North Dakota Law Review

Volume 68 | Number 1 Article 8

1992

Partnership - Notice of Authority of Partner to Person Dealing with Firm: Partner's Authority Under the Uniform Partnership Act - Is Ignorance Bliss

Steven J. Sarbacker

PARTNERSHIP—NOTICE OF AUTHORITY OF PARTNER TO PERSON DEALING WITH FIRM: PARTNER'S AUTHORITY UNDER THE UNIFORM PARTNERSHIP ACT—IS IGNORANCE BLISS?

First National Bank and Trust Co. v. Scherr, 467 N.W.2d 427 (N.D. 1991).

On September 15, 1981, Pius and Albinus Scherr opened a checking account at the First National Bank and Trust Company of Williston (the Bank) in the name of their newly formed construction and building investment partnership, Scherr and Scherr.[1] That same day, the Scherrs both signed a partnership checking account signature card that allowed either partner to act individually when borrowing money for the partnership.[2] Later, a partnership agreement was drafted which prohibited a single partner from borrowing money on behalf of the partnership without the other partner's written consent.[3] A copy of the signed partnership agreement was delivered to the Bank at its request.[4] Over the next few years, the partnership borrowed money from the Bank on several occasions for use in buying and constructing

---

1. First Nat'l Bank and Trust Co. v. Scherr, 467 N.W.2d 427, 427 (N.D. 1991) (*Scherr III*). This case is the third in a series of three involving the Scherrs. For the history of these cases, see *infra* note 7.

2. *Id.* The Partnership checking account signature card gave the Bank permission:

> to accept (whether or not payable to the partner who signs the same or to any other partner) checks, endorsements, notes, . . . mortgages or any other instruments for the deposit or withdrawal of funds, for borrowing money and pledging or mortgaging assets of the partnership as security for the payment thereof and for the transaction of any other business with it, when signed by any __ of the undersigned.

Id. A box on the signature card next to the partners' signatures which read "Number of Signatures Required" was filled in with the number "1." *Id.* at 428. The signature card was filed in the Bank's checking account files but was not put in the Bank's loan files. *Id.*

3. *Id.* Pius and Albinus signed the partnership agreement on October 1, 1981 and on December 21, 1981, respectively. *Id.* The agreement provided as follows:

> Neither partner shall, without the written consent of the other partner, endorse any note, or act as an accommodation party, or otherwise become surety for any person. Without the written consent of the other partner, neither partner shall on behalf of the partnership borrow or lend money, or make, deliver or accept any commercial paper, or execute any mortgage, security agreement, bond or lease, or purchase or contract to purchase, or sell or contract to sell any property for or of the partnership. Neither partner shall, except with the written consent of the other partner, assign, mortgage, grant a security interest [sic] in, or sell his share in the Partnership or in its capital assets or property, or enter into any agreement as a result of which any person shall become interested with him in the Partnership, or do any act detrimental to the best interests of the Partnership or which would make it impossible to carry on the ordinary business of the Partnership.

Id. (quoting the partnership agreement).

4. *Scherr III*, 467 N.W.2d at 428. The Bank filed the agreement with the partnership loan papers. *Id.*

properties.[5] On October 27, 1983, Pius Scherr, by himself and without written approval from his partner, Albinus Scherr, took out a short-term partnership note for $65,000, which he signed individually.[6] After the Scherrs defaulted on their debts, the Bank sued the Scherrs and the partnership to recover on the $65,000 note.[7] The trial court held that Albinus and the partnership were not liable for the $65,000 note, because the Bank "had written knowledge" of the restriction in the partnership agreement that prohibited a single partner from borrowing money on the partnership's behalf.[8] On appeal, the North Dakota Supreme Court *held* that although the Bank had a previously signed signature card authorizing a single partner to bind the partnership to a loan, the fact that the Bank had subsequent knowledge of a restriction in the partnership agreement it had received and retained in its files precluded a finding of liability against Albinus and the partnership

5. *Id.* There were a series of loans which were made to the Scherrs from 1981 to 1985. *See* Brief of Appellant at 3-5, First Nat'l Bank and Trust Co. v. Scherr, 467 N.W.2d 427 (N.D. 1991) (No. 90091) (available at the Thormodsgard Law Library) [hereinafter Brief of Appellant]. One of the partnership's construction projects involved the building of a Famous Recipe Chicken Restaurant. *Scherr III*, 467 N.W.2d at 428. This venture was financed through a $100,000 mortgage that was given to the Bank and signed by both Pius and Albinus in April 1983. *Id.* Subsequently, Pius alone signed four separate notes for a total of an additional $100,000. *Id.* On October 26, 1983, these four individual notes were combined into a single long-term mortgage that was signed by both Pius and Albinus. *Id.*

6. *Id.* The following language was typed on the loan papers: "THE PURPOSE OF THIS LOAN IS: *Final construction on the Famous Recipe Chicken.*" *Id.* (quoting the loan papers). The Bank renewed the note several times until May of 1985, with only Pius signing for the partnership. *Id.*

7. *Id.* The Bank also foreclosed on the long-term mortgage. *Id.* Initially, the trial court granted the Bank's motion for summary judgment against the partnership, Pius, and Albinus for the unpaid portion of the $65,000 note, plus interest. *Id.* All three appealed. *Id.* The North Dakota Supreme Court upheld the Bank's summary judgment award against Pius; however, the court reversed and remanded the summary judgment decisions that were rendered against Albinus and the partnership. First Nat'l Bank and Trust Co. v. Scherr, 435 N.W.2d 704, 707 (N.D. 1989) (*Scherr I*). On remand, the trial court was to determine the consequences, if any, the restriction in the partnership agreement would have on the issue of liability of Albinus and the partnership. *See id.*

Later, in a related matter, Pius sought further review of the summary judgment entered against him on grounds of recently discovered evidence. First Nat'l Bank and Trust Co. v. Scherr, 456 N.W.2d 531, 532 (N.D. 1990) (*Scherr II*). Pius argued that evidence revealed that the $65,000 note was secured and that anti-deficiency judgment statutes did not allow a judgment against him. *Id.* at 532-33. The North Dakota Supreme Court reversed the summary judgment against Pius and remanded. *Id.* at 534. Pius then filed for bankruptcy, and the issue of Pius' liability to the Bank was decided in that court. First Nat'l Bank and Trust Co. v. Scherr, 467 N.W.2d 427, 429 n.1 (N.D. 1991) (*Scherr III*).

8. *Scherr III*, 467 N.W.2d at 429. The trial court found an additional factor supporting its decision; namely, that the Bank " 'thereafter established a course of conduct of business with the partnership consistent with those restrictions.' " *Id.* (quoting the trial court decision). While the trial court felt it was not clear whether the checking account signature card could bind the partnership to a note signed by only one partner, it stated that " 'in any event, the restrictive language . . . in the Partnership Agreement . . . overrides and controls the signature card in the event of a conflict.' " *Id.* (quoting the trial court decision). The court dismissed the Bank's action against the partnership and Albinus, and the Bank appealed the decision to the North Dakota Supreme Court. *Id.*

on the $65,000 note.[9]

During the 1800s, increased use of partnerships in the United States led to the growth of the common law of partnership.[10] Early court decisions recognized that a third person having notice of a restriction on a partner's authority was bound by the restriction.[11] One court characterized this rule as "an old principle of the common law."[12] Thus, a third party who deals with a partner who is acting outside his authority may recover from only the acting partner and not the dissenting partner or the partnership.[13]

---

9. *See id.* at 430.

10. JUDSON A. CRANE AND ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP, § 2, at 12 (1968).

11. *See, e.g.*, Irwin v. Williar, 110 U.S. 499, 505 (1884); Monroe v. Conner, 15 Me. 178, 182 (1838); Lord Gallway v. Matthew, 103 Eng. Rep. 775, 776 (1808). Courts and legal writers in many instances have used the terms "notice" and "knowledge" in unintended ways. UNIF. PARTNERSHIP ACT § 3, 6 U.L.A. 14-15, official cmt. (1914). Specifically, the word "notice" has been used when "knowledge," as defined below, was intended. *Id.* The term "notice," as defined in the Uniform Partnership Act, refers to actions that allow the person who acted "to assert that notice has been had and claim the benefit thereof, irrespective of whether the person charged has had knowledge or not." *Id.* at 15. The Uniform Partnership Act attempts to distinguish the terms "knowledge" and "notice" as follows:

> (1) A person has "knowledge" of a fact within the meaning of this act not only when he has actual knowledge thereof, but also when he has knowledge of such other facts as in the circumstances shows bad faith.
> (2) A person has "notice" of a fact within the meaning of this act when the person who claims the benefit of the notice:
> (a) States the fact to such person, or
> (b) Delivers through the mail, or by other means of communication, a written statement of the fact to such person or to a proper person at his place of business or residence.

Id. at 14. Another writer has also tried to avoid confusion by defining notice, notification and knowledge as follows:

> Notice of a fact is the legal consequence of the receipt of a notification, or of the acquisition of knowledge with reference to a fact.
>
> . . . . A notification is an act intended to give information to another, which for most purposes has the same legal effect as if the other had received the information.
>
> . . . . Knowledge, on the other hand, is subjective, although the evidence to prove it is objective.

WARREN A. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 9, at 17-18 (1964). *See also* Red River Commodities, Inc. v. Eidsness, 459 N.W.2d 805, 809 (N.D. 1990) (holding under commercial law that actual knowledge of a fact may supersede the requirement of notice in a contract).

12. *See* Urquhart v. Powell, 54 Ga. 29, 32 (1875) (citation omitted).

13. *See* Leavitt v. Peck, 3 Conn. 124, 128 (1819). Authority has been defined as "the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him." *See* RESTATEMENT (SECOND) OF AGENCY § 7 (1958). Under partnership law, partners are considered agents of the partnership. UNIF. PARTNERSHIP ACT § 9, 6 U.L.A. 132 (1914); Egner v. States Realty Co., 26 N.W.2d 464, 468 (Minn. 1947); Engstrom v. Larson, 44 N.W.2d 97, 109 (N.D. 1950). Furthermore, the Uniform Partnership Act states explicitly that "[t]he law of agency shall apply under this act." UNIF. PARTNERSHIP ACT § 4(3), 6 U.L.A. 16 (1969). Thus, the liability of a partner for the obligations incurred by his partners without his consent is "a question of agency" law. *Irwin*, 110 U.S. at 505. *See also* RESTATEMENT (SECOND) OF AGENCY § 24 cmt. a (1958) (the agent "may have power to affect the interests of the principal . . . ."). Evidence of authority may come in three types: (1) the partnership

The nonliability of the partnership and the other partners flows from "principles of justice and equity" which apply to all contracts, including partnership agreements.[14] Furthermore, it has been said that this rule results entirely from the third party being on notice that the partnership and other partners will not be bound.[15]

With the development of the common law came problems, however, including deficiencies of authority in important areas of the law and conflicts in legal theory between jurisdictions.[16] In 1902, the National Conference of Commissioners on Uniform State Laws took action to establish a uniform law on partnership entitled

---

agreement, (2) the partnerships course of business, (3) the course of business of comparable partnerships in the area. CRANE & BROMBERG, *supra* note 10, § 49, at 276.

"The Uniform Partnership Act gives rise to a presumption of a partner's authority and agency" to carry on business on behalf of the other partners and the partnership. *See* 59A AM. JUR. 2D *Partnership* § 249 (1987). The Act provides that "the act of every partner . . . for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership . . . ." UNIF. PARTNERSHIP ACT § 9(1), 6 U.L.A. 132 (1914). Thus, if the act is within the partnership's "usual" way of doing business, the partnership and the other partners will be liable. *Id.* Problems have arisen in trying to interpret whether "usual way" means for the specific partnership or for other comparable partnerships. CRANE & BROMBERG, *supra* note 10, § 49, at 277. The correct position is probably to use both tests in the determination. *See id.*; Burns v. Gonzales, 439 S.W.2d 128, 131 (Tex. Civ. App. 1969). The partners are held jointly liable for the debts of the partnership. *See* UNIF. PARTNERSHIP ACT § 15, 6 U.L.A. 174 (1914).

14. *See* JOSEPH STORY, COMMENTARIES ON THE LAW OF PARTNERSHIP, § 129, at 217 (7th ed. 1881).

15. *See Leavitt*, 3 Conn. at 128. Common law opinions discussing the issue of notification to persons dealing with the firm regarding a partner's authority are exemplified by Baxter v. Rollins, 57 N.W. 838 (Iowa 1894). In *Baxter*, a bank sued the individual partners of an egg preserving partnership to collect on a past due promissory note that the partnership's business manager had signed. *Baxter*, 57 N.W. at 839. The partners argued that the bank knew the partnership agreement did not in any manner authorize the business manager to borrow money for the partnership. *Id.* Construing the partnership agreement, the Supreme Court of Iowa reasoned that because the agreement lacked any reference to additional funding, it was apparent that no extra funds were to be acquired by the partnership. *Id.* at 840. Thus, the manager had no authorization to sign for the partnership on the note in question. *Id.*

The court noted the general rule by saying third persons "knowing the stipulations of the contract, are bound by it." *Id.* In this case, however, the partners had later agreed to reduce the initial investment amount, and the manager represented to the bank that the loan was needed to cover the shortfall. *Id.* While the bank had no knowledge of the change, the court stated that they did not need to be fully informed to be responsible to make further inquiries. *Id.* at 841. The court concluded, as a matter of law, that the bank had notice of the partnership agreement, was put on inquiry, and consequently could not recover against the partnership. *Id.*

16. UNIF. PARTNERSHIP ACT, 6 U.L.A. 7 (1914). As the number of partnerships increased, the need for uniformity of partnership law also grew. *Id.* This was especially the case where firms began operating in several states and had members of the partnership living in different states. *Id.*

The lack of legal authority was evident in areas such as daily operations and in the winding up of the partnership. *Id.* Many states did not have any authority on these significant matters. *Id.* Clearly, statutes that would guide people in making these decisions would be of great value. *Id.*

Other problems surfaced in the area of partner-creditor rights. *Id.* Here, the problem was "an almost hopeless confusion of theory and practice," which made legal decision difficult and, at times, unfair. *Id.*

the Uniform Partnership Act.[17] In October 1914, the Conference voted to approve the Act and to support its adoption by all of the state legislatures.[18] Pennsylvania was the first state to adopt the Uniform Partnership Act, doing so in 1915.[19] North Dakota adopted the Uniform Partnership Act in 1959 as North Dakota Century Code sections 45-05-01 to 45-09-15 and 45-12-04 (1978).[20]

The Uniform Partnership Act incorporates the common law of agency and partnership.[21] Section nine of the Act provides as follows:

> 1) Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.
>
> . . . .
>
> 4) No act of a partner in contravention of a restriction on his authority shall bind the partnership to persons having knowledge of the restriction.[22]

---

17. *Id.* at 5. The Committee on Commercial Law was given the job of hiring an expert to begin work on a proposal. *Id.* At first, the Committee employed Dean James Barr Ames of Harvard Law School to begin work on the draft. *Id.* Upon Dean Ames's death, Dr. William Draper Lewis, Dean of the Pennsylvania School of Law, and Mr. James B. Lichtenberger began to rework the initial draft and notes of Dean Ames. *Id.* at 5-6. The subsequent drafters changed the basis of the draft from the entity theory to one based on the aggregate or common law theory of partnership. *Id.* at 6 (citation omitted).

The entity, or mercantile, theory considers the partnership to be a legal person, "owning the property and incurring obligations." Judson A. Crane, *Uniform Partnership Act A Criticism*, 28 HARV. L. REV. 762, 763 (1915). *See* CRANE & BROMBERG, *supra* note 10, § 3, at 16-25. Under the common law or aggregate theory, the partners are the only legal persons, and they own the property and incur the partnership obligations. Crane, *supra*, at 763. *See also* A. Ladru Jensen, *Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity?*, 16 VAND. L. REV. 377, 377-79 (1963) (concluding that both theories are used in the Uniform Partnership Act). North Dakota is evidently an aggregate state. *See* 501 DeMers, Inc. v. Fink, 148 N.W.2d 820, 824 (N.D. 1967) (holding that a partnership is not a legal entity aside from the partners).

18. UNIF. PARTNERSHIP ACT, 6 U.L.A. 7 (1914).

19. UNIF. PARTNERSHIP ACT, 6 U.L.A. 1 (1969 & Supp. 1991); HAROLD G. REUSCHLEIN AND WILLIAM A. GREGORY, HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP, § 174 (1979).

20. UNIF. PARTNERSHIP ACT, 6 U.L.A. 1 (Supp. 1991).

21. *See* UNIF. PARTNERSHIP ACT § 4, 6 U.L.A. 16 (1914); Ellis v. Mihelis, 384 P.2d 7, 13 (Cal. 1963); Bank of Bellbuckle v. Mason, 202 S.W. 931, 933 (Tenn. 1918). In *Mason*, the Supreme Court of Tennessee held that notification from one partner to a bank that he would not cover the overdrafts of his partner was sufficient to relieve the notifying partner of liability. *Mason*, 202 S.W. at 933.

22. UNIF. PARTNERSHIP ACT § 9(1)-(4), 6 U.L.A. 132-33 (1914). The National Conference of Commissioners on Uniform State Laws is currently drafting a proposed

A recent case properly applying section nine of the Uniform Partnership Act is *Evans v. Pioneer Bank*.[23] In *Evans*, Pioneer Bank brought an action to collect a partnership debt against partner Jim Evans, personally.[24] Evans argued that, because only one of the managing partners had signed the note, the partnership could not be liable.[25] Evans attempted to buttress his argument with the partnership agreement, which stated that no partner could borrow money without the consent of all the managing partners.[26] Pioneer Bank argued, however, that not all of the signatures were needed to hold the partnership liable.[27]

The Supreme Court of Wyoming first considered Wyoming's version of section nine of the Uniform Partnership Act.[28] The

---

revision to the Uniform Partnership Act. *See* UNIF. PARTNERSHIP ACT, (Proposed Draft 6/7/91); *Should the Uniform Partnership Act Be Revised?*, 43 BUS. LAW. 121, 121 (1987). Under the proposed revision, § 9 of the Uniform Partnership act may be modified to explicitly state that the "usual way" test will include both the partnership in question and other similar partnerships. *See* UNIF. PARTNERSHIP ACT § 103, at 22-23 (Proposed Draft 6/7/91). For an explanation of the "usual way" test, see *supra*, note 13. In addition, the proposed revision may also make changes to § 3 (Interpretation of Knowledge and Notice) of the Uniform Partnership Act. *Id.* at 7. Generally, the proposed revision of § 3 would be substantially based on the Uniform Commercial Code. *See* UNIF. PARTNERSHIP ACT, § 103 cmt. (Proposed Draft 6/17/91); U.C.C. § 1-201(25)-§ 1-201(27) (1991). The proposed revision does vary from the U.C.C. by providing "that a person knows or has knowledge of a fact when that person is aware of it." UNIF. PARTNERSHIP ACT, § 103 cmt. (Proposed Draft 6/17/91). The U.C.C. provides that "[a] person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it." U.C.C. 1-201(25) (1991). The drafting committee hopes to have a final draft ready in the summer of 1992. Telephone Interview with Debra Perelman, Legislative Counsel, National Conference of Commissioners on Uniform State Laws (Jan. 20, 1992).

23. 809 P.2d 251 (Wyo. 1991).

24. Evans v. Pioneer Bank, 809 P.2d 251, 252 (Wyo. 1991). Mr. Evans, along with five additional people, was a member of a partnership named Environmental Safeguards. *Id.* According to the partnership agreement, Ronald J. Bolin and Dee A. Bolin were the managing partners of Environmental Safeguards. *Id.*

In May of 1984, Mr. Bolin individually signed a $35,000 promissory note for the partnership. *Id.* The business name "Environmental Safeguards" was inserted above Mr. Bolin's signature on the note. *Id.*

25. *Id.* at 253.

26. *Id.* Paragraph 7 of the Environmental Safeguards partnership agreement provided as follows:

> Except with the consent of all the managing partners, no partner shall on behalf of the partnership borrow or lend money, or make deliver, or accept any extraordinary commercial paper, or execute any mortgage, security agreement, bond, or lease, or purchase or contract to purchase, or sell or contract to sell any property for or of the partnership, other than the type of property bought and sold in the regular course of its business.

Id. at 254 (quoting the partnership agreement).

27. *Id.* at 253. As a basis for its argument, Pioneer Bank sought to focus the trial court's attention on the following language in the partnership agreement: " 'Any managing partner shall have the right to draw checks upon any bank account of the partnership, and to make, deliver, and accept commercial paper in connection with the business of the partnership.' " *Id.* (quoting the partnership agreement).

28. *Id.* at 252. The Wyoming Statute provides as follows:

> (a) Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the

court found that " '[t]he Uniform Partnership Act states that no act of a partner in contravention of a restriction on authority will bind the partnership to persons having knowledge of the restriction.' "[29] Next, the court concluded that the partnership agreement's general business language was subordinate to the precise reference in the partnership agreement limiting the borrowing and lending authority of the partners.[30]

Another argument by Pioneer Bank, that Evans had the burden of proving that the other managing partner did not give his assent to the signing of the note, was also found to be without merit.[31] The trial court had found that " '[a]ll the managing partners consented to the loan.' "[32] The Supreme Court of Wyoming reversed, holding that Pioneer Bank knew about the restriction in the partnership agreement and was therefore bound by it.[33]

In *First National Bank and Trust Co. v. Scherr*,[34] the North Dakota Supreme Court examined North Dakota's version of section nine of the Uniform Partnership Act in determining what effect notice of a borrowing restriction in a partnership agreement had on a bank that was dealing with an individual partner.[35] In *Scherr*, the Bank contended that the lending authority granted to it by the partnership checking account signature card was a binding contractual agreement between the parties to the loan, and therefore the signature card should control over the partnership agreement.[36] The Bank argued further that while it knew about

---

partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

. . . .

(d) No act of a partner in contravention of a restriction on his authority shall bind the partnership to persons having knowledge of the restriction.

WYO. STAT. § 17-13-301 (1989). Wyoming's statute is identical to the North Dakota statute concerning a partner's authority to act for the partnership. *Compare id.* with N.D. CENT. CODE § 45-06-01 (1978). For text of § 45-06-01, see *infra* note 39.

29. *Evans*, 809 P.2d at 253 (quoting 59A AM. JUR. 2D *Partnership* § 267 (1987)).

30. *Id.* at 253-54. For the general language argued by Pioneer Bank, see *supra* note 27. For the specific reference used by Evans in his argument, see *supra* note 26.

31. *Id.* at 254.

32. *Id.* (quoting the trial court's decision).

33. *Id.* at 254-55. The court found that the trial court's ruling that Dee Bolin had consented to the note was very questionable. *Id.* at 254. Moreover, the court did not feel that the appellee had met its burden of proof. *Id.* at 255.

34. 467 N.W.2d 427 (N.D. 1991) (*Scherr III*).

35. First Nat'l Bank and Trust Co. v. Scherr, 467 N.W.2d 427, 430 (N.D. 1991) (*Scherr III*).

36. *Id.* at 429. The Bank reasoned that because Albinus had signed the signature card, he had consented to Pius' individually signing the $65,000 note. *Id.* Consequently, any variation of the terms between the signature card and partnership agreement should be found irrelevant. *Id.*

the restriction in the partnership agreement,[37] the explicit authorization given to it by the signature card was not modified by a subsequent restriction in the partnership agreement made unilaterally by the partners.[38] The court did not discuss the Bank's argument based on contract law, however, but decided the case pursuant to Agency-Partnership law.[39] Analyzing section 45-06-01 of the North Dakota Century Code (North Dakota's version of section nine of the Uniform Partnership Act) and case law from other jurisdictions, the court stated that "knowledge of a restriction on, or revocation of, an individual partner's authority controls over a preexisting arrangement with a creditor."[40]

---

37. *Id.* Indeed, the Bank's former President, Duane Sorensen, testified that he was aware of the restriction in the partnership agreement at the time he dealt with Pius in making the loan. Brief of Appellant, *supra* note 5, at 8. Mr. Sorensen felt that an agreement between the Scherrs could not override the authority given to the Bank through the signature card. *Id.*

38. *Scherr III*, 467 N.W.2d at 429. The Bank believed that the signature card was a binding contract between it and the Scherrs. *See* Brief of Appellant, *supra* note 5, at 8 (arguing that the signature card fulfilled all of the requirements of a contract under the North Dakota Century Code). The Bank went on to argue that a contract could not be modified or changed without its consent. *Id.* at 9. The court did not find these arguments persuasive. *Scherr III*, 467 N.W. 2d at 429.

39. *See Scherr III*, 467 N.W.2d at 429. First, the court noted that it had previously stated that statutes control "the authority of a partner to act for the partnership." *Id.* (citing First Nat'l Bank and Trust Co. v. Scherr, 435 N.W. 2d 704, 707 (N.D. 1989) (*Scherr I*) (citing N.D. CENT. CODE § 45-06-01 (1978))). Next, the court recognized that North Dakota had adopted the Uniform Partnership Act. *Id.* The court then quoted from § 45-06-01 of the North Dakota Century Code, North Dakota's version of § 9 of the Uniform Partnership Act, which provides as follows:

> 1. Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact he has no such authority.
>
> . . . .
>
> 4. No act of a partner in contravention of a restriction on authority shall bind the partnership to persons having knowledge of the restriction.

N.D. CENT. CODE § 45-06-01 (1978). The court concluded from the above quoted statute that the law of agency governs a partner's liability to third parties. *Scherr III*, 467 N.W. 2d at 429. The court also cited to the RESTATEMENT (SECOND) OF AGENCY for authority to support its conclusion. *Id.* The Restatement provides that "the rights and liabilities of partners with respect to each other and to third persons are largely determined by agency principles." RESTATEMENT (SECOND) OF AGENCY § 14A cmt. a (1958).

40. *Scherr III*, 467 N.W. 2d at 429-30. The court recognized that the duplication in parts one and four of § 45-06-01 of the North Dakota Century Code highlighted the fact that the law required such a decision. *Id.* at 429.

To further support its position, the court stated that many other courts have held that a third party is later unable to recover from the other partners or the partnership for dealings with the partner to the transaction when the third person was on notice of a restriction on the acting partner's authority. *Id.* (citing Van Dusen v. The Star Quartz Mining Co., 36 Cal. 571 (1869); Baxter v. Rollins, 57 N.W. 838 (Iowa 1894); Dawson Blakemore & Co. v. Elrod, 49 S.W. 465 (Ky. 1899); Bank of Bellbuckle v. Mason, 202 S.W. 931 (Tenn. 1918); Dayle L. Smith Oil Co. v. Continental Supply Co., 268 S.W. 489 (Tex. Civ. App. 1924); Gladson v. Heagle, 212 N.W. 175 (Minn. 1927); T.T. Word Supply Co. v. Burke, 57 S.W.2d 610 (Tex. Civ. App. 1933); De Santis v. Miller Petroleum, 85 P.2d 489 (Cal. App. 2d 1938); West Side

Finding that the partnership agreement controlled, the court then focused its attention on deciding "whether delivery of the written partnership agreement to the Bank was effective notice that Pius' individual authorization had been restricted."[41] The court reiterated the trial court's finding that, as a matter of fact, the Bank had received notification of the restrictions in the partnership agreement.[42] Next, the court looked to the North Dakota Century Code for guidance in answering the notice question.[43] The court recognized that not only had the Bank known of the restriction in the partnership agreement, but it also had requested and been given a copy of the agreement.[44] As a result, the court ruled that the Bank had knowledge of the restriction on the partner's authority, was bound by that knowledge, and could not

---

Trust Co. v. Gascoigne, 121 A.2d 441 (N.J. Super. 1956); Arrington v. Columbia Nitrogen Corp., 309 S.E.2d 428 (Ga. App. 1983). *See also* 59A AM. JUR. 2D *Partnership* § 267 (1987); 68 C.J.S. *Partnership* § 143 (1950). *Compare* Owens v. Palos Verdes Monaco, 191 Cal. Rptr. 381, 386-90 (Cal. Ct. App. 1983)).

41. *Scherr III*, 467 N.W. 2d at 430. Initially, the court noted that the burden of proof fell upon the party asserting that the agent acted within his authority—in this case, the Bank. *Id.*

42. *Id. See also* Red River Commodities, Inc. v. Eidsness, 459 N.W.2d 805, 810 (N.D. 1990) (agency is a question of fact to be determined by the trial court).

43. *Scherr III*, 467 N.W.2d at 430. Section 45-05-02 provides as follows:

> A person has "knowledge" of a fact within the meaning of this title not only when he has actual knowledge thereof, but also when he has knowledge of such other facts as in the circumstances shows bad faith.
>
> A person has "notice" of a fact within the meaning of this title when the person who claims the benefit of the notice:
>
> 1. States the fact to such person; or
>
> 2. Delivers through the mail, or by other means of communication, a written statement of the fact to such person or to a proper person at his place of business or residence.

N.D. CENT. CODE § 45-05-02 (1978).

The court also found the RESTATEMENT (SECOND) OF AGENCY helpful in solving the notice issue. *See Scherr III*, 467 N.W.2d at 430. Section 167 RESTATEMENT (SECOND) OF AGENCY provides as follows:

> If a person dealing with an agent has notice that the agent's authority is created or described in a writing which is intended for his inspection, he is affected by limitations upon the authority contained in the writing, unless misled by the conduct of the principal.

RESTATEMENT (SECOND) OF AGENCY § 167 (1958). The court stated that no issue of fraud was asserted at trial or on appeal. *Scherr III*, 467 N.W. 2d at 430.

In addition, the court found that the Bank had not raised the question of a ratification of the $65,000 note by the partnership. *Id.* In Askew v. Joachim Memorial Home, 234 N.W.2d 226, 237-38 (N.D. 1975), the Supreme Court of North Dakota discussed the concept of ratification. *See id.* The court defined ratification as follows: "The affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons, is given effect as if originally authorized by him." *Id.* (quoting RESTATEMENT (SECOND) OF AGENCY § 82 (1958)). Ratification of an act can be done expressly or through conduct. *Askew*, 234 N.W.2d at 237. Furthermore, while normally a principal must know all the material facts before ratification will be found, if the principal deliberately makes himself or herself accountable without finding out all of the facts, the principal will be liable for the unauthorized acts of the agent. *Id.* at 238.

44. *Scherr III*, 467 N.W.2d at 430.

recover against Albinus and the partnership.[45]

The decision of the North Dakota Supreme Court in *Scherr* may have some impact on the way business operates in North Dakota. Not only lenders, but also manufacturers, wholesalers, retailers and other entities doing business with a partnership could find themselves in the same position as the Bank in *Scherr*. For example, if a business is on notice not to supply goods to partner *A* without partner *B*'s consent, but does so anyway, the business may find itself without a remedy against either the partnership or partner *B*.[46]

At first glance, the logical thing for a business to do in response to *Scherr* is to request a copy of the partnership agreement and to thereafter conduct business in strict compliance with the terms of authority expressed in the agreement. However, this inquiry would greatly increase the risk to the business that its partnership accounts could eventually become uncollectible debts, even if extremely reliable measures of recording and utilizing the

45. *Id.* The court presented the issue in *Scherr* as "whether delivery of the written partnership agreement to the Bank was effective notice that Pius' individual authorization had been restricted." *Id.* The statute in question clearly indicates that it is "knowledge" of the fact or restriction, not "notice," that is required. *See* N.D. CENT CODE § 45-06-01 (1978). By referring to notice several times, it seems that the court may have been trying to use "notice" to satisfy the "knowledge" requirement. *Scherr III*, at 467 N.W.2d at 430. However, the court does state twice that the Bank "knew" about the restrictive partnership agreement. *Id.* at 429-30. Moreover, the court concludes by finding that the trial court was not clearly erroneous in holding "that the Bank was bound by its knowledge . . . ." *Id.* at 430. Factual determinations are overturned only when they are found to be clearly erroneous. *Id.* (citing N.D. R. CIV. P. 52 (a)). Therefore, the court acted reasonably in finding that the Bank had actual knowledge of the fact there was a restriction in the partnership agreement. *See id.*; N.D. CENT. CODE. § 45-05-02 (1978).

46. *See* DeSantis v. Miller Petroleum Co., 85 P.2d 489, 491 (Cal. Dist. Ct. App. 1938); Dawson Blakemore & Co. v. Elrod, 49 S.W. 465, 465 (Ky. 1899); Arrington v. Columbia Nitrogen Corp., 309 S.E.2d 428, 430 (Ga. Ct. App. 1983); T.T. Word Supply Co. v. Burke, 57 S.W.2d 610, 613 (Tex. Civ. App. 1933). In *Burke*, the plaintiff corporation brought an action against the partnership to recover for oil field equipment it had supplied to the partnership. *Id.* at 610-11. Burke, a member of a two person partnership, was the only partner to answer the complaint. *Id.* at 610. Burke had given notification to the plaintiff that he would not be liable for any bills incurred by his partner without his prior approval. *Id.* The plaintiff sent a letter to Burke confirming his request. *Id.* at 612.

The partnership agreement made reference to the fact that the expenses were to be paid out of the sale of the oil leases. *Id.* at 611. The court did not discuss whether the partnership agreement contained any restriction on the other partner's authority. *Id.* Instead, the court stated that the dissenting partner's notification to the plaintiff indicated that the "implied agency" had terminated. *Id.* (citation omitted). The court gave considerable weight to the fact that the plaintiff had received and "acknowledged" the notification. *See id.* at 613. The court then held that after a partner has given notification, he " 'is not liable for the price of goods sold to his co-partner over his protest' . . . ." *Id.* (quoting Dawson Blakemore & Co. v. Elrod, 49 S.W. 465 (Ky. 1899)). *But cf.* National Biscuit Co. v. Stroud, 106 S.E.2d 692, 695 (N.C. 1959). The defendant partner in *Stroud* gave notification to a supplier that he would not be held liable for continued shipments to his co-partner. *Id.* at 694. The partnership had only two members. *Id.* The court held the protesting partner was liable because he was not a majority, and therefore he could not restrict the authority of his partner, who was just continuing to buy goods in the ordinary course of the partnership business. *Id.* at 695.

information are in place. This risk can be appreciated when one considers that it was the Bank's affirmative action in *Scherr* in gaining knowledge of a restriction in the partnership agreement that led to its inability to collect on the $65,000 note.

While businesses will want to be aware of the holding in *Scherr*, they should not be overly concerned. As North Dakota Century Code section 45-06-01 indicates, a business that does not have knowledge of a restriction on a partner's authority and is dealing with the partnership through one of its partners in the context of the partnership's usual way of doing business, should be able to recover from the partnership.[47] *Scherr* suggests that the best solution for businesses that deal with partnerships in the ordinary course of the partnership's business may be to cautiously carry on business as usual, without inquiring into the partner's limitations of authority.

Steven J. Sarbacker

47. *See* N.D. CENT. CODE § 45-06-01 (1978); RESTATEMENT (SECOND) AGENCY § 14A cmt. a (1958).