.

In *Hammond v. Smith*, 2016 N.Y. Slip Op. 50670(U) (Monroe Co. April 22, 2016), Justice Matthew A. Rosenbaum of the Monroe County Commercial Division determined that a partnership did not exist where the plaintiff had no "skin in the game" and was not "at risk of losing anything in the event the project was not successful." In *Hammond,* the plaintiff and defendant entered into an agreement to develop immersion litho tools. The plaintiff claimed that, based on the success of the product, the parties agreed to share profits and losses equally. The court found, however, that this statement failed to demonstrate that the plaintiff was liable for any losses because it did not account for what would occur if the product was unsuccessful. Rather, the defendant alone was at a risk of financial loss if the project failed because he had loaned the company money, took out lines of credit under his name, and contractually agreed to reimburse payments made by customers.

Conversely, in *Koether v. Sherry*, 2013 N.Y. Slip Op 51471 (U) (Kings Co. Sept. 4, 2013), Justice Carolyn Demarest of the Kings County Commercial Division denied a motion to dismiss an implied partnership claim where documentary evidence clearly supported plaintiffs assertion that losses were shared between the parties. In *Koether*, plaintiff entered into an agreement with defendant to start a hedge fund in the United States. Observing that the plaintiffs complaint "contain[ed] allegations that the relationship between the parties was more than merely profit-sharing," Justice Demarest found that losses had been built into the parties' agreement, thus fulfilling an essential element of a partnership.

Conclusion

The Commercial Division's emphasis on the sharing of losses has increased the burden placed on a party seeking to establish an implied partnership. Although evidence of the sharing of profits alone has never been conclusive, lack of evidence that the parties shared losses is a significant factor weighing against finding that a business relationship meets the definition of a partnership under the UPA. Thus, where a party fails to establish evidence of an agreement to share losses, it appears that the Commercial Division is more inclined to find an implied partnership does not exist.

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