Articles

SERVICE PARTNER CAPITAL AGREEMENTS: THE LEADING CASES AND A RESPONSE TO CRITICS

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Two persons form a partnership. One, the "money partner," agrees to provide money for the venture, the other, service. Business begins, proceeds for a time, and then ends. There is a loss, overall. Creditors are paid, but there are no profits, and less cash at the end than at the beginning. The service partner's time has been wasted. The money partner has made a bad investment.

When the money partner looks at the partnership code, she sees that the partnership has an obligation to reimburse her capital losses.[1] The money partner has a capital loss.[2] But the partnership is too poor to pay it. Nonetheless, the default provisions of the partnership code require that losses—including, apparently, capital losses—be split equally between the partners.[3] Many money partners have claimed at this point that, as a capital loss is split equally, the service partner should therefore pay into the

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1. UNIF. P'SHIP ACT §§ 18(a), 40 (1914); UNIF. P'SHIP ACT §§ 401(a)-(b), 807 (1997). In Texas, this result is reached through Texas Business Organizations Code §§ 152.202, .706, .707 (2006).

2. A comparison of balance sheets shows the loss. At the time of formation, the partnership has assets equal to the money partner's contribution. With $0 in liabilities, equity is exactly equal to the money partner's contribution. When a "poor" partnership liquidates, it has fewer assets than were contributed by the money partner. With $0 in liabilities, equity will equal the money partner's original contribution less the amount by which assets are worth less than the original money contribution. This is the amount of the loss.

3. UNIF. P'SHIP ACT §§ 18(b), 40(b), 40(d) (1914); UNIF. P'SHIP ACT §§ 401(a)-(b), 807(b)-(c); TEX. BUS. ORGS. CODE §§ 152.202, .706, .707 (2009).

partnership half of the cash loss. The money would be redistributed to the money partner. The code supports the money partner's view.[4] Courts have often applied the code as written.[5] The code covers all partnerships. If every partner puts in cash or property in exchange for a partnership interest, the result the code reaches is unobjectionable. But the general rule gives no exception here.

For good reasons, the result seems odd and unfair. Had the service partner the money himself, or had he borrowed it, the service partner might have undertaken the business without the money partner's involvement. That would have risked the service partner's own wealth. Instead, another invested. Now that there is a loss of that investment, the service partner is to repay part of it? Moreover, the service partner also has a loss. Whereas the money partner loses cash, the service partner loses time and service. The money can be repaid, or even re-earned, but the service partner's time and service are lost forever. On top of that loss, the service partner is now to repay the money partner half of the cash loss? The service partner might ask what is the point of having a money partner.

How many service partners would have thought it possible that they must cover not just their own investment but also half of their partner's? The commentary to the Uniform Act suggests that service partners actually will not—but legally must—contemplate just such an implausible result:

> It may seem unfair that the contributor of services, who contributes little or no capital, should be obligated to contribute toward the capital loss of the large contributor who contributed no services. In entering a partnership with such a capital structure, the partners should foresee that application of the default rule may bring about unusual results and take advantage of their power to vary by agreement the allocation of capital losses.[6]

The code thus presumes that the service partner should foresee that, if the business fails, the service partner might not only lose his own investment but also be liable for half of his partner's loss.

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4. *See* statutes cited *supra* note 3 (supporting the notion that the service partner should contribute to the partnership's losses).

5. *See, e.g.*, Parker v. N. Mixing Co., 756 P.2d 881 , 890 (Alaska 1988) (applying Alaska's Uniform Partnership Act to determine partners' division of losses); Seguin v. Boyd, 654 P.2d 808, 812 (Ariz. Ct. App. 1982) (applying ARIZ. REV. STAT. § 29 to determine the rules of payment in relation to the partnership); Richert v. Handly, 330 P.2d 1079, 1081 (Wash. 1958) (using the provisions of the Uniform Partnership Act to determine the "rights and duties" of the partners).

6. The commentary to the Uniform Partnership Act (1997) suggests that service partners should know just that. UNIF. P'SHIP ACT § 401 cmt. 3 (1997). The comment suggests that a partner should foresee an unusual result from a legal principle's application, an application not apparent on that principle's face. This suggestion is unrealistic.

The presumption is unrealistic.[7] Only a partner contemplating a loss while entering a business would consider how that loss might be allocated, and businesspeople do not usually enter a business contemplating a loss. Partners often do not allocate losses at all.[8] Not only would the partner have to plan for a loss, the partner would have to plan for the loss of someone else's money, namely, the money partner's. The service partner would also have to assume that the loss would become an obligation of the partnership, a result unique to partnership law.[9] And then the service partner would have to believe that the law would require the entirely counterintuitive result that the partner would be liable for the loss of some part of someone else's investment. While all of this thinking against self-interest might be expected of a partner's lawyer, it is too much to expect of the partner.

The presumption that a partner foresees the code's counter-intuitive result depends on another counter-intuitive conclusion mandated by the code: The service partner's service is not a capital contribution.[10] Yes, that

7. Eisenberg is even more emphatic. He argues that the code comment

> does more to show why [the code] is wrong than why it is right. The Comment begins by frankly recognizing that the result "may seem unfair." It then states that even if the rule is unfair the partners can contract around it. Of course, any rule of partnership law, no matter how foolish, could be "justified" by the argument that it can be contracted around. The point of partnership law, however, should be to make good rules that the parties probably would have agreed to if they had addressed the issue, not to make bad rules that the partners can contract around. Furthermore, many partners don't know partnership law, and therefore won't realize they need to contract around any given rule. Indeed, because persons can be partners without an intention to form a partnership, many partners don't even realize that they are partners, let alone realize that they should consider contracting around any given rule of partnership law.

MELVIN ARON EISENBERG, AN INTRODUCTION TO AGENCY, PARTNERSHIPS, AND LLCS 75 (3d ed. 2000).

8. *See, e.g.*, Kovacik v. Reed, 315 P.2d 314, 315 (Cal. 1957) (“The subject of a possible loss was not discussed in the inception of this venture.”); Kessler v. Antinora, 653 A.2d 579, 580 (N.J. Super. Ct. App. Div. 1995) (“No thought was given to losses.”).

9. *See* Randy E. Barnett, *The Sounds of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 884-85 (1992) ("Partnership law also provides an example of a default rule that defies common sense."). Corporate and LLC capital losses are suffered by individual shareholders. No obligation exists for the entity to repay a capital loss, let alone for another shareholder to repay. Corporate and LLC law make no distinction between shares and interests purchased with money and shares and interest purchased with services or the promise of services. *See, e.g.*, MODEL BUS. CORP. ACT § 6.21(b) (1984) ("any tangible or intangible property or benefit to the corporation, including . . . services performed, contracts for services to be performed"); DEL. GEN. CORP. LAW § 152 (2008) ("any tangible or intangible property or any benefit to the corporation, or any combination thereof"); UNIF. LTD. LIAB. CO. ACT § 401 (1996) ("tangible or intangible property or other benefit to the company, including . . . services performed, . . . or contracts for services to be performed").

10. UNIF. P'SHIP ACT § 18(a) (1914) ("contributions, whether by way of capital or

service buys an interest in the partnership, including, under default rules, an interest in half the profits,[11] but the contribution is not credited to the partners' equity account.[12] (A partner also is not generally entitled to compensation for services.[13]) Thus, as the partnership begins, the law gives the money partner a capital account of $X, equaling the money the partner provided. The service partner has a capital account of $0, as service is not considered capital. This is not a natural conclusion for a service partner, but the service partner's obligation to pay half the money partner's loss depends as much on this presumption as on the other provisions. If the partnership on dissolution, after paying creditors, has less cash than at the beginning, it has a cash loss. Losses are split equally, as noted. Therefore, at this juncture, the money partner's capital account will have $X-1/2L, where L is the loss. The money partner's capital account may well show a positive balance. It will if $X > 1/2L. The service partner, who began with $0, now has a capital account totaling $0-1/2L. This will always be a negative number, implying a duty to pay.[14] The duty to contribute to a cash loss is thus dependent on the code's judgment that, ordinarily, the service partner's contribution is not capital.

The effect of the code on the service partner is in fact arbitrary relative to the way cash contributions are treated. If the partnership breaks even on cash, all the cash is returned to the money partner, but the service partner suffers a complete loss. If there is a loss of cash, the service partner not only suffers a complete loss but is required by the code to pay half the cash loss, also.[15]

These premises lead to several conclusions: The code's default rule is not the rule the parties would have chosen. The deal the parties actually made is counter to the result imposed by the code's rule. Inasmuch as the code's rule surprises the parties, and in particular the service partner, after the partnership formation deal has already been struck, the rule is unfair. Inasmuch as the code's rule departs from the deal actually struck by the parties, the rule is inefficient.

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advances to the partnership property"); UNIF. P'SHIP ACT § 401(a)(1) (1997) ("money plus the value of any other property . . . the partner contributes"); TEX. BUS. ORGS. CODE § 152.202(a)(1) (2008) ("the cash and the value of property the partner contributes").

11. UNIF. P'SHIP ACT § 18(a) (1914); UNIF. P'SHIP ACT § 401(b) (1997); TEX. BUS. ORGS. CODE § 152.202(c) (2008).

12. *See* statutes cited *supra* note 3.

13. UNIF. P'SHIP ACT § 18(f) (1914); UNIF. P'SHIP ACT § 401(h) (1997); TEX. BUS. ORGS. CODE § 152.203(c) (2008).

14. UNIF. P'SHIP ACT § 807(b) (1997) ("A partner shall contribute to the partnership an amount equal to any excess of the charges over the credits in the partner's account . . . ."); TEX. BUS. ORGS. CODE § 152.707(d) (2006).

15. *See* EISENBERG, *supra* note 7, at 73-74 (pointing out the arbitrary nature of this result).

These results appear inevitable under the code in most service partner cases, unless the one exception allowed by the code applies. The code holds that all of the provisions mentioned thus far can be altered by agreement.[16] Partners who think ahead and prepare for a potential loss are likely to reach some alternative agreement.[17] If the partners agree that the services of the service partner are worth \$X, or some other amount (\$Y), as a capital contribution, then the service partner's account should begin at that number and on dissolution will equal \$X-1/2L or \$Y-1/2L, in the same fashion as the money partner's account. Service partners are likely to insist on something like this. Who would ever agree ex ante that their services are worthless?[18] If the partners agree to split profits evenly and have equal management rights without pay other than profits, they likely will call themselves "equal partners" and mean that phrase to include the value of their contributions.[19] An agreement may seem even more apparent to a court when faced with imposing on an equal service partner the code's

16. UNIF. P'SHIP ACT § 18 (1914); UNIF. P'SHIP ACT § 103(a) (1997); TEX. BUS. ORGS. § 152.002(a) (2006).

17. The comments to the Uniform Partnership Act (1997) imply this result. *See supra* text accompanying note 6. *See also, e.g.*, EISENBERG, *supra* note 7, at 74-75 ("It is unlikely that the parties would have agreed to this result if they had negotiated on the issue when the partnership was formed."); Stephen M. Bainbridge, *Contractarianism in the Business Associations Classroom:* Kovacik v. Reed *and the Allocation of Capital Losses in Service Partnerships*, 34 GA. L. REV. 631, 648-49 (2000) ("Eisenberg likely is correct that [the partners] would not have agreed to an equal division of [cash] losses.").

18. Of course, the commitment to perform service is exchanged also for a share of the profits, but the code's default rule operates before profits exist. The service partner would only choose the default rule at formation if he believed, ex ante, that his service was valueless both at the beginning and throughout the life of the partnership. Otherwise, that service should entitle him to some credit at dissolution.

19. Professor Bainbridge argues that "[a] rational service-only partner probably would accept some obligation to share capital losses." Bainbridge, *supra* note 17, at 650. (By "capital," Bainbridge means cash or money.) This assertion is unconvincing. Bainbridge reasons that the service partner might have accepted employment (with no risk) or sole proprietorship (with all the risk) as alternatives. Thus, "[b]y choosing to enter into a partnership . . . [the service partner] accepted a higher degree of risk than he would bear as an employee, but he moderated the risks associated with sole ownership." *Id.* These premises do not lead the service partner to accept the risk of paying the money partner's loss, however. Equally consistent with these premises is that the service partner expected to bear the risk of working without any compensation at all, a risk he did not have as an employee. The service partner would most likely believe that he had less risk than a sole proprietor because the money partner would be putting up (and presumably losing, if a loss occurred) the cash. Of course, the service partner would be mistaken in part if, in addition to losing all of his time and work, he also had to pay half of the money partner's loss. No, given the equality evidenced elsewhere in the relationship, that the service partner would risk the loss of the value of his services while the money partner would shoulder all the risk of cash loss is the most likely deal a rational service partner would seek. Why would the service partner take on more risk than an equal bargain required? Of course, the service partner might explicitly accept that risk if facts showing bargaining inequality existed despite the otherwise equal deal the partners made.

requirement that the service partner pay back half of the other partner's investment.[20]

Perhaps not surprisingly, a long line of cases exists in which courts have found agreements that alter the code's default provisions. The most recent leading case is *Becker v. Killarney* (1988),[21] but the most prominent is *Kovacik v. Reed*,[22] a 1957 California case. The oldest of these is *Heran v. Hall* (1840).[23] None of these rests on an explicit agreement between the money partner and the service partner. But the lack of an explicit agreement should be expected if the service partner would not rationally have suspected the need for such an agreement. Accordingly, all of these cases rest on an implied understanding between the partners.

I discuss these leading cases, in particular *Kovacik*, in Part I. Lately, advocates of the code's default rule have imposed a new round of criticism on the case. The criticism is not particularly persuasive, as I explain in Part I.B. I am concerned to defend *Kovacik* not only because I believe it reaches a sound result but also because the policies that support it also support the line of Texas cases finding agreement in similar circumstances.[24] The Texas case law falls on the *Kovacik* side of the argument, as I explain in Part II. Thus, the defense of *Kovacik* also explains the Texas case law. Briefly put, whether one sees *Kovacik* as a method of loss sharing based on agreement or as a kind of hypothetical bargain, *Kovacik* reaches the result most likely reflective of the partners' actual understanding and agreement. It is therefore the most fair and efficient rule.

I conclude with a recommendation that, given the sound principles supporting the current line of leading service partner agreement cases, both *Kovacik* and the Texas branch of the *Kovacik* line of cases be retained and applied or codified as explications of the agreement exception to the otherwise applicable default capital loss sharing rule of the partnership

20. *See, e.g.*, Sturdevant v. Hooper, 101 S.W.2d 379, 380 (Tex. Civ. App. 1937) (explicitly allocating by agreement all of the losses to the money partner). On the line between *Sturdevant* and *Kovacik* is *Baker v. Safe-Deposit & Trust Co. of Baltimore*, 45 A. 1028 (Md. 1900).

21. 532 N.E.2d 931 (Ill. App. Ct. 1988).

22. 315 P.2d 314 (Cal. 1957).

23. 40 Ky. (1 B. Mon.) 159 (1840).

24. Please pardon the parochial interest. I teach in Texas and enjoy association with corporate counsel in the state. I am also thinking of just how many people are governed by the *Kovacik* rule. The rule is followed in Texas, California, Illinois, and Kentucky. It is imposed as a default rule as a matter of public policy in New Jersey and Pennsylvania. *See* Kessler v. Antinora, 653 A.2d 579 (N.J. Super. Ct. App. Div. 1995); Snellbaker v. Herrmann, 462 A.2d 713, 716-17 (Pa. Super. Ct. 1983). I have not done a full, fifty-state survey, but according to 2008 Census estimates, U.S. Census Bureau, Population Estimates Data Sets, http://www.census.gov/popest/states/NST-ann-est.html (last visited Oct. 6, 2009), over 99 million people, nearly one-third of the U.S. population, reside in these six states.

code.

I. THE LEADING SERVICE PARTNER AGREEMENT CASES

A. Becker v. Killarney (Ill. App. 1988)[25]

Becker's facts indicate that the services contributed to the partnership had value that the partners had by implicit agreement monetized and capitalized. A lender repossessed a hotel in the middle of its renovation.[26] Not wanting a half-finished project on its books, it approached the contractor, Becker, about taking over. Becker responded by forming a partnership to take the hotel. The partners included Becker himself, architect Burns, financier Dailey, attorney Parkhurst, and hotel manager Rosel. None of the five contributed any money, only services. Only Rosel was compensated for services. The partnership agreement prohibited other salaries.[27]

The cash to run the hotel came from Killarney and Feely. Within months after the partnership formed, Killarney had contributed $160,000 in exchange for an 8% interest and Feely had contributed $100,000 for a 5% interest. Both also signed the partnership agreement. The lender invested another $10,500,000 non-recourse loan in the hotel, and Becker's construction company also fronted some costs.

The hotel, however, was unsuccessful. It borrowed another $500,000 from the lender and eventually called on all the partners for two sets of capital infusion, each of $100,000, paid according to percentage shares in the venture.[28]

Eventually losses forced the hotel to close. On finding themselves personally liable for some of the hotel's debts, the service partners sued the cash partners for contribution. The cash partners, Killarney and Feely, responded by counterclaiming for losses of their capital.[29]

The court ruled in favor of the service partners. In justifying its decision, the court reasoned, "[I]t is more likely that the parties 'by their agreement to share equally in profits, agreed that the value of their contributions—the money on the one hand and the labor on the other—were likewise equal.'"[30] The court also claimed, "Equity requires that the

25. 532 N.E.2d 931 (Ill. App. Ct. 1988).

26. *Id.* at 932.

27. *Id.*

28. *Id.* at 932-33.

29. *Id.* at 933.

30. *Id.* at 934 (citing Kovacik v. Reed, 315 P.2d 314 (Cal. 1957)). At another point in the opinion, the court used language which appears at first glance contrary to the agreement rationale; the court noted that it would capitalize the value of services "[a]bsent an agreement to the contrary." *Id.* Taken at face value, this statement seems opposite that of

value of services be recognized and capitalized, so as to prevent unjust enrichment."[31]

A striking aspect of *Becker* is that the partners themselves showed the monetization and capitalization of the service partners' contribution by naming the percentage of the partnership that Killarney and Feely purchased with cash. No matter which way the court rationalized the rule, it would be difficult to argue that the partners had not given the services the status of valuable capital when they declared that an investment of $160,000 gave Killarney 8% of the partnership. Obviously the partnership, which had never made a profit, was worth $2,000,000 by agreement of the partners. Feely purchased 5% with $100,000. Who owned the other 87%? There were only five other partners. By elimination, the service partners owned it. The facts show that the partners considered those services to be worth $1,740,000. The case is justifiable as much on the grounds of tacit agreement as on equity and the avoidance of unjust enrichment.

B. Kovacik v. Reed (Cal. 1957)[32]

Kovacik provides not much more in the way of rationale than does *Becker*. Kovacik, a contractor, asked Reed, a job superintendent and estimator, to join him in a venture doing remodeling work for Sears Roebuck.[33] Kovacik said he had $10,000 to invest. He told Reed that, if Reed would estimate and superintend, Kovacik would split the profits with him 50-50. The parties did not discuss losses.

The venture bid on, and was awarded, a number of remodeling jobs. Reed superintended all of them. About ten months after it began, Kovacik told Reed that the venture had been unprofitable. Kovacik demanded contributions from Reed for $4,340, half of Kovacik's capital losses of $8,680.[34] Reed refused to pay anything.[35] Kovacik sued. He won at trial.

The California Supreme Court reversed. The Court held that

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the code, which fails to capitalize the value of services absent agreement to the contrary. *See, e.g.*, UNIF. P'SHIP ACT § 18 (1914) ("capital or advances to the partnership property"); UNIF. P'SHIP ACT § 401 (1997) ("credited with an amount equal to the money plus the value of any other property . . . the partner contributes"); TEX. BUS. ORGS. CODE ANN. § 152.202(a) (2009) ("the cash and the value of property the partner contributes"). Actually, the court's language is consistent with the agreement rationale: Given the facts of the case, including the agreement to share profits equally (or perhaps according to the interests allocated by the parties' apparent agreement in this case), only evidence of explicit agreement otherwise would have turned the court away from its conclusion that the service partners' services had by implicit agreement been capitalized.

31. 532 N.E.2d at 934.
32. 315 P.2d 314 (Cal. 1957).
33. *Id.* at 315.
34. *Id.* at 315-16.
35. *Id.* at 315.

"[w]here . . . one partner or joint adventurer contributes the money capital as against the other's skill and labor . . . neither party is liable to the other for contribution for any loss sustained."[36] The court gave alternative rationales for this rule. One is that it is equal: "[W]here one party contributes money and the other contributes services, then in the event of a loss each would lose his own capital—the one his money and the other his labor."[37] Alternately, the court reasoned,

> [I]n such a situation the parties have, by their agreement to share equally in profits, agreed that the value of their contributions—the money on the one hand and the labor on the other—were likewise equal; it would follow that upon the loss, as here, of both money and labor, the parties have shared equally in the losses.[38]

Proving that the parties agreed to split profits equally is not a difficult burden. If showing that fact proves, absent evidence otherwise, an agreement that the partners not seek contribution for capital losses, then many money-service partnerships would qualify. There is intuitive sense in the court's reasoning. Would the parties have agreed to split profits equally if they considered their contributions to be unequal in value? It is possible but not likely.

Kovacik has drawn more comment than any other case discussed in this paper. The opinion is short, and rests on only a few facts showing agreement. The combination of these aspects and the case's applicability in a large commercial jurisdiction have made it a target for criticism, and some have raised objections, most notably Professor Stephen Bainbridge[39] and Professor Royce de Rohan Barondes.[40] I do not believe their objections hold weight and shall explain why.

a. Economics?

Professor Bainbridge purports to analyze the *Kovacik* case economically.[41] Bainbridge sees *Kovacik* solely as establishing a default rule.[42] A default rule is one that applies in the absence of an agreement of

36. *Id.* at 316.

37. *Id.* Many courts have followed *Kovacik*'s lead in declaring essentially as a matter of law that a service partner has no obligation to contribute to a capital loss upon dissolution. *See, e.g.*, Kessler v. Antinora, 653 A.2d 579 (N.J. Super. Ct. App. Div. 1995); Snellbaker v. Herrmann, 462 A.2d 713, 716-17 (Pa. Super. 1983).

38. 315 P.2d at 316.

39. *See* Bainbridge, *supra* note 17, at 631 et seq.

40. *See* Royce de R. Barondes, *Services as Capital Contributions: Understanding* Kovacik v. Reed, 3 ENTREPREN. BUS. L.J. 1 (2008).

41. Bainbridge, *supra* note 17, at 635.

42. *Id.*

the parties. The court suggested that it might be imposing a default rule when it described the necessary antecedents to its ruling as "one party contributes money and the other contributes services" and a loss occurs.[43] But calling *Kovacik* merely a default rule ignores the *Kovacik* court's characterization of its own holding as based on agreement. Recall that the court also stated:

> [I]n such a situation the parties have, by their agreement to share equally in profits, agreed that the value of their contributions—the money on the one hand and the labor on the other—were likewise equal; it would follow that upon the loss, as here, of both money and labor, the parties have shared equally in the losses.[44]

This "situation" is a limited exception to the statute: one party contributes money, another contributes services (and presumably is receiving no other compensation for services, as Reed was not), they agree to split profits equally, and there is a capital loss. The court is suggesting that when money and services are given solely and expressly for an equal share of profits, the two partners have impliedly agreed that the services are a capital contribution equal to the capital investment made by the money partner at least for the purpose of capital losses.

It is difficult to argue with the court's understanding. The money partner is willing to split profits with the service partner because of the service partner's service—the service partner's so-called sweat equity in building the business. The two have agreed that co-ownership of the business and half the profits, the exact things the money partner purchased with her money, are adequate quid pro quo for that service. If the two really are partners—co-owners of a business and not employer and employee—then co-ownership and half the profits have been exchanged solely for the service of the service partner, the only thing the service partner has offered. Co-ownership was not a gift from the money partner. If it was not, then the most likely and logical conclusion is that it was bought with the services that the service partner contributed.

The word *services* is in fact reductive. By services, I mean, and certainly money partners mean to pay for, more than a mere act or a promise of acts. Partners are not hiring someone to wash windows. Why does one choose a particular service partner and not just hire an employee? It is not just the acts but the knowledge, skill, and commitment of a person that bring a business opportunity to fruition, what one commentator appropriately calls "human capital."[45] It also includes business reputation

43. 315 P.2d at 316.
44. *Id.*
45. Sarah Pendergraft, *From Human Capital to Capital Gains: The Puzzle of Profits Interests*, 27 VA. TAX REV. 709, 740-46 (2008).

and network, knowledge of what will not work, potential customer contacts, judgment with respect to consumer demand (for example, Apple's Steve Jobs), and creativity.[46] Often it will include the very business idea in which the money partner is investing. The service partner often brings great value to the partnership, value that may in the long run bring a much greater return than the money contributed or than the money could have brought in any other investment. Therefore, it should not be surprising for a court to find that the parties have agreed that their equities are at least equivalent in an important sense. And if they consider their equities equivalent for purposes of profits, then they presumably see them as equivalent for purposes of losses.

I do not believe that the *Kovacik* court was suggesting that the parties thought their contributions were necessarily equal in monetary value for all purposes.[47] And the partners would likely never think that their contributions were equal in that sense after the moment of formation. The court's conclusion does not depend on this premise. Nonetheless, some have argued this red herring, most notably Professor Bainbridge and Professor Barondes. Both object that a money partner's and a service partner's contributions cannot be equal because a money partner's contribution, on the one hand, is to pay a sum certain of money at a specific time while a service partner's service, on the other hand, begins and then continues on indefinitely, changing value as it continues.[48]

This argument can be illustrated by a hypothetical given by Professor Bainbridge. On day 1 of the partnership, money partner contributes $20,000. On day 1, service partner works eight hours. If the partnership dissolves at the end of this day, does this mean that the service partner’s work was worth $10,000?[49] Or, we can stretch out the time (and

46. *Id.*

47. The money partner, if rational, believes at formation that the business opportunity and access to the service partner's services are worth more than the money contribution. Otherwise, the money partner would be knowingly overpaying.

48. *See* Bainbridge, *supra* note 17, at 662-63; *see also* Barondes, *supra* note 40, at 1 et seq. (positing that the implicit agreement that the value of services provided by the service partner equals the amount the partnership loses on a cash basis seems implausible because the more the firm ultimately loses, the more those services are therefore agreed to be worth).

49. Bainbridge believes this objection to the *Kovacik* rule is plausible at least theoretically. Bainbridge, *supra* note 17, at 662-63. It is actually completely implausible and irrelevant. First, *Kovacik* does not apply to the hypothetical because there is no loss. Second, Bainbridge misreads the parties' bargain. They have traded co-ownership for service, and after one day, the bargained-for service has not really been given. Third, no court would allow the service partner to game a legal rule in this fashion, especially one founded, as *Kovacik*'s is, on an implied agreement. The suggestion that the parties impliedly agreed that the service partner could cheat the money partner in this fashion assumes not that the parties are reasonable, the basis of nearly all implication, but rather that one partner is sneaky and the other is a dolt. No one would ever have agreed to such a result in the real world, and no court would conclude by implication that they had so agreed.

here I add to Professor Bainbridge's hypothetical). Suppose the partnership survives and thrives with only that $20,000 in seed money. The service partner runs it profitably for the next ten years without the money partner's paying another dime or lifting a finger. Eventually, the business is taken public and the two partners split $1 billion. Is there any way to say that the contributions of the two were equal? No, if by "equal" one means worth the same dollar amount.

Professor Bainbridge also suggests the case of *Larsen v. Claridge*.[50] In *Larsen*, one partner provided a farm and the other provided the labor to operate it. The two agreed to split profits equally. After five years, the partnership dissolved and the service partner claimed half the farm. The court rejected this claim. Professor Bainbridge argues, resting on the notion that *Kovacik* said the contributions were "equal," that *Larsen*'s holding is inconsistent with the rationale of *Kovacik*.[51] The holding is not inconsistent, as I explain below, but the court's rationale seems to be. Despite that the partners had agreed to split profits equally, the court said, "The record does not show that there was an agreement between [the partners] which would equate the labor as provided by [the service partner] in monetary value with the actual capital contributed by" the property partner.[52]

Both of these objections to *Kovacik* share the same flaw: They assume that *Kovacik* requires that the money and service offered as capital contributions be monetizable for the same amount for all purposes at a certain moment in time after formation. Surely they cannot be. But that is no objection to *Kovacik*. The court was not claiming that money partners know or even guess at what no one can know: the value of a service partner's contribution at every point in time in the future. Even ex post the value of that contribution is never in fact monetized. The worth of that service is never definite, even at the time of formation. Partly it depends on the value of the business opportunity. Ex ante, the business opportunity's monetary worth is itself generally ascertainable only within a range of values (depending at the least on what assumptions one makes about risk, cash flow, and the time value of money). Additionally, this valuation is normally made without taking into account inevitable and inefficient human error. Even the partnership formation itself as an event, with an agreement centered around a mix of money, property, service, and hope, is only partly sufficient at delimiting that range of values.

Whether the service partner is suited to bring the business plan to fruition is only proved by the business's success, and the value the service partner contributed to that success (or failure) is not quantifiable with

50. 534 P.2d 439 (Ariz. Ct. App. 1975).
51. Bainbridge, *supra* note 17, at 664.
52. 534 P.2d at 440.

certainty, nor is it generally quantified after the partnership forms. It was, however, roughly quantified once, at the time of formation, when the money partner agreed that it was roughly equal to the money contributed. That is not only the sole valuation of it that occurs, it is also the most relevant, because it occurred at the same time that the money partner determined her obligation to fund the venture. The fact that neither a court nor the other partner ever quantify it again does not detract from the fact that one person, once, named its value: the money partner, the very person who at dissolution is in these suits asking for an additional capital contribution from the service partner. Having named that value and assumed all the risk of the uncertainty inherent in that valuation decision for purposes of getting into the partnership, the money partner should be bound to that choice on the way out of the partnership. Doubling back on that choice would undercut the deal the partners made in the first instance. The *Kovacik* court asserted that the money partner has agreed that for purposes of capital formation, profits, and, hence, losses, the capital contributions are equal.

Thus, that a day after formation the service partner's contribution doesn't seem like much, or that fifteen years later it might seem overwhelmingly more valuable than it did that first day, is beside the point. In fact, no one gives a monetized value for the service partner's contribution after formation, and its value remains extremely uncertain. But one person once named it equal to the money contributed, and that person is now asking the service partner to contribute to a cash loss, as if the service partner's contribution were worth nothing at all.[53] It is right and just at that point to hold the money partner to the formation bargain.[54] The partners' implied agreement in the beginning prohibits the money partner from asking for that.

Why would it not also follow for the *Larsen* plaintiff to take half the farm? Logically, the problem is not that the partners have never agreed that their contributions are equal; they might have so agreed. But if the service partner agreed to take an equal share of the partnership for his services, then at dissolution he has already received back what he contributed. He received back his services for the future, and can take

53. Professor Bainbridge also suggests that the service partner should pay the loss because, if there is a loss, "it is likely to be a result of poor work by the service partner." Bainbridge, *supra* note 17, at 649. I find this completely implausible. I cannot think of a single reason for a service partner who will profit from a venture only from profits to shirk or act negligently. The mere failure of a business is no reason to fault the manager. The case law language Professor Bainbridge cites in support of this argument provides no support at all.

54. One might analogize it to an admission, estoppel, waiver, or any number of other legal doctrines. The economic and moral necessity of holding the money partner to the original deal would remain the same.

those services elsewhere, just as the money or property partner can take her farm elsewhere. This is surely what the court meant: The services "as provided by" the service partner are not equal to the farm, which has indefinite value and potentially infinite future use.[55] This conclusion is necessary no matter whether during the partnership the services committed indefinitely might have been worth the indefinite use of the land, as *Kovacik* might have concluded. Only if the services already provided were worth half the land in perpetuity would splitting the land be equal.

A service partner's entitlement to the land, as requested in *Larsen*, would require proving the value of the prior services at the moment of dissolution. This was five years after the partnership formed.[56] If at that moment, half the farm and the services already provided to the partnership, without any services going forward, were actually equal in value, it would be an extremely unlikely coincidence. And the court had no evidence before it of the value of the services already provided.[57] Consistently with *Kovacik*, the *Larsen* court might have reasoned that at this late date, lacking any means of ascertaining the value of the services already provided but no longer offered and remaining in the service partner's control, no way existed to determine how much of the farm should have been given to the service partner. Under *Kovacik*, the partners' contributions were equal at formation, when both would stretch indefinitely into the future. Thus, the most fair and equitable division of partnership property was to award the farm back to the property partner and the future services of the service partner back to the service partner. With the value of the future service taken into account, as *Kovacik* demands, the result in *Larsen* is an even split of partnership property. This is appropriate and consistent with *Kovacik* given the partners' initial, implied agreement that the property and service were of equal value. Because the service partner necessarily takes back future services, giving that service partner a part of the farm, too, might well have been overcompensation. Thus, *Larsen*'s result is not only consistent with *Kovacik* but in fact affirms it.[58]

55. 534 P.2d at 440.

56. *Id.* at 439.

57. The record in *Larsen* did not show evidence of an agreement equating the labor with the monetary contribution. 534 P.2d at 440.

58. Professor Bainbridge makes another argument against a court's finding an implicit agreement that the service partner not contribute to capital losses. It is a policy claim that this result gives the service partners an opportunity "for strategic behavior . . . in the end-game." Bainbridge, *supra* note 17, at 663.

> Assume the firm has suffered capital losses and the capital partner is considering pulling the plug by dissolving the firm. In such a situation, the service partner may be tempted to wager all of the firm's remaining assets on a high-risk venture: If the gamble pays off, and leaves the firm with profits to be divided, he shares in them. If the gamble fails, however, he bears none of any

b. Accounting?

Professor Barondes makes a related argument illustrated with partnership accounting.[59] He claims that *Kovacik*, which concludes that the parties have agreed that their contributions are of equal value, actually requires under partnership accounting practice that the service partner's contribution be deemed equal to the amount the partnership eventually loses on a cash basis: "The more the firm ultimately loses, the more those services are agreed to be worth."[60] Positing hypothetical numbers in capital accounts based on the facts of *Kovacik*, Professor Barondes suggests that the court would require initial capital accounts as follows:

INITIAL CAPITAL ACCOUNTS

Kovacik	$10,000
Reed	$10,000
Total	$20,000[61]

> additional capital losses. . . . If the service partner makes the firm's day-to-day operating decisions, as will often be the case, *Kovacik* thus allows the service partner to gamble with someone else's money.

Id. I am unsure why this is an objection, nor am I sure how it is strategic. If the service partner plays the partnership's last cash at the blackjack tables in Vegas and makes enough to meet payroll, the money partner may later thank him. *See, e.g.*, *Fred Smith on the Birth of Fedex*, BUS. WK., Sept. 20, 2004, *http://www.businessweek.com/magazine/content/04_38/b3900032_mz072.htm* (describing Fred Smith's successful trip to Las Vegas that allowed him to cover FedEx's payroll costs). Moreover, Professor Bainbridge seems to believe that the service partner's contribution is worth nothing at all or that only money can be a contribution. If all the money is gone, then neither gets any return on their contribution. Furthermore, betting the farm is a common problem inherent in all agency relationships in which the agent can claim a share of the profits. Corporate and LLC managers routinely bet the farm on the last few dollars and there is no possibility of their being liable because of a capital loss to shareholders or members. Should a partner necessarily be less of a manager than Fred Smith? Finally, Professor Barondes convincingly reasons that on certain facts the *Kovacik* rule may make managers more risk averse. *See* Barondes, *supra* note 40, at 12-14. If the money and service contributions are considered equal, then the managing partner may bet the farm as the money is about to run out, but will not do so if there is a possibility that the losses will exceed even the money contribution. *Id.* Even equal contributions do not prevent equal partners from being equally liable to third parties. Given the uncertainties involved in betting the farm, the values placed on the service partner's actions by the parties, and both partners' absolute default right to quit the partnership at any moment, the danger of betting and the danger of overcaution seem like a wash.

59. Barondes, *supra* note 40, at 1-12.

60. *Id.* at 1.

61. *Id.* at 8.

Professor Barondes notes that if Kovacik has agreed that Reed's services are worth $10,000, then not only does Reed have a $10,000 initial capital account entry, the partnership also has an asset worth $10,000, namely, Reed's services.[62]

When the Kovacik-Reed firm dissolved, it had only $1,320 in cash (based on the case's report of an initial Kovacik contribution of $10,000 and a cash loss of $8,680[63]). Barondes claims that the capital loss of the firm is therefore $20,000 - $1,320 = $18,680. Dividing this loss equally between the partners ($9,340 from each) leaves the firm owing Reed money (illustrated by the positive amount left in Reed's capital account):

CAPITAL ACCOUNTS AT DISSOLUTION

Kovacik	$10,000
	<u>($9,340)</u>
Total	$660
Reed	$10,000
	<u>($9,340)</u>
Total	<u>$660</u>
Total	$1,320[64]

This counter-intuitive result follows if accounting principles are applied to the court's conclusion, the argument goes. Thus, Professor Barondes claims that accounting principles reach a result inconsistent with the result the *Kovacik* court applied, which was that Kovacik take nothing from Reed and, presumably, that Reed take nothing from the partnership. Professor Barondes then asks what value must be given to Reed's services in order for Reed to take nothing: "The answer is $8,680. It is not a coincidence . . . that this is the amount that the partnership lost on a cash (actual) basis."[65] Professor Barondes then proposes that it is extremely unlikely that the partners agreed ex ante by implication that Reed's services would exactly equal Kovacik's ex post capital losses. On that premise, Professor Barondes suggests it is unlikely that the partners agreed in the beginning that their contributions were equal, contrary to the *Kovacik*

62. *Id.* ("In order to have a value of $1,320 when it is wound-up, it has 'spent' both the $10,000 initial capital contribution as well as the $10,000 of Reed's services.").

63. *Kovacik*, 315 P.2d at 315-16.

64. Barondes, *supra* note 40, at 8.

65. *Id.* at 9.

court's inference otherwise.[66]

Professor Barondes's accounting recitation is flawed (similarly to Professor Bainbridge's examples) and circular. While Professor Barondes has correctly identified the value of the initial contributions based on what probably was the value proposed by the parties, assumptions he makes later about the value of the services in particular are unwarranted and in fact determine his conclusions. At the firm's dissolution, Professor Barondes posits a loss of $18,680. He does this by considering only the cash on hand at dissolution. What happened to the value of the services? Professor Barondes assumes that away—assumes it was worth only $0—when he insists that the partnership has only $1,320 in net assets. Having assumed away the entire value of the services, Professor Barondes concludes that Reed necessarily ends up under accounting rules with a right to half of the remaining cash. The inconsistency to which Professor Barondes points arises from his own assumption, not the court's opinion.

Given the initial valuation of the service partner's contribution, an accountant would never make such an assumption. Equity is a residual category: that which is left after liabilities are subtracted from assets. We know how much cash the Kovacik-Reed partnership had on hand, but Professor Barondes first posited that Reed's services also had value. The difficulty with Barondes's analysis is that he assumes a value for the services at dissolution. In fact, their value at dissolution is uncertain, as we have noted. They were only valued once, at the start, and then only relatively to a business opportunity of uncertain value. Supposedly, the value of those services is now impaired somewhat, the business being in dissolution, but how much? Professor Barondes assumes the value is impaired completely, but that is just an assumption. What value is posited for those services at dissolution determines the accounting treatment entirely.

The *Kovacik* court appears to have given the benefit of the doubt to the only valuation that was ever put on the services: that made by the money partner at the time of formation. At that time, the money partner agreed that the services were equal to the money. In between formation and dissolution, no market or other valuation occurred and no depreciation or impairment of the value is calculated, so an accountant at dissolution is more likely to keep the value of the services at that same, initial number.[67] For purposes of capital contributions, that is the value the *Kovacik* court used: the same value as at formation, which is equal to the money. What else should it do? Given the uncertainty in the value itself and the money

66. *Id.* at 9-11

67. The value of the partner's future services may be diminished somewhat by shorter life expectancy but increased by greater firm-specific and business-plan-specific knowledge and ability.

partner's obvious prior concession, the court's decision is both economically and morally defensible.[68]

The court's analysis in partnership accounting therefore leads to quite a different accounting treatment at dissolution than the one Professor Barondes advocates:

Kovacik:	$10,000
	($4,340)
Total	$5,660
Reed:	$10,000
	($4,340)
Total	$5,660

The partnership owes Kovacik and Reed $5,660 each. Because the court has found, based on Kovacik's agreement at formation, that the services have a value equal to Kovacik's money, the value left in the partnership is actually $11,320. This the parties split evenly, again based on their agreement at formation. Kovacik will take the $5,660 in cash (the $1,320 left plus his $4,340 contribution to a capital loss), and Reed will keep the $5,660 of his services remaining in the partnership. Kovacik takes nothing from Reed because they both owe equal amounts, and paying into the partnership would be a wash. They are merely splitting the remaining capital. The accounting treatment is thus not inconsistent with the court's opinion. It is not true, then, that the parties must have agreed ex ante that Reed's services were worth the eventual amount of the cash loss. The accounting treatment does not undermine the implied agreement that the money and services were equal in value.[69]

68. Oddly, Professor Barondes mentions this possibility in another part of the article. Asking what accounting treatment would be required if the partnership's losses exceeded the money capital, he proposes that the partners would split them and calls this proposal "not unreasonable." *Id.* at 12-13. But this conclusion is possible only if the value of Reed's services is set not at the amount of the ex post cash loss, as Professor Barondes argues that capital accounting requires, but at the exact amount of Kovacik's contribution, as the *Kovacik* court stated. Barondes does not address this discrepancy.

69. In the final section of Professor Barondes's essay, he posits that Kovacik undertook not a one-time cash contribution of $10,000 but an ongoing contribution of $1,000 per month for ten months. Noting how Kovacik's capital account would grow through the months until it equaled $10,000, Barondes supposes that Reed's account would grow at the same rate. *Id.* at 14-16. Thus, in this section, also, Barondes relies on exactly the same circular argument.

c. Complexity.

Professor Bainbridge raises one other objection. He claims that the *Kovacik* rule is not worth its cost as an exception to an otherwise acceptable general rule.[70] Bainbridge interprets *Kovacik* as a default rule and not as a reflection of the parties' agreement, but the litigation costs necessary to take advantage of the agreement-based exception may well encourage courts to require a more explicit agreement. Just what costs does Professor Bainbridge attribute to the *Kovacik* rule? The exception is complex, he notes, because its limits are uncertain: "Only on the simple facts of *Kovacik* and its progeny . . . can such an exception be simply applied."[71]

The situations Bainbridge identifies as unclear, however, remain unlitigated since *Kovacik* was decided fifty-two years ago. It is not hard to imagine why, and the reasons belie the complexity argument. Bainbridge asks, What if partners are obliged to contribute additional capital? What if a new partner joins or an old one leaves?[72] But these situations force the partners to put a value on their shares, and thus on their contributions. The result is that these situations create evidence that even more clearly shows the agreement of the parties with respect to the value the money partners place on the service contributions. *Becker v. Killarney*[73] is a fine example. Killarney and Feely bought into the partnership with $160,000 and $100,000 contributions, which gave them an 8% and a 5% interest, respectively.[74] This fact showed that Killarney and Feely valued the partnership at $2 million and that they, at least implicitly, agreed that the other partners' contributions (all of which were service) were worth 87% of $2 million. All partners were later required to contribute additional capital in their respective percentages,[75] and this fact proved the same point. The facts Professor Bainbridge claims bring complexity actually bring clarity.

What if the service partner "performs poorly or fails to perform at all"? Bainbridge also asks.[76] With respect to this supposed ambiguity, Professor Bainbridge was interpreting *Kovacik* as a default rule only. If the agreement-based rationale of *Kovacik* is considered, this is not an objection. The service partner is guilty of breach, then, and having never contributed the required capital may not hold the money partner to the initial agreement. Contribution may then be required in that instance.

Finally, Bainbridge calls *Kovacik* complex because it "draws a

70. Bainbridge, *supra* note 17, at 665-66.
71. *Id.* at 666.
72. *Id.*
73. Becker v. Killarney, 532 N.E.2d 931 (Ill. App. Ct. 1988).
74. *Id.* at 932.
75. *Id.* at 933.
76. Bainbridge, *supra* note 17, at 666.

wholly arbitrary line."[77] Again, this conclusion reflects Bainbridge's insistence that the rule is merely a default rule. But based as it is on the parties' agreement to split profits and omit any other payment to the service partner, with resulting implied ex ante equality of the partners' contributions, the rule is not arbitrary at all. It rests on the need to hold the money partner to the original deal.

So the rule is not complex. Tellingly, after suggesting the complexity argument, Professor Bainbridge felt an immediate need to account for the fifty-two-year lack of litigation over the *Kovacik* rule.[78] As an explanation, he suggests that most dissolution suits result in a buy-out rather than litigation.[79] I believe that is correct, but a consistent and simpler explanation for the lack of litigation is that the *Kovacik* rule works well. There is no need to explain the lack of litigation.

It should be apparent at this point that *Kovacik* is much more easily defended on grounds of agreement than as an imposition of public policy. On that point, both Professors Bainbridge and Barondes in fact agree.[80] And in fact, doctrinally *Kovacik* clearly is grounded in agreement. That is apparent to anyone studying the two precedents on which the *Kovacik* court most expressly relied. Those precedents come from Kentucky, and after *Kovacik* are the most cited cases in this area. To those cases we now turn.

C. Heran v. Hall (Ky. Ct. App. 1840)[81] *& Meadows v. Mocquot (Ky. Ct. App. 1901)*[82]

Heran v. Hall is the source of the agreement-based rationale in *Kovacik*.[83] The facts are simple. Heran provided money and Hall provided the service of buying corn in Illinois and Missouri for shipment to New Orleans. They agreed to divide profits equally. There was no written agreement. Heran sued Hall for one-half of Heran's capital loss. The trial court denied Heran recovery, and the Court of Appeals of Kentucky affirmed. The appellate court stated that "each will have sustained a correspondent loss of his capital," the one money and the other labor, and

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77. *Id.* at 667.

78. *Id.* at 667-68.

79. *Id.* at 668 (citing, by analogy, John Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 30-34 (1977)).

80. Bainbridge, *supra* note 17, at 659 ("In sum, there does not appear to be a determinate majoritarian outcome to the hypothetical bargain in this context. . . . Similarly, none of the non-majoritarian default rules appear apt in this setting."); Barondes, *supra* note 17, at 14.

81. Heran v. Hall, 40 Ky. (1 B. Mon.) 159 (Ky. 1840).

82. Meadows v. Mocquot, 61 S.W. 28 (Ky. 1901).

83. *See Kovacik*, 315 P.2d at 316.

therefore neither would be liable for contribution to the other.[84]

The agreement-related holding of the court is more obscure. Here is the court's language:

> In this case, if, as we are disposed to consider the more probable, Hall was to furnish no other capital than his services, and *operam pro pecunia valere*, was, therefore, to receive a share of the profits, even had the purchase of the corn been, in fact joint, he would not be liable for the loss on Heran's capital.[85]

"The work to be for [or to be worth] the money," quite literally from the Latin, means that Hall was working as a partner for the share of profits, not to make Heran wealthy, or even to preserve Heran's wealth. By agreement, the partnership was created solely for the profit-making opportunity, not for the purpose of managing a pool of assets (contributed by Heran). This is the equivalent of the rationale later adopted in *Kovacik* that an agreement to split profits and not pay the service partner any other compensation implies an agreement that the service partner not be liable for the capital losses of other partners.

Meadows followed *Heran*. The facts are similar. Meadows and Mocquot formed a partnership for the buying, ginning, and selling of cotton.[86] Meadows paid for the cotton, kept accounts, and collected money from sales. The money was placed in Meadows's bank account. Mocquot handled the details—purchased the cotton, ginned it, and shipped it to market. Their contract was verbal and the two parties expressly disagreed about whether under it Mocquot was to bear part of the loss. Mocquot testified that he understood that he was not to bear any of the loss, "although nothing specially was said about loss."[87]

The court did not resolve the disputed testimony directly but nonetheless concluded that an agreement existed that Mocquot not be liable for half the loss. The court explained the guiding principle in terms of "use" of the money, quoting Rutherford:

> "In partnership, where work is contributed on one side and money on the other, the partner from whom the money comes may contribute only the use of the money, or the property of it. If he contributes the use of it, and still keeps his property in the principal, so that the joint stock is to be considered as made up of the labor of one partner and of the use of the other's money, it is plain that, supposing the principal to be safe, it belongs to him, and that, supposing it to be lost, he alone bears the loss. The other partner, . . . since . . . he had no claim to the principal

84. *Heran*, 40 Ky. (1 B. Mon.) at 160.
85. *Id.*
86. *Meadows*, 61 S.W. at 28.
87. *Id.*

> money, . . . cannot be obliged to make good any part of the loss . . . . But if he contributes the property of his money, so that the joint stock, upon which each of them has a common claim, is made up of his principal money and of the other's labor, then the partner who labors has a claim upon the principal money itself," [and therefore should share in its loss.][88]

The court claimed without much explanation that this principle was applied in *Heran v. Hall*.[89]

The point on which the court's analysis hangs is whether the partners became joint owners of the money contributed by the money partner, or only joint owners of the profits that could result from its investment. This is a matter of agreement between the parties, and can be investigated independently of whether the parties themselves agreed explicitly on whether the service partner should be liable for a loss. What facts show whether only the use of the money and not the property in it was contributed? In *Meadows*, the court found that "it was one of the conditions of the partnership that, before any division of profits could be had, all the money contributed by [the money partner] was to be restored to him,—in other words, that the firm was to have only the use of the money."[90] So therefore Mocquot was not liable for the money's loss. In other words, the stipulation that money will be returned before profits are distributed shows an agreement that the service partner will not be liable for any loss of the money capital. The inclusion of that kind of condition reaches the same result as an explicit agreement to declare the service partner's capital contribution equal to the money or other property contributed by the other partner.

In fact, the money partner's ability to dissolve, or disassociate from, the partnership at any time and demand a return of the money contribution is not very different than an explicit condition that the capital be repaid before profits are distributed. If the venture has the cash, it will pay out to the money partner whatever the partnership can afford that the money partner expresses a desire to receive, up to the amount of the capital contribution. A partnership is likely, as soon as it is able, to buy out a money partner who wants out, because the partnership under the implicit threat of dissolution or disassociation would rather be free of the threat. *Meadows* therefore adds relevant weight to the rule in *Kovacik*.

88. *Id.* at 29 (quoting T. RUTHERFORD, INSTITUTES OF NATURAL LAW, BEING THE SUBSTANCE OF A COURSE OF LECTURES ON GROTIUS DE JURE BELLI ET PACIS READ IN S.JOHNS COLLEGE CAMBRIDGE, Ch. XIII, §35 (2d ed., Cambridge Univ. Press 1774)).

89. *Id.*

90. *Id.*

II. THE TEXAS CASES IN THE *KOVACIK* LINE

Texas case law falls squarely in the *Kovacik* line, clearly supporting the finding in appropriate cases of implied agreement that the money partner will bear her own losses. These cases are justified or justifiable on the same principles that support the leading cases from other jurisdictions.

There is a story of case law development here. The cases involving money and service partners were decided against the background established for partnership capital cases in *Johnston v. Ballard*.[91] Description of that case and another following just after is a necessary preliminary.

A. Preliminary I: Johnston v. Ballard (1892)

Johnston is the precedential progenitor for Texas partnership capital cases. It arose before statutes addressed the problem, so it was resolved largely through common law reasoning and judicial policy. Ballard and Johnston formed and later dissolved a partnership.[92] At dissolution, Johnston agreed to buy Ballard's interest. Johnston paid Ballard $326.73, but then Ballard died, and his widow and children sued for more, complaining that Johnston had not paid the amount of Ballard's equity.[93] At issue, specifically, then, was how much capital Ballard owned. The two partners had contributed wildly different amounts of cash; Johnston contributed ten times more than Ballard.[94] In resolving this dispute, the court made several pronouncements later relevant in money and service partner cases.

First, the court stated that it would initially assume that the parties held equal shares of the partnership capital:

> There seems to have been no articles of partnership, and there was no direct evidence of any character as to the terms of the partnership agreement. Mr. Justice Story says: "In the absence,

91. Johnston v. Ballard, 18 S.W. 686 (Tex. 1892).

92. *Id.* at 686.

93. *Id.*

94. Ballard contributed $298.80 and, over the life of the partnership, withdrew $763.82. *Id.* at 686. Johnston contributed $2,404.86 and withdrew $240. *Id.* The partnership then dissolved, and Johnston agreed to purchase Ballard's interest for whatever the partnership books disclosed Ballard's interest to be worth. Johnston paid Ballard $326.73. *Id.* Ballard then died. *Id.* Thinking Johnston had not yet paid enough, Ballard's widow Emma Ballard sued Johnston for the remainder of Ballard's interest. *Id.* In response, Johnston claimed he had overpaid and that Ballard's interest in the partnership was worth only $78.10. *Id.* Johnson counterclaimed for the amount he overpaid. *Id.* The jury returned a verdict for Emma Ballard for $275. *Id.* At the time of the lawsuit, the partnership had net assets of $2,428.35. *Id.*

> however, of all precise stipulations between the partners in respect to their respective shares in the profits and losses, and in the absence of all other controlling evidence and circumstances, the rule of the common law is that they are to share equally of both, for in such case equality would seem to be equity." Story, Partn. § 24. The rule, we think, should be extended further, and that, when there is no evidence, either direct or circumstantial, as to their respective shares in the capital stock, the presumption is also that they hold an equal interest.[95]

Justice Story spoke of profits and losses. The court cited three cases from other jurisdictions all supporting the *Johnston* court's extension of the rule to partnership capital.[96]

This principle is fair on its face. It might also be fair as applied. Sometimes partners will have put in the same amount of cash or property as contributions to capital. When they have done this, a presumption that they hold an equal interest makes perfect sense. That the court would start with the same presumption in a case in which one partner contributed ten times what the other did is striking! The move indicates the strength of the presumption. Surely it would also cover a case in which neither partner contributed money but both contributed only service. The court next stated the presumption as a general rule for all partnerships:

> Where there is no evidence except the mere fact that a partnership exists, a rule that the partners hold unequal shares in any distinct proportion would necessarily be arbitrary. But we know that each has some interest, and justice would seem to demand that their interests should be presumed to be equal. How inequality of interest, in the absence of proof of some controlling circumstance, could be arrived at and especially the proportion of the respective interests, we are at a loss to conceive.[97]

Surely the presumption is also strong enough to cover the money-service partner problem. If the presumption applies in a case in which one partner submitted ten times more cash than the other, surely the same presumption would apply in a case in which one partner submitted cash or property and the other submitted services of uncertain value. The rule

95. *Johnston*, 18 S.W. at 686 (quoting Story, Partn. §24) (internal citations omitted).

96. *Id.* (citing Northrup v. McGill, 27 Mich. 234, 235 (1873) ("Supposing that they were partners, the law would, doubtless, in the absence of explanations or of facts leading to another inference, fully authorize the presumption that they were equal partners."); Farr v. Johnson, 25 Ill. 522, 525 (1861) ("As we understand the rule, when a partnership has been shown to exist, unless rebutted, it is the presumption that the partnership is equal."); Roach v. Perry, 16 Ill. 37, 38 (1854) ("Where the proof shows a partnership, but does not show the respective interests of the several members of the firm, the law will presume that they were equal partners.")).

97. *Johnston*, 18 S.W. at 686-87.

seems to mandate that the service partner's contribution be held equal in value to the money partner's contribution.

Actually, the court had something to say about the service partner problem. It mentioned the problem in a confusing bit of dicta:

> We conclude that, although unequal contribution to the capital on part of the respective partners may not, in the absence of other evidence, be sufficient to overcome the presumption of an equal participation in the profits, it is sufficient to show that the capital is not to be divided upon a final settlement and distribution. It is not unreasonable to presume that the use of the money of the partner furnishing the greater proportion of the capital is compensated by the services of the other, and that, therefore, they should share equally in the profits. But upon dissolution of such a partnership the latter necessarily retains his services, and it would seem just that the other should be entitled to withdraw his capital.[98]

What are we to make of this? The court says that the equality presumption is applicable to profits, losses, and capital, but not strong enough to apply at dissolution. Then the court says the presumption applies to money-service partnerships such that they split profits equally. However, when it addressed what will happen "[b]ut upon dissolution," it recommends for a money-service partnership a result focused not on a difference in capital contribution value but on equality: the service partner "necessarily retains his services, and it would seem just that the other should be entitled to withdraw his capital." The apparent equality of the two contributions—"it would seem just" because it seems equal—is the focus of the court's reasoning and the basis of its recommendation.

All of this was dicta, anyway. As it turned out, some evidence of agreement resolved the question in the case, sort of. The court found evidence that the two partners "did not intend that the partner who paid in the larger proportion of the capital should not be compensated therefor [sic] in settlement upon dissolution."[99] The court reported that, sometime after each partner had contributed $241.65, a conversation between the partners occurred in which Johnston told Ballard that Ballard had to contribute equally, and Ballard agreed to do so.[100] But, in fact, Ballard had not contributed any more, and the court thought Ballard's declining to contribute (after an agreement to do so?) disrupted the presumption of equality. The court held that Ballard was fully compensated for his partnership interest by Johnston's payment of $326.73, about $900 short of

98. *Id.* at 687.
99. *Id.*
100. *Id.*

half of the partnership's capital.[101] The court did not say how it moved from the premise of Ballard's lack of further contribution to the conclusion that the partners intended unequal interests. What the parties "intended" was implied by their conduct.

Perhaps the court later felt some of the case's ambiguity and tried to resolve it. Over half a century later, in another partnership dissolution case, the court reported *Johnston* in such a way that the general presumption of equal capital is reversed, but the dicta retains the confusing attempt to refute equality while specifying an equal remedy—"it would seem just" because it is equal—in the dissolution of a money-service partnership:

> [T]he opinion in that case observed that where a partnership agreement is silent as to the distribution of the capital upon dissolution, the partners are entitled to share in the capital, not equally, but in proportion to the respective amounts contributed by them; that where one partner furnishes money and another services, upon dissolution the latter necessarily retains his services and it would seem but just that the other should be entitled to withdraw his capital.[102]

Note, however, that though the general presumption is reversed, the effect of the presumption of equality is preserved for partnerships of money and services, just as the *Johnston* court stated it. In fact, the force of that presumption is preserved explicitly in the holding of the next case, which addressed a service partner's capital rights.

B. Preliminary II: Washington v. Washington (1895)[103]

Not long after *Johnston*, the Court of Civil Appeals followed in another case involving dissolution of a partnership without a capital loss. J.R. Washington ranched with his father. When J.R. died, J.R.'s widow Mollie sued her father-in-law, alleging that J.R. and his father were partners and that she was now entitled to certain personal property from the partnership. Evidence as to who contributed what and who owned it at the time it was contributed was scattered and conflicting.[104] The court instructed the jury, if they found a partnership, to find for Mollie for "one-half of the value of all property owned by the firm at the time of the dissolution."[105] The jury found for Mollie, but the appellate court reversed. It held that an instruction from *Johnston v. Ballard* would have been more proper:

101. *Id.* at 686, 688.
102. Newman v. Newman, 198 S.W. 2d 91, 93 (Tex. 1946).
103. Washington v. Washington, 31 S.W. 88 (Tex. Civ. App. 1895).
104. *Id.* at 88-89.
105. *Id.* at 89.

> If the evidence shows an agreement to enter into a partnership, and nothing more, the law will presume equality of interests in all firm property on hand at the time of the dissolution. If the evidence shows an agreement to enter into a partnership, and that one of the partners contributed the capital and the other the labor and skill, and fails to show the basis upon which the division is to be made upon dissolution, the jury would at least be authorized to find that the amount so contributed was to be first returned, and only the remainder divided.[106]

The property and the service are equal, in other words. As a result, the service partner receives back his services for the future and the contributor of the property receives back the property.[107]

C. The First Case: Johnston v. Steele (1908)[108]

Johnston v. Steele is the first case I have found that squarely addresses a claim by a money (here property) partner against a service partner for contribution to a loss. Johnston leased certain pasture land.[109] Johnston and Steele entered into a partnership agreement under which Steele would have charge of the land. Johnston's sheep would graze there, but Johnston would continue to own the sheep. According to the agreement, when the sheep sold, expenses for pasturing would be deducted, Johnston would be paid his cost for the sheep, and then the two would split the profits. Johnston would always own both sheep and land.[110]

No profits resulted from this arrangement, only losses. Johnston sued Steele for one-half of those losses. The court rejected this suit, however, on the ground that the partnership agreement could not be construed to require Steele to pay. The court explained: "As we understand it, Johnston was to furnish the sheep, and out of the proceeds of the sale thereof expenses were to be paid. Steele, on the other hand, was to give his time and attention to the business and share in the profits."[111] These facts, the court said, required a verdict for Steele. The opinion is brief, and without any more or clearer rationale. A later court of appeals opinion reasoned,

> From the opinion . . . it is clear that Johnston furnished to the

106. *Id.*

107. A similar argument was accepted in *Kessler v. Antinora*, 653 A.2d 579, 582 (N.J. Super. Ct. App. Div. 1995) ("Thus, upon the loss of both some money and labor, the loss falls upon each proportionately without any legal recourse . . . . Each party shoulders a loss, one in determinative dollars; the other in labor, difficult, if not impossible, to quantify.").

108. Johnson v. Steele, 107 S.W. 631 (Tex. Civ. App. 1908).

109. *Id.* at 632.

110. *Id.*

111. *Id.*

> partnership only the use of his land and sheep, against the labor and personal services of Steele, and that the potential profits were all that was owned by the partnership. In that kind of case the law is well established that the partner furnishing only the use of his money or property must stand the loss of such of that money or property as may be incurred in the operation of the business.[112]

D. The Leading Second Case: Bivins v. Proctor[113]

In *Bivins*, an opinion by the Texas Commission of Appeals later adopted by the Texas Supreme Court, the court finally addressed the service partner problem in terms that remain familiar today.

Bivins, Goodman, and Proctor were partners from October 1, 1928, to January 15, 1929, when Bivins died.[114] Bivins furnished cattle and part of the money for the purchase of other cattle. Goodman and Proctor gave their time and service to the pasturing, handling, and sale of the cattle. There was a division of net profits planned after the sale. The firm name was "Bivins, Proctor & Goodman."[115]

But on Bivins' death, the partnership had to buy out Bivins' interest. The partnership was not wealthy: It was unable to pay back all Bivins had put in, without the other partners contributing. The question was whether the other partners had to contribute to a capital loss.

The court first reasoned, in language harking back to *Johnston v. Ballard*,[116] that partners, absent any other agreement, are "presumed . . . equal as to both profits and losses."[117] This general rule, the court said, includes capital losses.[118] The court explained: "'The partnership, as an entity distinct from its individual members, becomes indebted to them for the capital they advance, and upon a settlement this debt should be paid just as any other liability of the firm, except that it is subordinate to the prior claims of creditors.'"[119]

But the rule is not so hard and fast as it seems:

> A partnership in its very nature involves the essentials of a "community of interests, the common enterprise, its operation for the joint account, and a right in the owner of each interest to share as a principal in its profits as such." Proof, therefore, of the

112. Paggi v. Quinn, 179 S.W.2d 789, 795 (Tex. Civ. App. 1944).
113. Bivins v. Proctor, 80 S.W.2d 307 (Tex. Comm'n App. 1935) (opinion adopted by the Texas Supreme Court).
114. *Id.* at 308.
115. *Id.*
116. *See supra* Part II.A.
117. *Bivins*, 80 S.W.2d at 308-09.
118. *Id.* at 309.
119. *Id.* at 315 (quoting Buie v. Kennedy, 80 S.E. 445, 446 (N.C. 1913)).

> partnership being made—nothing else appearing—there would be prima facie a community of interests in the capital, with an implication of law that each owner would participate in losses; but such is seldom the case, and the underlying general rule is that "whether a loss of capital is a partnership loss, to be borne by all the parties, depends upon the nature and extent of the contract of partnership."[120]

Regarding cases departing from the general rule that a service partner participate in money or property losses, the court reasoned as follows:

> [Y]et a careful consideration of such cases will show that they . . . are cases where the proof established a particular fact situation by which it was shown that there was in reality a specific agreement which fixed the rights and liabilities of the parties. . . . In our opinion, . . . "it requires a special agreement to prevent the conclusion of a community of interests in the property as well as in the profit and loss."[121]

Clearly direct proof of a special agreement would suffice to show that one exists,[122] but the court describes when it will find an implied agreement: It will look to "the nature and extent of the contract of partnership," "a particular fact situation [that would show] that there was in reality a specific agreement"[123] to depart from the general rule. The particular fact situation is proved, and the specific agreement is inferred from it.

The court does not elaborate further in general terms but later in the opinion the court describes one such particular fact situation:

> There is [a] line of cases . . . where the use of money or property was contributed by one partner over against the labor and services of another, the one contributing the money or property retaining title thereto, and expecting to realize interest thereon or from the use thereof from the profits of the venture, in which event the one contributing the labor and services was not liable for contribution to losses sustained by the other. In each of the cases mentioned there was a special written agreement to that effect or a finding that such was the nature of the contract.
>
> There is a line of cases where property or money itself, as distinguished from its mere use, was contributed on the one part and labor and services on the other, and in those cases it has been

120. *Id.* at 311 (citing Freeman v. Huttig Sash & Door Co., 153 S.W. 122, 125 (Tex. 1916) (first quotation); citation omitted from second quotation).

121. *Id.* at 309 (internal citations omitted).

122. *Id.* at 309, 311. An example of an agreement directly proved can be found in *Sturdevant v. Hooper*, 101 S.W.2d 379 (Tex. Civ. App. 1937).

123. 80 S.W.2d at 309, 311.

held that losses of capital must be borne by all partners.[124]

Readers of this paper will recognize the reasoning. The *Bivins* court cited for it *Hall v. Heran*[125] and *Meadows v. Mocquot*.[126]

In *Bivins* itself, the court reviewed the evidence—correspondence, bank records, and so on—and found that the partners, including Bivins, clearly intended the partnership to own Bivins' contributions rather than merely to have the use of them. A great deal of circumstantial evidence existed showing that title to cattle Bivins contributed and financed was transferred to the firm name.[127] This was enough to show that the exception did not apply.

After concluding that the exception did not apply, the opinion casts doubt on its breadth. The court suspected in dicta that it may not apply "except in cases of the use of real estate or buildings by a partnership," which may be restored after use by the partnership to the original owner.[128] But the court in fact entertained the argument when a partner contributed cattle. And a long quotation from an opinion quoted with approval in *Bivins* indicates that money may also be contributed in this fashion.[129] Clearly there was life left for the exception in later cases, which is why it was discussed again at length a few years later in the next case.

E. The Third: Paggi v. Quinn (1944)[130]

Paggi, Quinn, and Turner entered into a written contract of partnership in January 1917 for the purpose of buying and farming "the Norton farm."[131] This was a rice farm. The partnership took over Norton's lease on the farm in exchange for $12,000, including the teams, tools, and machinery. Paggi took a half interest in the partnership, Quinn 4/10ths, and

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124. *Id.* at 311.

125. Heran v. Hall, 40 Ky. 159 (Ky. Ct. App. 1840), discussed *supra* Part I.C.

126. Meadows v. Mocquot, 61 S.W. 28, 28 (Ky. Ct. App. 1901), discussed *supra* Part I.C.

127. *Bivins*, 80 S.W.2d at 308-09.

128. *Id.* at 315.

129. The opinion is *Masterson v. Allen*, 69 S.W.2d 539, 542 (Tex. Civ. App. 1934), cited in *Bivins*, 80 S.W.2d at 310. The language in *Masterson* states:

> In partnership, where work is contributed on one side and money on the other, the partner from whom the money comes may contribute only the use of the money or the property of it. If he contributes the use of it, and still keeps his property in the principal, so that the joint stock is to be considered as made up of the labor of one partner and the use of the other's money, it is plain that, supposing the principal to be safe, it belongs to him, and that, supposing it to be lost, he alone bears the loss.

Id. at 542 (quoting T. Rutherford, INSTITUTES OF NATURAL LAW at 140 (2 Am. Ed. 1802)).

130. Paggi v. Quinn, 179 S.W.2d 789 (Tex. Civ. App. 1944).

131. *Id.* at 791.

Turner 1/10th. The agreement provided that Paggi would furnish all the money, or secure a loan for the partnership, initially to buy the Norton property. The other partners agreed to pay 8% interest annually as it accrued on the amount of money required to pay for their respective interests. The agreement also provided that Paggi might supply money to buy livestock, too, on the same basis. Turner was to be in active charge and control of the farm and receive $75 per month as salary. The expenses of the operation were to be paid first from gross revenues. The residue was to be divided among the partners in proportion to their shares. The arrangement was to last for five years and was known as B.E. Quinn & Company. Quinn later purchased the interests of Turner.[132]

Paggi died on January 30, 1921. His estate sued Quinn in 1926 over continuing partnership expenses and also for half of what Paggi contributed to the partnership in the first place, which it claimed formed the capital of the partnership.[133] Eventually, the estate and Quinn decided to wind up the partnership, but Quinn refused to pay either the half of the expenses the estate had advanced or a share of the money Paggi had originally paid to begin the partnership. The trial court dismissed the complaint, but the court of appeals reversed.[134]

The court had no trouble ordering Quinn to repay his share of the expenses the Paggi estate had advanced to the business. The court noted that a partnership operates for the joint account of the partners, with the right of each to share in profits and "the responsibility of each for the losses."[135] Moreover, partners are liable for the debts of the partnership, the court noted, and "advances of money to the firm by a partner to discharge partnership obligations are nothing more than loans to the partnership, and the party advancing them becomes a creditor of the partnership."[136] Hence, Quinn owed Paggi half of the advancements.

With regard to the money Paggi originally used to finance the partnership, which the Paggi estate claimed to be a capital investment, the court began by noting the traditional rule: "Where it is sought to relieve any of the members from loss of capital in the partnership, a special contractual stipulation to that effect is essential. *Bivins v. Proctor* . . . ."[137] The court later confirmed, "[P]artners may stipulate for a variance of the rule as between themselves and it is always necessary to look to the contract entered into between them to ascertain the exact liability the

132. *Id.*
133. *Id.* at 792.
134. *Id.* at 792, 795.
135. *Id.* at 793.
136. *Id.*
137. *Id.* (citing Bivins v. Proctor, 80 S.W.2d 308 (Tex. Comm'n Appl. 1935)).

parties . . . have assumed."[138] Citing the rule from *Bivins* that a partner is liable for her own capital loss if she has merely contributed use of the money or property, rather than its title, Quinn argued that the money Paggi originally used to fund the partnership was only given to the partnership to use, not to own, and that Quinn was therefore not liable for any share of its loss.[139] Quinn's argument seems reasonable enough given that Paggi charged an interest rate for the money.[140]

In the end, the court preserved the exception but refused to grant Quinn judgment:

> In most of the cases involving the use of capital furnished by one of the partners, the capital so furnished was property, such as buildings, livestock, and the like. It is, no doubt, true that the use of money could be so furnished as the capital of the firm, such, for instance, as a partnership formed for the purpose of loaning money or where property is purchased with the money of one of the partners and the ownership placed in him and retained by him as his property; but the contract here involved plainly provides that the capital of the partnership should be the lease and that it was being acquired, not by Paggi, but by the partnership.[141]

So Paggi had not even given the partnership the use of the money.[142] The initial capital of the partnership was in fact only the Norton farm. Since the money was not capital, Quinn "was not liable . . . for his proportion of the money advanced by . . . Paggi upon the theory . . . that each partner is liable for his proportion of lost capital."[143] But then what was the status of the money Paggi advanced? The court gave a number of other options, including that the money might or might not be a partnership debt and that the partners may have intended to pay it back only through profits.[144] The court apparently thought it impossible that the partners did not provide for its repayment at all, however, and remanded for further factual development. Quinn thus might still have been liable for the money's loss, as his share of the repayment of an advancement.

The court made one other pronouncement on the theory. On a motion for rehearing, the court also found that Quinn had been paid for his services. This, the court explained, "is another feature which we think

138. *Id.*

139. *Id.* at 794.

140. In discussing the "use only" situation, the court considered two cases it thought were examples. One is a Texas case, *Johnston v. Steele*, 107 S.W. 631 (Tex. Civ. App. 1908), discussed *supra* Part II.C. The other is *Heran v. Hall*, 40 Ky. 159 (Ky. Ct. App. 1840), discussed *supra* Part I.C.

141. *Paggi*, 179 S.W.2d at 794.

142. *Id.*

143. *Id.*

144. *Id.* at 794.

shows it was not contemplated by the parties that Paggi would merely furnish the use of his money against the labor and personal services of [Quinn]."[145] *Paggi* thus preserves the *Bivins* precedent while not expanding it.

F. The Texas Cases Live On

Johnston v. Steele and *Bivins* are clearly cousins of *Kovacik.*[146] The other cases cited here are their children or other lineal relatives. This family of Texas cases has not been touched, judicially.[147] Nor has it been superseded by Texas statutes, which have always preserved the potential modification of default capital allocation rules by agreement.[148]

III. CONCLUSION & EPILOGUE

I am not sure what other than antipathy to litigation itself or perhaps to litigation over business relationships causes commentators and even the Uniform Partnership Code such concern with *Kovacik* and its relatives. Perhaps the commentators and code favor money over brains, or disregard any value that cannot be easily monetized (certainly economists and accountants favor numbers that are certain). The arguments against the cases rely on faulty logic, unrealistic expectations of both service and money partners, or spurious arguments from code provisions that actually

145. *Id.* at 796.

146. *Bivins* was recognized as falling in the *Heran v. Hall* line of authority in *Newton v. Sackett*, 10 Pa. D. & C.2d 507 (Ct. Comm'n Pl. 1957).

147. In fact, *Bivins* was cited as authoritative by the Texas Supreme Court in *Park Cities Corp. v. Byrd*, 534 S.W.2d 568, 673 n.6 (Tex. 1976), and *Newman v. Newman*, 198 S.W.2d 91 (Tex. 1947).

148. *See* Texas Business Organization Code, TEX. BUS. ORGS. CODE ANN. § 152.002(a) (2006); Revised Partnership Act, TEX. BUS. ORGS. CODE ANN. art. 6132b-1.03(a) (1993) (current version at TEX. REV. CIV. STAT. ANN. art. 6132b-1.03 (2008)); Texas Uniform Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132b § 18 (1987) (expired). Sher and Bromberg criticized the cases in a wooden, deductive manner in 1957. Byron D. Sher & Alan R. Bromberg, *Texas Partnership Law in the 20th Century—Why Texas Should Adopt the Uniform Partnership Act*, 12 SW. L.J. 263, 288-94 (1958). Sher & Bromberg argued that the cases are not based in agreement but on notions of "use" and "labor" which could not arise under the Uniform Partnership Act. *Id.* at 294. But the language from the cases themselves proves that the reasoning is grounded in agreement. The Uniform Partnership Act stated in 1914 that the rights of each partner to be "repaid his contributions" was "subject to any agreement between" the partners, Uniform Partnership Act § 18(a) (1914), an exception that continues in the partnership codes today, Uniform Partnership Act § 103(a) (1997); Texas Business Organizations Code § 152.002(a) (2006). Moreover, *Kovacik*, decided under the Uniform Partnership Act, proves that such cases could arise under the Act. *See also* Steven G. Frost, *Illinois' Revised Uniform Partnership Act*, 90 ILL. B.J. 644, 648 n.7 (2002) ("Presumably, the account provisions added in the Act will not change the results of this decision [Becker v. Killarney].").

allow the *Kovacik* line life and health. The *Kovacik-Bivins* cases align most closely with the deal the partners likely struck at formation. Accordingly, the finding of an implied agreement in them is justified.

Of course, the agreement exception cannot be applied in ham-handed fashion. Of course there will be times when an agreement cannot be implied in a money and service partnership. Perhaps the parties are sophisticated enough that they are actually aware of the default rule. Perhaps they are sophisticated enough to bargain around it. Sometimes other facts may preclude a finding of an implied agreement. But categorically outlawing them denies what the parties most likely agreed. To the extent a categorical rule denies the parties' actual bargain, it is both inefficient and unfair.

Kovacik and *Bivins* should be preserved.