

**The Law Commission  
and  
The Scottish Law Commission**  
(LAW COM No 283)  
(SCOT LAW COM No 192)

**PARTNERSHIP LAW**

**Report on a Reference under Section 3(1)(e) of the Law  
Commissions Act 1965**

*Presented to the Parliament of the United Kingdom by the Lord High Chancellor  
by Command of Her Majesty  
Laid before the Scottish Parliament by the Scottish Ministers  
November 2003*

The Law Commission and the Scottish Law Commission were set up by the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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The terms of this report were agreed on 10 October 2003.

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**THE LAW COMMISSION**  
**THE SCOTTISH LAW COMMISSION**

**PARTNERSHIP LAW**

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# ABBREVIATIONS

1890 Act	Partnership Act 1890
1907 Act	Limited Partnerships Act 1907
ACCA	Association of Chartered Certified Accountants
ADR	Alternative Dispute Resolution
APP	Association of Partnership Practitioners
Blackett-Ord, <i>Partnership</i>	Mark Blackett-Ord, <i>Partnership: the modern law of partnership, limited partnership and limited liability partnership</i> (2nd ed 2002)
<i>Bowstead &amp; Reynolds</i>	F M B Reynolds with the assistance of M Graziadei, <i>Bowstead &amp; Reynolds on Agency</i> (16th ed 1996)
BMA	British Medical Association
BVCA	British Venture Capital Association
DTI	Department of Trade and Industry
ECHR	European Convention on Human Rights and Fundamental Freedoms
EEA	European Economic Area
FSMA	Financial Services and Markets Act 2000
ICTA 1998	Income and Corporation Taxes Act 1998
Joint Consultation Paper	Partnership Law: A Joint Consultation Paper (2000) Consultation Paper No 159; Discussion Paper No 111
Joint Consultation Paper (LP)	Limited Partnerships Act 1907: A Joint Consultation Paper (2001) Consultation Paper No 161; Discussion Paper No 118
LLP	Limited Liability Partnership
<i>Lindley &amp; Banks</i>	R C I Anson Banks (editor), <i>Lindley &amp; Banks on Partnership</i> (18th ed 2002)
LIBOR	London Interbank Offered Rate
<i>Megarry &amp; Wade</i>	Megarry & Wade, <i>The Law of Real Property</i> (6th ed 2000)
NILRAC	Law Reform Advisory Committee for Northern Ireland
RUPA	Revised Uniform Partnership Act (1994) (USA)
<i>Twomey</i>	M Twomey, <i>Partnership Law</i> (1st ed 2000)
UPA	Uniform Partnership Act (1914) (USA)
VATA 1994	Value Added Tax Act 1994

# THE LAW COMMISSION

Report on a reference to the Law Commission under section 3(1)(e) of the Law Commissions Act 1965

## PARTNERSHIP LAW

*To the Right Honourable the Lord Falconer of Thoroton, Lord High Chancellor of Great Britain*

### PART I INTRODUCTION

#### PARTNERSHIP LAW REFORM IN ITS CONTEXT

##### **The role of partnerships in the business world**

- 1.1 Partnerships play an important role in the United Kingdom economy. At the start of 2002 there were 567,955 partnerships in the United Kingdom with a combined turnover (excluding VAT) of £136,902 million.<sup>1</sup> Partnerships provide substantial employment: 33,995 partnerships employ more than 10 persons and 200 partnerships have 200 or more employees.<sup>2</sup>
- 1.2 Partnerships vary in size and formality. An informal association of two persons in a short-term profit-making venture may be a partnership. Many small family businesses are conducted in partnership. There are also professional or business partnerships with many members and elaborate management structures.
- 1.3 Partnerships carry on work in a wide range of business activity. Many professionals carry on business in partnership. Partnerships are also prominent in the retail trade and in the construction, manufacturing, agricultural and tourist industries.
- 1.4 The great differences in the size and nature of partnerships illustrate the flexibility of partnership as a business entity.<sup>3</sup> As partners have unlimited liability for the debts which a partnership may incur, partnerships require much less regulation than limited liability vehicles such as the company or the limited liability partnership. Partnerships also have the advantage of a large degree of privacy in financial matters. The consultation exercise in this project has confirmed that people value this flexibility and informality. One of our aims in making recommendations for reform is to preserve these attributes.

<sup>1</sup> See Small and Medium-sized Enterprise (SME) Statistics for the UK 2002 (August 2003), Table 2. The turnover of partnerships is less than that of the approximately 2.3 million sole proprietorships (£149,641million). The number of partnerships and the turnover which they achieve have declined since 1998 when the comparative figures were 684,645 partnerships with a turnover of £151,213 million.

<sup>2</sup> See Small and Medium-sized Enterprise (SME) Statistics for the UK 2002 (August 2003), Table 2.

<sup>3</sup> Very large partnerships are a modern phenomenon. See para 3.14 below.

### **The relationship of the general partnership to the limited partnership**

- 1.5 While the partnership is used as a business vehicle in a very wide range of activities, the limited partnership is much more specialised in nature.<sup>4</sup> The partnership is a means by which business people pool their resources and skills in the management of a business. Partners have unlimited liability for the partnership's obligations. By contrast the limited partnership is a useful vehicle for investors, who do not wish to take an active role in the management of their funds, to combine to create an investment fund under the control of a general partner who alone has unlimited liability for the partnership's obligations. The limited partner is liable only to the extent of his contributions. However, the limited partner loses limited liability if he takes part in the management of the partnership business.
- 1.6 Since 1987 when the Department of Trade and Industry (DTI) and the Inland Revenue agreed guidelines on the use of limited partnerships as venture capital funds, the UK limited partnership (and in particular the English limited partnership) has become one of the most important vehicles for venture capital investment across Europe. This has contributed to the UK's leadership in the private equity and venture capital sector of the European economy. Businesses backed by private equity now employ around 2,700,000 people in the UK.<sup>5</sup> Due to their separate personality, Scottish limited partnerships have also been used as a vehicle for investment in underwriting at Lloyd's.<sup>6</sup>
- 1.7 The reform of the limited partnership raises discrete issues which we address in Parts XV to XIX of this report.

### **The relationship of the general partnership to the limited liability partnership**

- 1.8 The new limited liability partnership (LLP) was created in response to pressure from large professional partnerships, which were concerned about the unlimited liability of partners for very large legal claims, in particular for professional negligence.<sup>7</sup> The LLP is designed for professional or trading partnerships. It enables partners who are actively involved in the business of their partnership to limit their liability for the partnership's debts and obligations. But a partner may not enjoy the benefit of limited liability in relation to any negligent act which he commits in the course of the LLP's business.<sup>8</sup>

<sup>4</sup> There are about 3000-4000 limited partnerships that are currently functioning in England and Wales and about 3000 in Scotland.

<sup>5</sup> This information is derived from correspondence with the APP, Jonathan Blake of S J Berwin, and the British Venture Capital Association.

<sup>6</sup> In Scotland limited partnerships have also been used in agricultural tenancies.

<sup>7</sup> The Limited Liability Partnerships Act 2000 came into force on 6 April 2001 (SI 2000 No 3316).

<sup>8</sup> See the Limited Liability Partnerships Act 2000, ss 1(4) and 6(4): a member of the LLP can be liable for his wrongful acts and omissions and the LLP is liable for such acts and omissions which occur in the course of the LLP's business or with its authority. Other members of the LLP are not liable for the LLP's debts, although they may have to contribute to the LLP's assets in the event of its being wound up where they have made

- 1.9 The limited liability of the LLP comes at the price of considerable regulation. This contrasts with the almost total absence of regulation of the general partnership.<sup>9</sup> Provisions of the Companies Act 1985 relating to the preparation, audit and publication of accounts and the delivery of annual returns, and provisions of the Company Directors Disqualification Act 1986, among others, are applied to LLPs.<sup>10</sup> Partnerships which choose to become LLPs therefore lose the privacy enjoyed by existing partnerships in relation to their financial affairs.
- 1.10 We understand from Companies House that, as at 1 September 2003, the number of incorporated LLPs was 5420 in England and Wales and approximately 250 – 260 in Scotland. It appears that the number of such incorporations has been greater this year than last. However, while limited partnerships and LLPs will provide useful business vehicles for particular businesses, it is likely that the vast majority of partnerships will remain general partnerships.

#### **TERMS OF REFERENCE**

- 1.11 The Department of Trade and Industry gave us the following terms of reference:

To carry out a review of partnership law, with particular reference to: independent legal personality; continuity of business irrespective of changes of ownership; simplification of solvent dissolution; a model partnership agreement; and to make recommendations. The review is to be conducted under the present law of partnership, namely the Partnership Act 1890 and the Limited Partnerships Act 1907.

#### **The relationship of partnership law reform to the Company Law Review**

- 1.12 The DTI launched a wide-ranging review of company law in March 1998. This was completed in July 2001 when the Company Law Review Steering Group published their final report.<sup>11</sup> In that report the Steering Group adopted three core policy principles as the basis of their recommendations. They described these principles as:
- The “think small first” approach to private company regulation and legislative structure;
  - An inclusive, open and flexible regime for company governance; and
  - A flexible and responsive institutional structure for rule-making and enforcement, with an emphasis on transparency and market enforcement.

personal drawings when they had reasonable cause to believe that the LLP was or, as a result of the drawings, would be unable to pay its debts (see Insolvency Act 1986, s 214A).

<sup>9</sup> Partnerships involved in professional practice and in providing financial services are regulated (for example, solicitors are regulated by the Law Society and investment managers by the Financial Services Agency), but not simply because they are partnerships.

<sup>10</sup> See the Limited Liability Partnerships Regulations 2001 (SI 2001 No 1090).

<sup>11</sup> Modern Company Law for a Competitive Economy, Final Report Volumes I and II, July 2001, DTI/Pub 5552/5k/7/01/NP. URN 01/943.

***“Think small first”***

- 1.13 The first policy principle is the most relevant of the three core principles to partnership law reform. The emphasis on a simplified and accessible regime for small companies seeks to make the law correspond to the reasonable expectations of honest business people. We think that the much less detailed rules of partnership law should also correspond to such expectations. Partnership law should not contradict the perceptions of such business people and thus contain traps for the unwary. The rules of partnership law should be readily understood. The reform of the Partnership Act 1890 should provide an accessible default code, setting out the basic rules which will govern a partnership if the partners do not agree different terms. We discuss the aims of partnership law reform more fully in Part III below.

**THE STRUCTURE OF THE REPORT**

- 1.14 The report is divided into five Sections (including six Appendices). Section A comprises this introduction (Part I), a summary of existing partnership law (Part II) and an overview of the reform proposals in Part III. In Section B (Parts IV to XIV) we consider and make recommendations for the reform of the general law of partnership. Section C (Parts XV to XIX) contains our review of the law relating to limited partnerships and our recommendations for its reform, including our recommendation of the special limited partnership. Section D (Part XX) contains a summary of our recommendations. Section E contains the Appendices.
- 1.15 A draft Bill to implement our recommendations is contained in Appendix A. The Bill deals with both general partnerships and limited partnerships and is designed to replace both the Partnership Act 1890 and the Limited Partnerships Act 1907. The subject matter of the draft Bill is not within the legislative competence of the Scottish Parliament, as it relates to the reserved matter of business associations.<sup>12</sup> We believe that enactment of our recommendations would not breach Convention rights.

**THE CONSULTATION EXERCISE**

- 1.16 In September 2000 the Law Commission and the Scottish Law Commission issued a Joint Consultation Paper on partnership law.<sup>13</sup> The Paper set out proposals and questions for the reform of the general law of partnership. In October 2001 the Commissions issued a shorter Joint Consultation Paper dealing with the reform of limited partnerships.<sup>14</sup>
- 1.17 We received 84 responses to the Joint Consultation Paper on partnership law. The responses came from a wide range of respondents including judges, barristers, advocates, solicitors, academics, accountants, organisations representing business, Government departments, public bodies and individuals. There have been several

<sup>12</sup> Scotland Act 1998, Sched 5. The draft Bill, however, contains amendments to the Prescription and Limitation (Scotland) Act 1973 and the Bankruptcy (Scotland) Act 1985. See Sched 2, paragraphs 4-10 and Sched 4, part 4.

<sup>13</sup> (2000) Consultation Paper No 159; Discussion Paper No 111.

<sup>14</sup> (2001) Consultation Paper No 161; Discussion Paper No 118.

journal articles discussing the reform proposals.<sup>15</sup> The Institute of Advanced Legal Studies organised a conference in London in June 2001 on the Law Commissions' proposals to reform partnership law. The Manchester Law Society and Manchester Chamber of Commerce organised a joint conference on partnership law in December 2001. We are most grateful to those who organised the conferences and to all those who responded to the Joint Consultation Paper or otherwise contributed their views.

- 1.18 We received 42 responses to the Joint Consultation Paper on limited partnerships. The limited partnership is a more specialised subject as it is a vehicle for particular investment activities. We received responses from barristers, advocates, solicitors, academics, accountants, financial and venture capital organisations and companies, government departments and individuals. The Institute of Advanced Legal Studies organised a conference in London in April 2002 on the proposals for the reform of limited partnerships. Again we are very grateful to the Institute for organising the conference and to those who responded to the Joint Consultation Paper and assisted us.
- 1.19 We list the persons and organisations who commented on the two Joint Consultation Papers in Appendices E and F.

#### **ACKNOWLEDGEMENTS**

- 1.20 In addition to thanking our respondents, we wish to thank Roderick I'Anson Banks, who acted as our consultant, Tony Sacker and the Association of Partnership Practitioners (APP), the Scottish Law Commission's Advisory Group (R Craig Connal QC, Professor George L Gretton, David Guild, Advocate, Sheriff William H Holligan, David B Sinton CA, Ian M Stubbs, David S Williamson QC, and the late Campbell White), Lord Phillips of Sudbury OBE, Professor Geoffrey K Morse, Professor John F Avery Jones CBE, Colin Ives CTA, ATT, Janet Stephenson FCA, Glen Davis, David Marks QC, the staff of HM Land Registry and the Registers of Scotland, the Insolvency Service, the Bankruptcy Registrars, the Inland Revenue (London and Edinburgh), Lee Robins of Companies House, Professor Johan J Henning and the Institute of Advanced Legal Studies at London University, the Manchester Law Society and Chamber of Commerce, Professor Joseph A McCahery of the Netherlands and, last but not least, our contacts in the United States of America, namely, Professor Deborah A DeMott, Professor Larry E Ribstein, Professor Allan W Vestal and Professor Donald J Weidner.
- 1.21 Although this report is presented by the current Commissioners, the great majority of the work was carried out under the leadership of former Commissioners, Lord Justice Carnwath, Judge Diana Faber (Law Commission for England and Wales) and Patrick Hodge QC (Scottish Law Commission). We are extremely grateful to them all. We particularly wish to record our indebtedness to Patrick Hodge QC for leading the project during the preparation of the report and for continuing to work long hours for many months after his term of office as a Scottish Law Commissioner had officially ended in order to see it through to completion.

<sup>15</sup> For example, E. Deards "Partnership Law in the Twenty-first Century" [2001] JBL 357 and D. Guild "Partnership Law for the New Millennium" 2000 SLT (News) 315.

# **PART II**

## **A SUMMARY OF THE CURRENT LAW**

### **INTRODUCTION**

- 2.1 This Part seeks to set out the basic structure of partnership law, which we discuss in more detail in this report. The Partnership Act 1890 forms the basis of partnership law in the United Kingdom. But the 1890 Act is a basic code and the rules of common law and equity relating to partnerships continue to play an important role in the law of partnership.

### **A CONTRACTUAL RELATIONSHIP**

- 2.2 A partnership depends upon an existing relationship which results from a contract. The contract is, as Jessel MR explained in *Pooley v Driver*:<sup>1</sup>

A contract for the purpose of carrying on a commercial business – that is, a business bringing profit, and dividing the profit in some shape or another between the partners.

- 2.3 A partnership relationship can arise only by mutual consent, which may be express or inferred from parties' conduct. The personal nature of partnership means that a partner has agreed to associate with his co-partners and no-one else: no new partner can be introduced without the consent of all the partners.
- 2.4 Notwithstanding the contractual origin of a partnership, it appears that once in being a partnership is not governed solely by the rules of contract law. In *Hurst v Bryk*,<sup>2</sup> Lord Millett has suggested that, in English law, a partnership is more than a simple contract; it is a continuing personal as well as commercial relationship. He has argued that the Court of Chancery controls this relationship and that the Court has a discretionary power under section 35 of the 1890 Act to dissolve a partnership. As a result he suggests that repudiatory breach of contract by a partner is not a ground for the automatic dissolution of a partnership. Since then, Neuberger J has adopted Lord Millett's reasoning in reaching judgment in *Mullins v Laughton*.<sup>3</sup>

### **PARTNERSHIP AND LEGAL PERSONALITY**

- 2.5 In English law a partnership is not an entity separate and distinct from the partners who at any time may compose it. The firm cannot acquire rights nor can it incur obligations. A firm cannot hold property. The rights and liabilities of a partnership are the collection of the individual rights and liabilities of each of the

<sup>1</sup> (1877) 5 Ch D 458, 472.

<sup>2</sup> [2002] 1 AC 185.

<sup>3</sup> [2003] Ch 250.

partners. The firm name is a mere expression, not a legal entity.<sup>4</sup> We call this the “aggregate” approach to partnership.<sup>5</sup>

- 2.6 Any change in the membership of a firm, whether the withdrawal of a partner or the admission of a new partner, “destroys the identity of the firm”.<sup>6</sup> The “old” firm is dissolved. If the surviving partners continue in partnership (with or without additional partners) a “new” firm is created. The new firm can take over the assets of the old one and assume its obligations. This involves a contractual arrangement between members of the old firm and the new firm, to continue the old firm’s business. In addition, the transfer of an obligation will normally require the consent of the creditor. Continuing a partnership’s business in this way does not continue the partnership itself. Even an agreement in advance that partners will continue to practise in partnership on the retirement of one of their number does not prevent the partnership which practises the day after the retirement from being a different partnership from that in business on the previous day.<sup>7</sup>
- 2.7 In Scots law, “a firm is a legal person distinct from the partners of whom it is composed”.<sup>8</sup> A partnership is able to own property,<sup>9</sup> hold rights and assume obligations. It can sue and be sued.<sup>10</sup> It can be a partner in another partnership. It can have a partner in common with another partnership while remaining separate from that firm, and can also be its debtor or creditor. A partnership can enter into contracts with its partners, who can thus be creditors or debtors of the firm.
- 2.8 There is serious doubt as to whether the legal personality of a Scottish partnership can continue on a change in the composition of the partnership. On one view, in contrast with English law, partners can agree that a partnership will continue on a change of membership and thus the legal personality of the firm continues. On the other view, even where partners agree that the partnership is not to be dissolved on a change of membership, any alteration in the composition of the partnership gives rise to a new legal personality. On the latter approach the law in both jurisdictions

<sup>4</sup> *Sadler v Whiteman* [1910] 1 KB 868, 889, per Farwell LJ.

<sup>5</sup> There has been an academic debate in the United States of America on the conceptual approach to partnership: see Gary S. Roslin, “The Entity-Aggregate Dispute: Conceptualism and Functionalism in Partnership Law” (1989) 42 *Arkansas Law Review* 395 – 466. The move in the United States from the aggregate theory of partnership to the entity theory in section 201(a) of the Revised Uniform Partnership Act (RUPA) has enjoyed broad support while other aspects of RUPA have been controversial. See Alan W. Vestal “...Drawing Near the Fastness?” – the failed United States experiment in unincorporated business entity reform”, (2001) *The Journal of Corporation Law* Vol 26, No 4, 1019 – 1030. See Part V below.

<sup>6</sup> Lord Lindley quoted in *Lindley & Banks on Partnership* (18<sup>th</sup> ed 2002) para 3-04; and see *Green v Herzog* [1954] 1 WLR 1309.

<sup>7</sup> *Hadlee v Commissioners of Inland Revenue* [1989] 2 NZLR 447, 455 per Eichelbaum CJ.

<sup>8</sup> 1890 Act, s 4(2).

<sup>9</sup> Historically, a Scottish partnership has not been entitled to hold title to immovable property held on feudal tenure but this restriction will disappear when s 70 of the Abolition of Feudal Tenure etc (Scotland) Act 2000 is brought into force.

<sup>10</sup> There are however anomalous rules as to how a partnership may sue and be sued, depending upon whether the partnership has a “social” name or a “descriptive” name. See para 7.7 below.

does not allow continuity of partnership, making partnership a less stable business relationship than it might be.

- 2.9 English law has maintained the “aggregate” approach to partnership: the name of the firm is, subject to certain exceptions which we discuss below,<sup>11</sup> no more than convenient shorthand for referring to a group of persons who conduct a business together. Scots law, subject to certain limitations, has adopted the “entity” approach to partnership. In summarising the basic features of partnership law we draw attention to some of the effects of these different approaches.

#### **AGENCY**

- 2.10 In England and Wales a partner cannot be an agent of the partnership as an entity because it lacks legal personality. Whenever a partner makes a contract, it is on behalf of that partner and the other partners.<sup>12</sup> If they breach the contract they will be liable for any consequential loss without limit of liability.
- 2.11 In Scots law the partners are agents of the partnership which is the principal.<sup>13</sup> The partnership has primary liability for all debts and obligations which it incurs through the agency of its partners. The liability of the partners is subsidiary in nature.<sup>14</sup> In effect the partners are guarantors of the partnership. Because they have subsidiary liability for the firm’s debts and obligations, anything which they do (as the firm’s agents) to bind the partnership binds the partners indirectly. Partners of a Scottish partnership are jointly and severally liable for the obligations of the firm.<sup>15</sup> As in English law, their liability is unlimited.
- 2.12 The 1890 Act contains several statutory rules which set out the agency of a partner.<sup>16</sup> In both jurisdictions, the partners are jointly and severally liable for loss and injury caused to a third party by a partner who commits a wrong while acting within the limits of his actual or apparent authority.<sup>17</sup> Partners are also jointly and severally liable for the misapplication of money or property which a partner receives in the course of carrying on the partnership business or which is in the custody of the firm.<sup>18</sup> The Act also provides that admissions and representations made by a partner concerning partnership affairs and in the ordinary course of business are evidence against the firm.<sup>19</sup> There is also a provision, which has caused some concern in particular to the accountancy profession, which appears to

<sup>11</sup> See Part V below.

<sup>12</sup> 1890 Act, s 5.

<sup>13</sup> 1890 Act, s 5.

<sup>14</sup> See *Mair v Wood* 1948 SC 83, 86 *per* the Lord President (Cooper).

<sup>15</sup> 1890 Act, s 9.

<sup>16</sup> Sections 5 and 6 set out the express, implied and apparent authority of the partner. Specific rules restricting the liability of the firm where a partner uses the credit of the partnership for private purposes and where notice has been given of a restriction on a partner’s authority are contained in ss 7 and 8.

<sup>17</sup> 1890 Act, ss 10 and 12.

<sup>18</sup> 1890 Act, ss 11 and 12.

<sup>19</sup> 1890 Act, s 15.

impute to a partnership knowledge relating to partnership affairs acquired by a partner in the course of partnership business.<sup>20</sup>

- 2.13 The liability of a partner (in English law as principal and in Scots law as quasi-guarantor) lasts for as long as other partners (as agents) have authority to bind that partner. The partner is not liable for obligations incurred before this agency relationship is created,<sup>21</sup> and he is not liable for obligations incurred by his former partners after the agency relationship has ended.<sup>22</sup>

#### **FIDUCIARY DUTIES**

- 2.14 Partners place mutual trust and confidence in each other. They stand in a fiduciary relationship. A partner must display the utmost good faith towards his fellow partners in all partnership dealings. A partner owes his co-partners a duty to be honest in his dealings with third parties, even if the transactions are not of a partnership nature.<sup>23</sup>
- 2.15 The 1890 Act contains statements on some aspects of the partners' fiduciary relationship. A partner must give any of his partners true accounts and full information of all things affecting the partnership.<sup>24</sup> A partner must account to his partners for any profit which he obtains without their consent from any transaction concerning the partnership or from his use of partnership property.<sup>25</sup> Similarly, a partner who carries on a competing business of the same nature as the partnership's business without his partners' consent must account for any profits made by him in that business.<sup>26</sup>
- 2.16 Other fiduciary duties are left to the general law. A partner should not make a secret profit in the course of the sale to or purchase from his firm and must account for such profit.<sup>27</sup> To avoid this duty to account a partner must make full disclosure of his interest to his fellow partners. A partner will be liable to account if he secures a personal benefit which should, as a consequence of his duties to his fellow partners, be obtained for the benefit of the firm.<sup>28</sup> A partner's use of information received in the course of the partnership business to secure a personal benefit will give rise to a similar obligation.<sup>29</sup>

<sup>20</sup> 1890 Act, s 16. The operation of this rule is considerably more complex than the terse statutory wording suggests and is discussed in paras 6.15 – 6.21 below.

<sup>21</sup> 1890 Act, s 17(1) (in absence of agreement to the contrary).

<sup>22</sup> See paras 6.81 – 6.83 below and the 1890 Act, s 36.

<sup>23</sup> See *Carmichael v Evans* [1904] 1 Ch 486. In this context "honest" means abstaining from fraud.

<sup>24</sup> 1890 Act, s 28.

<sup>25</sup> 1890 Act, s 29.

<sup>26</sup> 1890 Act, s 30.

<sup>27</sup> *Gordon v Holland* (1913) 108 LT 385.

<sup>28</sup> *Powell and Thomas v Evan Jones & Co* [1905] 1 KB 11.

<sup>29</sup> *Boardman v Phipps* [1967] 2 AC 46.

- 2.17 In English law a partner's fiduciary duties are owed to his fellow partners. It appears that in Scots law certain duties are owed to the partnership as an entity: sections 29 and 30 refer to the obligation to account "to the firm". In both jurisdictions the duty to render true accounts and full information of all things affecting the partnership is a duty owed to co-partners rather than to the partnership.<sup>30</sup>

#### **MANAGEMENT AND FINANCIAL RIGHTS**

- 2.18 Section 24 of the 1890 Act sets out partners' management and financial rights which apply in the absence of contrary agreement. These are default rules. Section 19 of the 1890 Act provides:

The mutual rights and duties of the partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.

- 2.19 The default rules set out in section 24 include, for example, that partners are entitled to share equally in the capital and profits of the firm,<sup>31</sup> are entitled to take part in the management of the business<sup>32</sup> and can agree ordinary matters connected with the partnership business by a majority<sup>33</sup> so long as all partners are able to express a view.<sup>34</sup> As we have already mentioned,<sup>35</sup> unanimity is required for the introduction of a new partner.<sup>36</sup>

#### **PARTNERSHIP PROPERTY**

- 2.20 It is necessary in English law, which adopts the "aggregate" approach to partnership, to distinguish between property held for the partnership and the property of its individual members. This is done in the 1890 Act by the concept of partnership property.<sup>37</sup> It is of fundamental importance in distinguishing between the assets available to meet the claims of the creditors of individual partners and the creditors of the partnership and in attributing the benefit of any increase in the value of the property.
- 2.21 It is not always easy to determine whether an asset is partnership property. Property can be used for the purposes of the partnership and yet not be part of the partnership's property.<sup>38</sup> Its status depends on the agreement, express or implied, between the partners. If there is no express agreement sections 20 and 21 of the

<sup>30</sup> 1890 Act, s 28.

<sup>31</sup> 1890 Act, s 24(1).

<sup>32</sup> 1890 Act, s 24(5).

<sup>33</sup> 1890 Act, s 24(8).

<sup>34</sup> *Const v Harris* (1824) Turn & R 496, 525; 37 ER 1191, 1202; *Lindley & Banks* para 15-08; *Miller*, p 185.

<sup>35</sup> See para 2.3 above.

<sup>36</sup> 1890 Act, s 24(7).

<sup>37</sup> 1890 Act, s 20(1).

<sup>38</sup> See, for example, *Miles v Clarke* [1953] 1 All ER 779.

1890 Act set out the factors which will generally be relevant.<sup>39</sup> The circumstances behind and the purpose of the acquisition of the asset, the source from which it is financed and how it is subsequently dealt with, will normally determine the status of the property.

- 2.22 In English law a legal estate in land can only be held by a maximum of four partners.<sup>40</sup> For larger firms four partners will hold the legal estate on trust for themselves and their co-partners according to their beneficial interests. Other options are for a partnership to vest land in a company controlled by the partnership or in a nominee which holds the land in bare trust for the firm. This avoids the need to transfer the estate on the death or retirement of one of the trustees.
- 2.23 In Scots law, a partnership can hold moveable property such as vehicles, computers and intellectual property. It can also hold title to a lease of heritable property. But it is common practice to take title to leases in the name of trustees for the firm. The prohibition against the partnership holding title to feudal property has resulted in the partners taking title to heritable property as trustees for the firm.<sup>41</sup> The options of vesting land in a company or in a nominee are available as in England and Wales.
- 2.24 The trust by which a partner or partners hold property in trust for the firm is often implied rather than express and similar issues arise as to the status of the property as in England and Wales. The agreement of the partners, express or implied, determines the status of the property.<sup>42</sup> Again sections 20 and 21 of the 1890 Act illustrate factors which are relevant to establishing such agreement.
- 2.25 The separate personality of the Scottish partnership prevents partners having title to sue for damage to partnership property or having an insurable interest in partnership property.<sup>43</sup>

#### **DURATION OF PARTNERSHIP**

- 2.26 A partnership falls into one of two categories namely a partnership at will or a partnership for a fixed term. The default rule is the partnership at will: it exists where the partnership agreement is silent as to the duration of the partnership.<sup>44</sup> A partner in a partnership at will can dissolve the partnership immediately by

<sup>39</sup> The partnership accounts are often a good guide as to whether an asset is partnership property. If every partner has agreed to the inclusion of an asset in the balance sheet, this will normally be sufficient agreement.

<sup>40</sup> Trustee Act 1925, s 34(2); Law of Property Act 1925, s 34(2).

<sup>41</sup> See para 2.7 and footnote 9 above.

<sup>42</sup> Bell, *Comm*, II, 501-502. The title of a bona fide third party may however prevail over a latent trust: see *Redfearn v Somervail* (1813) 1 Dow 50; 3 ER 618.

<sup>43</sup> See *MacLennan v Scottish Gas Board*, First Division, 16 December 1983 (unreported on this point); *Arif v Excess Insurance Group Ltd* 1987 SLT 473; *Mitchell v Scottish Eagle Insurance Ltd* 1997 SLT 793.

<sup>44</sup> *Moss v Elphick* [1910] 1 KB 465 and 846; *Walters v Bingham* [1988] 1 FTLR 260; *Abbott v Abbott* [1936] 3 All ER 823.

notice.<sup>45</sup> In absence of agreement between the partners to the contrary, the partnership must then be wound up. Transactions begun but unfinished may be completed,<sup>46</sup> and the partnership's assets distributed.<sup>47</sup>

- 2.27 Unless the partners agree otherwise, the death or bankruptcy of a partner means that the partnership is dissolved as regards all partners and that it should be wound up.<sup>48</sup> This is so even if the partnership was entered into for a fixed term which has not expired.<sup>49</sup>
- 2.28 In a partnership for a fixed term, a partner who wants to retire can only do so with the consent of his fellow partners. Alternatively, he can apply to the court to wind up the firm under section 35 of the 1890 Act.
- 2.29 If a partnership for a fixed term is continued after the expiry of that term, without any express new agreement, the rights and duties of the partners remain the same as they were at the expiration of the term, so far as is consistent with the incidents of a partnership at will.<sup>50</sup> In English law, where a new partner is admitted to a fixed term partnership, that partnership is determined and a new one is created, which may also be a fixed term partnership or a partnership at will, depending upon the terms of the original agreement.<sup>51</sup>
- 2.30 All the partners can agree to dissolve the partnership. The partnership agreement may provide that unanimity is not required so that a majority of partners can decide to dissolve the firm.
- 2.31 A temporary cessation of business may not cause a dissolution.<sup>52</sup> But, as the very existence of a partnership is intrinsically linked to the carrying on of a business, an agreement of the partners permanently to cease all forms of business must be taken as an agreement to dissolve the partnership.
- 2.32 A partnership is dissolved where an event occurs which makes it unlawful to carry on the business of the firm or for the members to carry it on in partnership.<sup>53</sup> The 1890 Act also provides that a partner may apply to the court to dissolve a partnership on a number of specified grounds, including the general ground that it is just and equitable that the partnership be dissolved.<sup>54</sup>

<sup>45</sup> 1890 Act, ss 26 and 32.

<sup>46</sup> 1890 Act, s 38.

<sup>47</sup> 1890 Act, ss 39 and 44.

<sup>48</sup> 1890 Act, s 33.

<sup>49</sup> *Gillespie v Hamilton* (1818) 3 Madd 251; 56 ER 501; *Downs v Collins* (1848) 6 Hare 418; 67 ER 1228; *Lancaster v Allsup* (1887) 57 LT (NS) 53.

<sup>50</sup> 1890 Act, s 27(1).

<sup>51</sup> *Firth v Amslake* (1964) 108 SJ 198. The position in Scots law is unclear: see para 2.8 above.

<sup>52</sup> *Millar v Strathclyde Regional Council* 1988 SLT (Lands Tribunal) 9.

<sup>53</sup> 1890 Act, s 34.

<sup>54</sup> 1890 Act, s 35.

- 2.33 Views differ as to whether a partnership is dissolved where a repudiation of the partnership contract is accepted by the partner or partners not in breach.<sup>55</sup> There are also differing views on whether the frustration of the partnership contract brings a partnership to an end.<sup>56</sup>

#### **THE EFFECT OF CHANGES IN MEMBERSHIP OF THE FIRM ON THIRD PARTIES**

- 2.34 In both jurisdictions, the basic contractual position is that a party to a contract cannot transfer his obligations under that contract without the other party's consent.<sup>57</sup>
- 2.35 In English law a contract with a partnership is a contract with the members of that firm. It is a matter of construction whether a contract can be performed "vicariously" by another set of persons, for example, a "new" partnership. In general it is more likely that dissolution of the firm on a change in its membership terminates a contract when the firm is small, than where the contract is with a larger firm.<sup>58</sup>
- 2.36 In Scots law, similar issues arise, notwithstanding the separate personality of the firm. It is a matter of construction of the contract with the partnership as to whether the contract is with the firm as it is then constituted, or is with the firm (viewed as a continuing entity) as it might be constituted from time to time. The concept of a contract "with the house" which allows third parties to contract with the firm and its successors which carry on the same business is an established device in Scots law<sup>59</sup> but its conceptual basis is unclear.
- 2.37 In contracts of suretyship in English law and cautionary obligations in Scots law a change in the person for or to whom a third party stands as surety or cautioner may alter the third party's risk and so relieve him of liability, unless he consents to the change. This rule is preserved in section 18 of the 1890 Act.
- 2.38 Changes in the membership of a partnership can also cause difficulty in relation to other contracts. For example, insurance contracts are personal contracts and cannot normally be assigned without consent. This restricts the ability of a firm effectively to assign such contracts to the new firm, resulting from a change of membership.<sup>60</sup>
- 2.39 If a partnership maintains a single running account with a bank, on a change of membership of the firm, the well-known rule in *Clayton's Case*<sup>61</sup> will apply.

<sup>55</sup> See paras 8.83 – 8.84 below.

<sup>56</sup> See para 8.83 below.

<sup>57</sup> *Humble v Hunter* (1848) 12 QB 310, 317; 116 ER 885, 887; *Don King Productions Inc v Warren and Others* [2000] Ch 291, 318-319; Gloag, *Contract* (2<sup>nd</sup> ed 1929) p 416 but cf *Cole v Handasyde & Co* 1910 SC 68.

<sup>58</sup> *Briggs v Oates* [1990] ICR 473, 482. See also *Sheppard & Cooper Ltd v TSB Bank plc* [1997] 2 BCLC 222.

<sup>59</sup> See, eg, *Alexander v Lowson's Trustees* (1890) 17 R 571.

<sup>60</sup> For other complications caused by a change in the partners see *Lindley & Banks* paras 3-08 – 3-16.

<sup>61</sup> (1816) 1 Mer 572; 35 ER 781.

Withdrawals from the account will operate to reduce or cancel deposits in the order in which they were made - the “first in, first out” rule. Deposits will be applied in reduction of indebtedness in the same order. For partnerships this means that money paid into a current account by the “new” firm will reduce the debts of the “old”. Therefore, if deposits of the “new” firm exceed the debts of the “old”, a debit balance on the account will be the liability of the “new” firm alone. If the “new” firm becomes insolvent, the creditor has no recourse against the “old” firm whose indebtedness has been discharged. To avoid this, banks will often “freeze” the current account when a partner leaves the firm and thus keep the accounts of the “old” and “new” firms separate.

#### **PARTNERS’ LIABILITY AND A THIRD PARTY’S ACCESS TO INFORMATION**

- 2.40 A partner’s liability for new debts incurred on the firm’s behalf lasts for as long as other partners (as agents) have authority to bind that partner.<sup>62</sup> Nonetheless, third parties are entitled to assume that the other partners remain agents until they are notified to the contrary.<sup>63</sup> Partners should therefore notify any future clients by advertising their withdrawal from the partnership in the Gazette.<sup>64</sup> An outgoing partner who wishes to avoid any liability for post-withdrawal partnership debts may require to notify clients who had dealings with the firm before his withdrawal as the Gazette advertisement is notice only to persons who had no such dealings.
- 2.41 It is often difficult for a third party to ascertain who was a partner at a particular time. The Business Names Act 1985 requires the disclosure of the names of current partners where the firm has a place of business and carries on business in Great Britain under a business name which does not consist exclusively of the surnames of all of the partners (with certain permitted additions). The problem for the third party is that the Act does not require a firm to maintain a record of when a person became a partner or of former partners who have since withdrawn from the firm. The Act does not help the third party establish at a later date who were the partners at the time a liability was incurred. The third party may get access to that information when he initiates litigation against the firm. Rules of Court in England and Wales allow a claimant to require the disclosure of the names and addresses of the relevant partners.<sup>65</sup> In Scotland, the court may grant an order requiring the production of documents disclosing such information.<sup>66</sup>

#### **INSOLVENCY**

- 2.42 English law and Scots law have radically different insolvency regimes for partnerships. In English law there has been an attempt to assimilate partnerships

<sup>62</sup> In English law the partner is bound as principal; in Scots law he is bound through his subsidiary liability for the firm’s debts.

<sup>63</sup> 1890 Act, s 36.

<sup>64</sup> 1890 Act, s 36(2). If the firm is English or Welsh the notice is in the London Gazette; if the firm is Scottish it is in the Edinburgh Gazette.

<sup>65</sup> CPR, Sched 1, RSC O 81, r 2.

<sup>66</sup> *Mitchell v Grangemouth Coal Co* (1894) 2 SLT 104.

into the framework that governs corporate insolvency.<sup>67</sup> This is currently under review and is not within the scope of this report. By contrast partnership insolvency in Scots law is regulated by the Bankruptcy (Scotland) Act 1985, which provides the regime for individual insolvency.<sup>68</sup>

<sup>67</sup> See the Insolvency Act 1986 as applied by the Insolvent Partnerships Order 1994 (SI 1994/2421). See also Davis, Steiner and Cohen, *Insolvent Partnerships* (1996) and P Totty and G Moss, *Insolvency* (1986).

<sup>68</sup> See McBryde, *Bankruptcy* (2<sup>nd</sup> ed 1995).

# **PART III**

## **OVERVIEW OF PROPOSED REFORMS**

### **THE PRINCIPAL AIMS OF PARTNERSHIP LAW REFORM**

- 3.1 The rules of partnership law fall into two parts: external rules, which govern relations between the partnership and those dealing with it (customers, etc); and internal rules which govern relations between the partners themselves.
- 3.2 In making recommendations for reform of the general law of partnership we have four principal aims. Those aims are:
- (1) to preserve partnership as a flexible, informal and private business vehicle;
  - (2) to encourage continuity of business by facilitating continuity of partnership;
  - (3) to preserve mutual trust and good faith as critical components of the relationship between partners;
  - (4) to provide a modern law of partnership based on consistent and straightforward concepts, which are readily understandable by advisers and clients alike.

### **FLEXIBILITY AND INFORMALITY**

- 3.3 The partnership as a form is of great antiquity:

Historically, it has a traceable course from the ancient civilisations of Mesopotamia to classical Greece and Rome and hence onwards through medieval commercial practices and the far-flung enterprises of the Renaissance to its present-day position as one of the three most important forms of enterprise in the business world.<sup>1</sup>

- 3.4 This long history is no more than a reflection of the fact that it is the simplest form of business association. When two or more people come together in a business enterprise they need some basic rules to govern their relationship. Those rules should be as simple as possible. They should provide a basic framework governing the relations of the partners internally and with outside parties, which reflects commercial perceptions; they should provide the minimum intrusion while things are going well; and they should provide straightforward means of sorting things out when things are going badly.
- 3.5 Because of the great difference in size and nature of partnerships, it is vital that partnerships should retain the maximum flexibility in the way in which they organise themselves. Larger and more sophisticated partnerships have formal partnership agreements, but many small partnerships do not. Small partnerships

<sup>1</sup> Prof J J Henning, "The origins of the distinction between loan and partnership": *Company Lawyer* (2001) Vol 22 No 3 p 75.

play an important role in the economy. The 1890 Act contained a number of default provisions, that is, provisions which would apply unless the partners agreed otherwise. We have extended this approach in the proposed legislation by providing default clauses which together form a code of government for partnerships that will apply unless the partners choose to vary it (as they are free to do).

- 3.6 In drafting the default code we have followed a policy of “think small first”. Large partnerships are likely to have their own tailor made agreements. Small partnerships are not. The default code is intended to make life simpler for them by providing a suitable ready made set of rules, which they can change if they wish, and to reduce the likelihood of litigation (with its uncertainty, delay and cost) in the event of the partners falling out, because there will be an applicable set of rules in place.

## **CONTINUITY AND INDEPENDENT PERSONALITY**

### **Encouraging continuity**

- 3.7 The responses to consultation have convinced us that it is a serious defect of the 1890 Act that it provides no simple means to extend the life of a partnership, on a change of partners, and no presumption in favour of continuity. In English law, whenever the membership changes the partnership is in theory dissolved, and a new partnership created.<sup>2</sup> Furthermore, again apart from any provision in the agreement, a single partner can bring about a general dissolution simply by serving notice terminating the partnership.
- 3.8 It has often been observed that, in this respect, the legal position is far removed from the ordinary perceptions of those involved. In the words of one commentator:

... the great disadvantage of a partnership at will<sup>3</sup> is that ... it may be dissolved by any one partner at any time by simply giving notice to that effect to his co-partners. On such a dissolution, a partner in the firm is then entitled to have the firm wound up. It follows that the consequences of having a partnership at will are potentially devastating. Nonetheless, a concerning aspect of the 1890 Act is that the default form of partnership created thereunder is a partnership at will. This means that those successful trading or professional firms which are informally created are subject to winding up at the whim of one partner. Indeed, it is apprehended that there are many successful firms which are partnerships at will but in which the partners would be astonished to discover that they are subject to this risk ... In this

<sup>2</sup> See the Joint Consultation Paper para 2.29. Such a dissolution, where the business continues, is sometimes called a “technical dissolution”, to distinguish it from a “general dissolution” when the business comes to an end: see M Twomey, *Partnership Law* (2000 Butterworths Irish Law Library) paras 8.23, 23.07ff. In legal theory, however, there is no difference. (The 1890 Act seems to use the term dissolution in both senses: cf ss 42, 44).

<sup>3</sup> A “partnership at will” is one in which the agreement contains no provision as to duration: see *Lindley & Banks* paras 9-01 – 9-03.

way, it is suggested that the law of partnership fails the reasonable expectations of business men... .<sup>4</sup>

- 3.9 We highlighted this problem in the Joint Consultation Paper and proposed to address it in our reforms. Our proposal was to introduce a default rule that in such situations, provided that two or more partners remained, the partnership was not dissolved.<sup>5</sup> Instead, the deceased or outgoing partner could be bought out, leaving the partnership to continue between the remaining partners. There was widespread support in principle for this proposal among consultees. It was perceived as benefiting not only the members of a partnership but also those who deal with partnerships and as better reflecting the perceptions of business people.

### **Notice period and financial rights**

- 3.10 We have developed these proposals in more detail since the Joint Consultation Paper.<sup>6</sup> In particular, we propose an arrangement by which the outgoing partner must give a period of notice of withdrawal in order to allow the other partners an opportunity to consider their position and to respond to that withdrawal.<sup>7</sup> While this was not part of our original proposals in the Joint Consultation Paper, we are persuaded that it is a desirable reform in order to achieve a workable and fair regime for changes of partners where there is continuity of partnership.
- 3.11 Continuity of partnership will mean that an outgoing partner will normally have an entitlement to payment of his share in the partnership instead of a right to have the partnership wound up. We have decided against detailed statutory valuation rules, both because valuation practice may alter in future and because the rules might be unsuitable for many partnerships. We recommend that there should be a basic default principle that the outgoing partner is entitled to be paid the value of his share in the partnership on a notional sale of the partnership business. This reflects closely the existing financial rights of a partner as to the application of partnership property on the dissolution and winding up of a partnership.<sup>8</sup>

### **Independent legal personality**

- 3.12 As already explained,<sup>9</sup> under English law partners are agents of each other, but the partnership does not exist as a legal entity. As mutual agents, the partners share unlimited liability for all obligations incurred to other people in the course of the partnership. They also owe each other a duty of good faith (but, provided that they act honestly, they are otherwise free to regulate their affairs between themselves as they wish).

<sup>4</sup> *Twomey, op cit* p 8.02.

<sup>5</sup> See the Joint Consultation Paper para 6.19.

<sup>6</sup> See Part VIII below.

<sup>7</sup> See para 8.100 below.

<sup>8</sup> 1890 Act, s 39.

<sup>9</sup> Para 2.10 above.

- 3.13 Under Scots law a partnership is a legal entity, but the partners have the same unlimited liability towards those who deal with it, and have the same duty of good faith towards each other, as they would under English law.
- 3.14 We think that it would be much more satisfactory in today's world that a partnership should be a legal entity. In 1890 all partnerships were small concerns. Twenty was the maximum number of partners permitted by the law. That restriction has been removed, and partnerships now vary in size from two to many hundreds. But the framework of partnership law was simply not devised for larger partnerships.
- 3.15 Many people would be astonished to learn that a firm is automatically dissolved whenever there is a change of partner, or that it cannot own property, but that remains the law in England and Wales (although not in Scotland). In practice, firms habitually operate as if they were legal entities and are regarded as entities by those who deal with them. The fact that they are not presently recognised as such by the law is a throw back to the nineteenth century.
- 3.16 We believe that it is time to end this anomaly and that partnerships in England and Wales should become legal entities, so that their legal nature would reflect their role in the commercial life of Britain today. Partnerships would be able to enter contracts and hold property; they would not be automatically dissolved on any change of partner; but partners would continue (as in Scotland) to be personally responsible for the obligations of the partnership and would continue to owe duties of good faith to each other. The result would be a largely uniform law of partnership in England, Wales and Scotland.
- 3.17 Legislation will be needed to ensure that this change does not result in any change in the treatment of partnerships under UK tax law. We have received confirmation from the Inland Revenue of its intention that (subject to ministerial approval) the necessary legislation will be included in a Finance Bill.<sup>10</sup>

#### **MUTUAL TRUST AND GOOD FAITH**

- 3.18 Partners have to trust each other in order to engage in a business for their joint benefit. Before the 1890 Act, the courts recognised the central importance of the fiduciary relationship in partnership:

If fiduciary relation means anything I cannot conceive a stronger case of fiduciary relation than that which exists between partners. Their mutual confidence is the life blood of the concern. It is because they trust one another that they are partners in the first instance; it is because they continue to trust each other that the business goes on.<sup>11</sup>

- 3.19 Notwithstanding that recognition, the 1890 Act does not contain a general statement of the duty of partners to act in good faith. Rather, the Act contains

<sup>10</sup> See paras 3.50 - 3.53 below.

<sup>11</sup> *Helmores v Smith* (1885) 35 Ch D 436, 444, *per* Bacon V-C.

certain rules which are examples of obligations arising out of the particular fiduciary relationship which partnership involves.<sup>12</sup>

- 3.20 As mutual trust underpins partnership, we believe that there should be a statutory statement that in relation to any matter affecting the partnership a partner must act in good faith towards the partnership and each of the other partners. As this duty is fundamental to partnership, it should not be capable of being excluded by the partnership agreement. By their agreement partners may determine the nature and extent of the particular duties which they undertake to each other and to the partnership. But we think that it would be inconsistent with the partnership relationship if partners were to exclude their duty of good faith.<sup>13</sup>

## **CLARITY OF CONCEPT**

### **The 1890 Act as a “model”**

- 3.21 The 1890 Act has often been praised as a model of its kind,<sup>14</sup> but not all comment has been so kind. The leading Australian textbook comments critically on the results of the long period of gestation of the Bill, following Sir Frederick Pollock's draft of 1879:

In the course of the succeeding decade the Bill was resubmitted at frequent intervals, suffering alterations and deletions, almost amounting to mutilation, and resulting in many obscurities in the Act. In these circumstances, although the Act that ultimately reached the statute book in 1890 was based upon Pollock's original Bill, he is not wholly to blame for its many ambiguities and inaccuracies.<sup>15</sup>

### **Missing links**

- 3.22 Our own work on the project has confirmed our respect for the 1890 Act as a whole, in particular its simplicity of expression. However, we have also been struck by the lack of clarity on some important concepts and by the ambiguity concerning the continuance of a partnership on a change among the partners. In relation to the latter, while it remains a basic rule of the English law of partnership that a change in membership creates a new partnership,<sup>16</sup> some sections of the 1890 Act

<sup>12</sup> 1890 Act, s 28 (duty to render true accounts and full information); s 29 (duty to account for any private benefit derived from the partnership); s 30 (duty to account for profits of competing business).

<sup>13</sup> We also favour the re-enactment of the more specific fiduciary duties (ss 28, 29 and 30 of the 1890 Act: see above) as default rules, which may be modified, but only so far as consistent with the general duty of good faith.

<sup>14</sup> See eg per Harman LJ: “A model piece of legislation” (*Keith Spicer Ltd v Mansell* [1970] 1 All ER 462, 463). We also note respectfully the warning of our consultant, Roderick Banks, in his introduction to the latest edition of *Lindley & Banks* (p vii); he refers to the prospect of a new Partnership Act to replace the 1890 Act “which has stood the test of time so remarkably well” and comments “Would that new statutes were as well and as economically drafted!”

<sup>15</sup> Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand* (8<sup>th</sup> ed, by Keith Fletcher) p 6-7. See also Davis, Steiner and Cohen, *Insolvent Partnerships* (1996) para 1.3 where the authors describe the 1890 Act as “deceptively clear”.

<sup>16</sup> See *Income Tax Commissioners for the City of London v Gibbs* [1942] AC 402, *Lindley & Banks*, para 3-04.

appear to assume continuity of partnership.<sup>17</sup> Other sections, by contrast, do not.<sup>18</sup> In relation to the former, we take two examples: the nature of partnership property and the role of contractual remedies.

### **Partnership property**

- 3.23 It is a surprising feature of the 1890 Act that the same provision (section 20(1)) defines “partnership property” in both England and Scotland, even though the nature of the interest is, in theory at least, quite different in the two jurisdictions. In Scotland partnership property is owned by, or held in trust for, the partnership as a separate person;<sup>19</sup> in England, it is owned by the partners who have “a beneficial interest, in the form of an undivided share, in the partnership assets”.<sup>20</sup>
- 3.24 There is no guidance in the 1890 Act, and very little discussion in the textbooks, of how English law achieves the transfer of property on a change of membership in a continuing partnership. Where a partnership is initially the aggregate of A, B and C but A resigns and D is admitted as a partner, a new partnership comes into being as the aggregate of B, C and D. The problem is how the property of the “old” partnership comes to be transferred to the “new” partnership.<sup>21</sup>
- 3.25 One important practical issue is whether “partnership property” is available to satisfy a judgment against the partnership, where the membership has changed since the cause of action arose. The 1890 Act makes clear that an incoming partner is not personally liable for anything done before he became a partner,<sup>22</sup> but says nothing about execution against partnership property to which he has contributed. English rules of court enable the partners to be sued in the name of the partnership,<sup>23</sup> but this is said to be no more than a procedural convenience for naming the partners at the time the cause of action arose.<sup>24</sup>
- 3.26 This view appears to conform to that of the Insolvency Service, who commented in response to the consultation:

We also note that one of the effects of continuing legal personality is that new partners’ capital contributions would be available to meet

<sup>17</sup> 1890 Act, s 17(1) and (2).

<sup>18</sup> 1890 Act, ss 17(3) and 18.

<sup>19</sup> In Scots property law there is no separation of legal and beneficial ownership. In *Memec plc v IRC* (1998) 71 TC 77, 112 Peter Gibson LJ speaks of the assets of a partnership being vested in a Scottish partnership “legally and beneficially” which is an English lawyer’s analysis of property owned by a Scottish partnership and not held on trust for another person.

<sup>20</sup> See *Memec plc v IRC* (1998) 71 TC 77, 112 per Peter Gibson LJ.

<sup>21</sup> In the United States, a court has held that a successor partnership did not have title to enforce a title insurance policy that had been issued to an “old” partnership: *Fairway Development Co v Title Insurance Co* 621 F. Supp.120 (N.D. Ohio 1985). This case influenced the drafters of the Revised Uniform Partnership Act (1994) (RUPA) to adopt a default rule of continuing legal personality.

<sup>22</sup> 1890 Act, s 17.

<sup>23</sup> CPR, Sched 1, RSC O 81, r 1.

<sup>24</sup> *Lindley & Banks*, para 14-03.

the existing liabilities of the partnership. Since this mirrors what we suspect most partners and creditors believe happens when the composition of a firm changes, we think it is to be welcomed.

- 3.27 However, that is not a universal view. In their response, the Chancery Bar Association commented that our proposals would involve “a major change in the law” because “the capital of an incoming partner (would be) available for the use of the creditors of the old firm”. It seems strange that this potentially important issue remains unresolved.<sup>25</sup> Under our proposals, the incoming partners would not be personally liable for “old” debts, but the liability would be that of the continuing partnership, and its property (whatever the source) would be available for execution.

### ***Contractual remedies***

- 3.28 The recent case of *Hurst v Bryk*<sup>26</sup> has revealed considerable uncertainty in partnership law as to the respective roles of contractual and equitable doctrines. In that case, it was common ground up to the Court of Appeal that the contractual doctrine of repudiation of contract applied to partnerships with the effect that an acceptance by the innocent parties of a repudiation of a partnership agreement dissolved the partnership. In the House of Lords, Lord Millett challenged that view. Although a contract was necessary to bring a partnership into being, once created it was subject to the control of the courts of equity, and dissolution, unless consensual, was equally subject to control.<sup>27</sup> This view was not part of the decision and has received criticism, but it has been followed in a decision at first instance.<sup>28</sup> It is remarkable that, even among experts, an issue so fundamental to the conceptual nature of partnership in English law has been uncertain.
- 3.29 The present draft Bill provides an opportunity to clarify the position. It views the partnership as a legal person, whose characteristics are determined (a) by the draft Partnerships Bill except so far as varied by contract and (b) by the terms of the partnership contract (if different from the default rules in the draft Bill) and (c) by the rules of common law and equity so far as not inconsistent with the terms of the draft Bill. On this approach the draft Bill will provide the framework in which a partnership comes into existence and is terminated. The grounds of termination will be those, if any, which the partners agree upon in their partnership agreement and those set out in the draft Bill.<sup>29</sup> The partnership will not be terminated by the

<sup>25</sup> In the United States of America, the Uniform Partnership Act (1914) (UPA) met this problem by providing that an incoming partner’s liability for old debts should be satisfied only out of partnership property (UPA s 17). The commentary says that this was designed to solve “one of the most perplexing problems of partnership law”. RUPA seeks to continue this position by the combined effect of s 306-7 (see official commentary to s 306: “In effect, a new partner has no liability to the existing creditors of the partnership, and only his investment in the firm is at risk for the satisfaction of existing partnership debts”).

<sup>26</sup> *Hurst v Bryk* is unreported at first instance; the Court of Appeal’s decision is reported in [1999] 1 Ch 1 and the decision of the House of Lords in [2002] 1 AC 185.

<sup>27</sup> Under the 1890 Act, s 35.

<sup>28</sup> See the Joint Consultation Paper paras 6.28 – 6.29, *Lindley & Banks* para 24-10 but see *Mullins v Laughton* [2003] Ch 250.

<sup>29</sup> See Part VIII below.

operation of contractual doctrines such as frustration and repudiation of contract but by agreement or by order of court or by the number of partners falling below two.

### **An accessible code**

- 3.30 Partnership law has to be accessible to a wide range of users and their advisers. Clarity of concept is as important as clarity of language. The market should not be seen as purely domestic. In recent years, there has been increasing competition between jurisdictions to produce business organisations which will be attractive to businessmen who operate internationally. This is evident in the reforms which have been introduced in many jurisdictions to legislation on limited partnerships and in the emergence of the limited liability partnership. Within the European Union, the decision of the Court of Justice in *Centros Ltd v Erhvervs-og Selskabsstyrelsen*<sup>30</sup> encourages jurisdictional competition. Ribstein states:

The recent *Centros* decision raises important questions about the future of European law, particularly the law of business organisations. By characterising a corporation as eligible for the privileges and immunities of a full-fledged citizen of its state of origin, including the right to establish a branch in a country outside its origin that is subject to home-state law, *Centros* sets the stage for increased jurisdictional competition for European business law.<sup>31</sup>

- 3.31 The law of partnership should be based on straightforward and consistent concepts, which can be readily understood by, or explained to, all categories of potential users and their advisers, domestic or foreign.<sup>32</sup>

### **Concepts in the draft Bill**

#### ***Partnerships as a legal entity***

- 3.32 As discussed above, we recommend that partnerships in England and Wales should as a general rule be legal entities. For reasons explained below, we recommend a limited exception to the general rule in the case of certain limited partnerships.

#### ***The liability of partners***

- 3.33 It is a fundamental concept that the partners in a general partnership have unlimited liability for the obligations incurred by the partnership while they are

<sup>30</sup> Case C – 212/97 [1999] ECR I – 1459. The decision characterises a corporation as eligible for the rights of a citizen of its state of origin, including the right to establish a branch in a country outside its country of origin that is subject to its home-state law.

<sup>31</sup> “The Evolving partnership”: Prof L Ribstein, *Journal of Corporation Law* Vol 26 No 4 (Summer 2001) p 820.

<sup>32</sup> Potential users of British partnerships may not be attracted by the risks to an established business of the default rule that a partnership is a partnership at will. As a partnership can become a partnership at will while partners are renegotiating a partnership agreement (see *Walters v Bingham* [1988] 1 FTLR 260) or through inadvertence on a change of membership, we think that a default rule of continuity will also increase the attractiveness of partnership.

partners. We discuss the liability of partners in Part VI.<sup>33</sup> By contrast a limited partnership must have one or more general partners each of whom has unlimited liability and one or more limited partners each of whom has limited liability. We discuss the liability of the general partner and the limited partner in Parts XVI and XVII. As the draft Bill covers both general partnerships and limited partnerships,<sup>34</sup> we think that it is appropriate to have a statement of the liability of partners early in the draft Bill (cl 3).

### ***The partnership agreement***

- 3.34 A partnership can only come into existence by an agreement between the partners. Such an agreement may be written, oral or inferred from conduct in whole or in part. The partnership agreement also provides the constitution which governs the partnership and the relationship between the partners. The agreement may contain a mechanism for the amendment of certain of its terms, for example by a special majority vote. In the absence of such a provision it requires the agreement of all the proposed partners or, after the partnership has been formed, all the partners to vary the partnership agreement. The draft Bill contains a provision to this effect (cl 4).

### ***Default partnership rules***

- 3.35 The flexibility of partnership law depends on allowing partners to determine the terms of their agreement. The 1890 Act by creating default rules which govern the relationship between the partners, subject to any contrary agreement, preserves this flexibility. Section 19 of the 1890 Act provides:

The mutual rights and duties of partners, whether ascertained by agreement or defined in this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.

- 3.36 We aim to preserve this flexibility and also to make clear which of the rules in the draft Bill are default rules and which are not. This we do by stating in each clause whether or not it is a default rule. We consider that it would be useful also to define a default rule as a rule which applies in relation to a partnership if the point dealt with in the rule is not dealt with in the partnership agreement. As default rules confer rights and duties on partners which the partners may wish to enforce against each other, we think that there should be a statement of the status of the default rules as terms of the partnership agreement. In function they are statutorily implied terms of a partnership agreement and we consider that a default rule should be treated as if it were a term of the partnership agreement so that partners may enforce their rights against each other in contract.<sup>35</sup> Finally, we think that it should be provided that partners may modify or exclude a default rule in

<sup>33</sup> See paras 6.47 - 6.88 below.

<sup>34</sup> As well as the special limited partnership in Part XIX below.

<sup>35</sup> This is subject to the exclusion of contract law doctrines as grounds for breaking up a partnership. See para 8.124 below.

accordance with the terms of the partnership agreement or if all the partners agree (draft Bill, cl 5).<sup>36</sup>

## **OTHER REFORMS**

### **Solvent dissolution**

- 3.37 Simplification of solvent dissolution was one of the issues expressly mentioned in our terms of reference. We recommend that a new system be introduced for the winding up of solvent partnerships when the partnership business is discontinued. Our recommendations will not prevent partners from agreeing the appropriate methods of winding up a partnership business. But problems occur where there is dissent among the partners and it becomes necessary to introduce a third party to effect the winding up. In England and Wales winding up under the supervision of the court is time-consuming and expensive. In Scotland also, winding up through the appointment of a judicial factor by the court causes expense, delay and difficulty. What is required is an officer with sufficient independent powers to wind up the partnership business and determine the financial rights and liabilities of the partners in an efficient manner.
- 3.38 We recommend that the court should have power to appoint a partnership liquidator with powers and duties modelled on those of a liquidator in a members' voluntary winding up of a company.<sup>37</sup> The partnership liquidator would be given express power, without the sanction of the court or the approval of the partners, to take specified steps for the winding up of the partnership's affairs and distributing its assets. He would require the sanction of the court or the unanimous approval of the partners to carry on the business for its beneficial winding up or to take other specified actions.<sup>38</sup>

### **Miscellaneous issues**

- 3.39 The introduction of continuity of partnership and separate legal personality will require the reformulation of a number of the provisions of the 1890 Act including the provisions relating to partnership property. We also recommend reform of the rules of litigation and the enforcement of claims against a partnership and its partners.

### **Transitional provisions**

- 3.40 We recommend that the new partnership rules should apply to all partnerships created after the commencement of the new Partnerships Act and to all other partnerships from a date two years after the commencement of the Act. In the interim partnerships created before the new Act comes into force may elect to be governed by the new Partnerships Act. We have recommended the delay in applying the new partnership rules to all partnerships in order to give existing

<sup>36</sup> Partners, of course, will not be able to modify or exclude default rules which have conferred rights on a former partner without his consent. See para 8.81 below.

<sup>37</sup> We also look to the rules of insolvent winding up in the Insolvency Act 1986, for example in relation to the release of a liquidator by the court on completion of a winding up.

<sup>38</sup> See Part XII below.

partnerships time to consider the provisions of the new Act and, if the partners think it appropriate, to contract out of the default regime of the new Act.

- 3.41 We received forceful representations from the Association of Partnership Practitioners (APP) that it was necessary to go further to protect the expectations of partners who had deliberately chosen to adopt the default regime of the 1890 Act which entitles an outgoing partner to insist on the winding up of the partnership on his departure.<sup>39</sup> In order to protect such expectations we recommend that an individual partner should have the right during the interim period to elect that the default regime of the 1890 Act should continue to apply to the partnership of which he is a member. This will enable Parliament to introduce the reforms to the default code without fear of taking away vested contractual rights from persons who wished to retain them.

#### **PROPOSALS WHICH WE ARE NOT TAKING FORWARD**

- 3.42 In the Joint Consultation Paper we discussed a proposal to introduce a new form of partnership with separate legal personality, the registered partnership. While there was some support for the proposal, particularly from financial bodies which lend money to partnerships, there was also strong opposition on the grounds that it involved unnecessary bureaucracy and complexity, that it would be expensive to administer and that there was little incentive for partnerships to register. While we recognise the advantages of transparency which a registration system may offer, nevertheless we are persuaded that it would not be appropriate to introduce the registered partnership.<sup>40</sup>
- 3.43 We are not proposing, as part of this project, that partnerships should have power to grant floating charges. In the absence of a registered partnership, or a general reform of the law of registration of charges, we do not think that it is practicable for partnerships to be allowed to grant floating charges. The Law Commission is consulting on a general reform of the law relating to charges over property other than land.<sup>41</sup> Although that project is directed in the first instance to company charges, it is also making proposals for non-corporate debtors, including partnerships.<sup>42</sup> This will provide an opportunity to review the issue of floating charges, in that context.

#### **LIMITED PARTNERSHIPS**

- 3.44 The Limited Partnerships Act 1907 has been criticised for its failure to create a coherent body of law and for the resulting uncertainty regarding the rights and obligations of general and limited partners.<sup>43</sup> In our Joint Consultation Paper on

<sup>39</sup> This was also an important issue in relation to agricultural partnerships in Scotland. See Part XIV below.

<sup>40</sup> See Part XIII below.

<sup>41</sup> See Registration of Security Interests: Company Charges and Property other than Land, Consultation Paper No 164. A separate reference is being undertaken by the Scottish Law Commission, which is limited to company charges: see Registration of Rights in Security by Companies, Discussion Paper No 121.

<sup>42</sup> *Ibid* Part X.

<sup>43</sup> *Twomey*, para 28.08.

Limited Partnerships we sought to identify the main areas in which the law required clarification. We recognised that business people use limited partnerships for specialised purposes and that most limited partnerships would have written partnership agreements governing the rights and obligations of the partners. As a result, there is less need in this specialised field to have a default regime. Rather the need is twofold: first, the application of the rules of the general law of partnerships to limited partnerships has to be clarified and, secondly, the role which a limited partner may play in a limited partnership without risking the loss of limitation of liability should be more closely defined.

- 3.45 Among the detailed recommendations for clarifying the law and for weaving limited partnerships into the general law of partnership we recommend that limited partnerships should be required to disclose their limited liability status, that the general partner alone should be responsible for default in registration formalities, that registration of a limited partnership should be conclusive as to its existence, that the liability of the limited partner should be limited to the amount of capital actually registered,<sup>44</sup> that legislation should provide guidance on the activities which a limited partner may undertake without losing limited liability status, and that the Registrar of Companies should be empowered to de-register defunct limited partnerships.

#### **SPECIAL LIMITED PARTNERSHIPS**

- 3.46 Limited partnerships have become a popular vehicle among venture capitalists for both UK and non-UK investment funds. We have referred to the increasing competition between jurisdictions to produce business organisations suited to international markets.<sup>45</sup> Serious concerns have been expressed to us, particularly by the APP, that giving legal personality to limited partnerships may affect their tax treatment overseas, and that uncertainty over that issue would affect their usefulness as a vehicle for investment and, therefore, be damaging to the economy. For those special reasons we propose that those who wish to do so should be able to enter into special limited partnerships which would not have separate legal personality.<sup>46</sup>

#### **FORM AND STYLE OF THE DRAFT PARTNERSHIPS BILL**

- 3.47 The draft Bill seeks to combine in one code introductory provisions which apply generally to partnerships and provisions which apply particularly to general partnerships and to limited partnerships respectively. By this means we seek both to preserve the flexibility of the statutory partnership code and to integrate the rules relating to limited partnerships into that code.
- 3.48 The draft Bill is similar to Sir Frederick Pollock's 1879 draft Bill in that it deals with both general partnerships and limited partnerships. The 1879 Bill comprised 97 clauses and two short schedules. Our draft Bill is longer than the combined 1890 and 1907 Acts principally because of additional clauses and schedules

<sup>44</sup> This is so long as he retains limited liability by not involving himself in the management of the business of the firm.

<sup>45</sup> See para 3.30 above.

<sup>46</sup> See Part XIX below.

relating to limited partnerships and the new provisions relating to the partnership liquidator.

#### **MATTERS NOT DEALT WITH**

- 3.49 Finally, in this Part we refer to two matters of domestic law which will be of importance to the reform of partnership law, but are not dealt with in detail in the present Bill.

#### **Tax law**

- 3.50 Notwithstanding the differences in the nature of partnership between the two jurisdictions, their treatment for tax purposes should in principle be the same.<sup>47</sup> In particular, the separate personality of partnerships in Scotland has not affected their transparency for tax purposes.
- 3.51 In fact, tax law has a variety of special rules, varying as to the extent to which the partnership is treated as separate from the partners, for example:-

- (1) Value Added Tax (VAT): Registration of a partnership may be in the name of the firm, and “no account shall be taken in determining .... whether goods or service are supplied to or by such persons ... of any change in the partnership”.<sup>48</sup>
- (2) Income Tax: There has been a radical change during the 1990s from joint to separate liability, accompanying the change from the “preceding year” to the “current year” basis:
  - (a) Former system: Under the former “preceding year” basis, profits taxed in any year were those of the firm<sup>49</sup> in the accounting period ending in the previous tax year, which was then treated as divided between the then partners for the purpose of calculating allowances, leading to a global assessment on the firm.<sup>50</sup> The tax was thus a debt of the partnership, for which all the partners were jointly liable.
  - (b) Current system: Under the new current year basis, it is provided that where a trade is carried on by persons in partnership, the partnership “shall not, unless the contrary intention appears, be treated for the purposes of the Tax Acts as an entity which is

<sup>47</sup> See *Income Tax Commissioners for the City of London v Gibbs* [1942] AC 402.

<sup>48</sup> Value Added Tax Act 1994 (VATA) s 45; for the purposes of liability, a member who has left the partnership is treated as remaining a partner until the Commissioners are notified of the change (s 45(2)).

<sup>49</sup> “What has to be ascertained is the profits of the firm and not of the individual partners. That is not, I think, stated anywhere in the Income Tax Acts, but it follows necessarily from the fact that there is only one business and not a number of different businesses carried on by each of the partners”: *MacKinlay v Arthur Young & Co* [1990] 2 AC 239, 249.

<sup>50</sup> Income and Corporation Taxes Act 1998 (ICTA) s 111: the total sum was treated as “one sum ... separate and distinct from any other tax chargeable on those persons ... and a joint assessment shall be made in the partnership name”.

separate and distinct from those persons.”<sup>51</sup> The profits or losses from the business are computed as if the partnership were an individual, and an individual partner’s share is determined in accordance with the partner’s shares in the partnership during the period.<sup>52</sup> Each partner is personally liable for tax only on his own share.

(3) Capital Gains Tax: The firm as such is disregarded, and all dealings in partnership assets are treated as dealings by individual partners.<sup>53</sup> The working out of this concept in practice has not been easy, and has had to be regulated by extra-statutory guidance.<sup>54</sup>

3.52 We regard it as important that our proposed reforms should not materially alter the treatment of partnerships for tax purposes, although they may provide an opportunity for addressing some of the anomalies of the present law. We have had the benefit of discussions with the Inland Revenue, who have seen a draft of this report and have considered our recommendations. If Parliament implements our recommendations by enacting a new Partnerships Bill, it will be necessary to alter taxation legislation to take account of the changes which the new Act will effect.<sup>55</sup>

3.53 The Inland Revenue propose to bring forward the necessary provisions in time to coincide with the enactment of any new Partnerships Bill. As the taxation consequences of any reform of partnership law are of great importance to business people who use partnerships, the Inland Revenue have authorised us to publish the following statement of their intentions:

The Inland Revenue has confirmed that, following any decisions by Parliament on partnership law, Treasury Ministers currently intend to bring forward any tax legislation necessary to maintain the present policy of generally treating partnerships as transparent for tax purposes.

### **Insolvency**

3.54 Our terms of reference do not include consideration of the law of partnership insolvency. It would in any event have been an unsuitable subject for a joint project between the two Commissions, in view of the different approaches of the two jurisdictions. In England and Wales, the Insolvency Act 1986, as applied in modified form by the Insolvent Partnerships Order 1994,<sup>56</sup> assimilates partnerships into the framework governing corporate insolvency. In Scotland, by contrast,

<sup>51</sup> ICTA 1988 s 111 (new form).

<sup>52</sup> *Ibid* s 111(2) & (3).

<sup>53</sup> Taxation of Chargeable Gains Act 1992 s 59: “tax in respect of chargeable gains accruing (to partners) shall, in Scotland as well as elsewhere in the United Kingdom, be assessed and charged on them separately.”

<sup>54</sup> See *Lindley & Banks*, para 35-02.

<sup>55</sup> The VAT treatment of partnerships under the new regime will be dealt with in consequential amendments, which will be prepared by Customs and Excise in due course.

<sup>56</sup> SI 1994/2421.

insolvency is regulated under the Bankruptcy (Scotland) Act 1985, which provides the regime for individual bankruptcy.<sup>57</sup>

3.55 However, there is a general recognition of the need for simplification and modernisation of English law, as contained in the 1994 Order, which:

... seeks to adapt the provisions of the 1986 Act piecemeal in order to accommodate the procedures applicable on the winding up of an insolvent firm, whether in conjunction with or independently of the insolvency of one or more of the partners. The product of this approach is an indigestible patchwork of provisions, some of which are in certain respects ill-suited to their task.<sup>58</sup>

3.56 Parallel with our work, an ad-hoc joint sub-committee<sup>59</sup> has been set up by the Insolvency Courts Users Committee in consultation with the Law Commission, to consider the treatment of insolvent partnerships and offer recommendations which can be considered alongside the Law Commission's report. A consultation paper making proposals for reform was issued at the beginning of 2002, the results of which have yet to be formally reported to the committee. The main points of the consultation paper are attached as Appendix D. It is hoped that this work will result in proposals for reform of the 1994 Order, which can be brought into effect at the same time as the proposals in this report.

3.57 In Scotland there are no proposals to reform the rules concerning the treatment of insolvent partnerships. We are not aware of any significant problems with the application of the Bankruptcy (Scotland) Act 1985 and its subordinate legislation to partnerships.

### **Consequential amendments**

3.58 The draft Bill does not include provisions for consequential amendments of other legislation, resulting from the proposed reforms. The detailed work necessary for this purpose is best undertaken once the principle of the reforms has been accepted, and at the time when the draft Bill is being prepared for Parliament. Otherwise, work done at this stage may be overtaken by other legislative change. We do not expect the consequential amendments to give rise to significant policy issues.

<sup>57</sup> A Scottish partnership can be sequestrated although the estates of the partners are not sequestrated. In practice, it is common that some or all of the partners (if apparently insolvent) are sequestrated at the same time as the partnership. See Bankruptcy (Scotland) Act 1985, ss 6(1) and (5), 7(3); McBryde, *Bankruptcy* (2<sup>nd</sup> ed) para 4.20f. Difficulties can arise in petitions to sequestrate partnerships if the separate personality of the partnership is overlooked, but the bankruptcy rules work well if the principles of the Scots law of partnership are borne in mind: McBryde *op cit* para 4.22. Complex factual issues, which can arise on the insolvency of informal or badly-run partnerships, will continue to arise, whatever rules are applied.

<sup>58</sup> *Lindley & Banks*, para 27-01.

<sup>59</sup> The sub-committee is chaired by Mr Justice Evans-Lombe and its members include practitioners in the field. The secretary to the sub-committee is Mr Registrar Baister, at the Royal Courts of Justice to whom enquiries should be directed (email to sbaister@lix.compulink.co.uk).

# **PART IV**

## **THE DEFINITION OF PARTNERSHIP**

### **INTRODUCTION**

- 4.1 In section 1 of the 1890 Act the existing definition of partnership is as follows:

Partnership is the relation which subsists between persons carrying on a business in common with a view of profit.

- 4.2 The definition raises a number of issues which we discussed in the Joint Consultation Paper.<sup>1</sup> In this Part we make recommendations to modernise the definition and to adapt it to a default rule of continuity of partnership and to the separate personality of a partnership. We also discuss the important concepts of the partnership agreement and default rules.

### **ISSUES ARISING OUT OF THE EXISTING DEFINITION**

#### **The use of the expression “relation”**

- 4.3 In the Joint Consultation Paper we suggested that the use of the expression “relation” was out of touch with ordinary usage. This is so particularly among people who are not lawyers. A lawyer may think that “relation” is a suitable expression to describe the connection between a particular group of partners but it is not appropriate for a continuing partnership which survives changes in membership. Just as an agreement between A, B and C is seen as different from an agreement in identical terms between B, C and D, so also a relationship between the former persons is seen as different from a relationship between the latter.

#### **The need for agreement**

- 4.4 Partnership arises out of an agreement between the partners.<sup>2</sup> The agreement may be formal or it may be inferred from the way in which the parties have acted. The definition makes no reference to agreement but such agreement is the precondition of partnership.

#### **Carrying on business with a view of profit**

- 4.5 A partnership is a vehicle by which persons carry on business. This distinguishes it from non-business associations. “Business” is widely defined as including “every trade, occupation, or profession”.<sup>3</sup> While the definition requires the partners to carry on a business for profit, it does not make the division of the profits a necessary part of the definition.

<sup>1</sup> Joint Consultation Paper, paras 5.1 – 5.26.

<sup>2</sup> *Lindley & Banks*, para 2-13. Roman law treated partnership as a consensual contract and the Scottish Institutional writers referred to it as a contract or association: Erskine *Institutes* III.3, 18, Bell *Principles*, s 351.

<sup>3</sup> 1890 Act, s 45.

- 4.6 The definition requires the partners to carry on the business before there can be a partnership. Lord Lindley in his Supplement on the 1890 Act<sup>4</sup> questioned whether this went too far. Since the publication of the Joint Consultation Paper, the House of Lords has considered the issue in *Khan v Miah*.<sup>5</sup> There it was held that it is not necessary for the partners to have commenced trading before there can be a partnership: the question is whether the partners have actually embarked upon the venture on which they had agreed.<sup>6</sup>

#### **Who carries on the business?**

- 4.7 The existing definition envisages that it is the partners who carry on the business of the partnership. This is consistent with the aggregate approach to partnership which English law adopts,<sup>7</sup> but it causes no practical difficulty in Scots law which treats a partnership as a separate legal person.<sup>8</sup> It is legitimate to speak of the partners in a partnership carrying on the partnership business. In carrying on the business of the partnership they bind the partnership;<sup>9</sup> they also have unlimited liability for the obligations of the partnership.<sup>10</sup> An entity approach to partnership<sup>11</sup> has the effect that the legal rights of the partnership are vested in the entity and the obligations of the partnership are those of the entity, for which the partners have unlimited liability. But this does not alter the economic reality of the intimate involvement of partners in conducting the partnership business.

#### **OUR PROVISIONAL PROPOSALS AND CONSULTATION**

- 4.8 We suggested in the Joint Consultation Paper that the definition of partnership could be updated and clarified. In particular we proposed (a) that the definition should refer to partnership as a voluntary association rather than a relation, (b) that it would not be necessary that business be carried on before a partnership commences, (c) that the business of a partnership with legal personality should be carried on by the partnership and not the partners and (d) that division of profits is not an essential feature of partnership.<sup>12</sup>

<sup>4</sup> The Supplement was to the 5<sup>th</sup> edition of *Lindley on Partnership* (1888) and was published in 1891 (hereinafter “the Supplement”). See the Supplement p14.

<sup>5</sup> [2000] 1 WLR 2123.

<sup>6</sup> *Ibid*, Lord Millett at p 2128.

<sup>7</sup> See para 2.5 above.

<sup>8</sup> 1890 Act, s 4(2). See also *Major v Brodie* [1998] STC (Ch D) 491.

<sup>9</sup> 1890 Act, s 5.

<sup>10</sup> 1890 Act, ss 9 and 12.

<sup>11</sup> The entity approach treats the partnership as a legal person distinct from the partners who compose it. This, as *Lindley & Banks*, paras 3-01 – 3-03 record, reflects the commercial view of partnerships. The separate legal personality of partnerships which are entities, such as partnerships in Scotland and the United States, does not make them corporations. The legal personality of a partnership is sui generis. See Part V below.

<sup>12</sup> See the Joint Consultation Paper, para 5.26.

### **Partnership as an “association”**

- 4.9 A majority of consultees supported the proposal to replace the expression “relation” with “association”. The APP suggested that the definition should be consistent with the statutory definition of a limited liability partnership in order to facilitate the conversion of an ordinary partnership into an LLP.<sup>13</sup>

### **The need for agreement**

- 4.10 There was support for our proposal that the definition should make clear that the association must be constituted by agreement, although several consultees argued cogently that it was not necessary as the existence of an agreement is implied, and such a definition might be harmful if it gave the impression that express agreement was required.

### **When a partnership is formed**

- 4.11 There was support for our proposals in relation to the commencement of a partnership but several consultees expressed the view that the House of Lords had resolved the matter in *Khan v Miah*.<sup>14</sup> Another suggested that there was a need for greater certainty as to when a partnership came into existence and suggested that it should be the earlier of (a) the date of the agreement to carry on business in common or (b) if no such express agreement was made, the date when the business itself commences.

### **Who carries on the business?**

- 4.12 The majority of the English and all of the Scottish consultees agreed with the proposal that, if partnerships have separate legal personality, the definition should state that the partnership carries on the business rather than the partners. One consultee, however, expressed concern over the foreign tax consequences of separate personality and of such a definition. Others were concerned that such a definition would change the perception of partnership. One consultee argued that the legal personality of a partnership was simply a legal device which treated the body of partners as a person and was different from the corporate nature of a registered company. Our consultant, Roderick Banks, disagreed with the proposal, arguing strongly that the involvement of the partners in carrying on the business was at the heart of partnership.

### **The division of profits**

- 4.13 Consultees generally supported the proposal that the division of profits was not an essential feature of partnership.

<sup>13</sup> The Limited Liability Partnerships Act 2000, s 2 provides that for an LLP to be incorporated there must be “two or more persons associated for carrying on a lawful business with a view to profit”. We believe that our definition of partnership (para 4.17 below) is consistent with this definition and will not prevent conversion from a general partnership to an LLP.

<sup>14</sup> [2000] 1 WLR 2123.

## THE RATIONALE FOR REFORM

- 4.14 It seems to us that the existing definition of partnership is inappropriate for four reasons. First, the expression “relation” is opaque and is confusing to people without expertise in partnership law. It describes an underlying relationship between the partners and not the business vehicle. Secondly, “relation” is not suited to a default rule of continuity of partnership and to the existence of separate legal personality. Thirdly, it is necessary to distinguish between the partnership itself and the underlying partnership contract: the terms of a partnership’s contractual constitution may change over time without creating a new partnership on each change. Fourthly, the language of the whole of section 1 of the 1890 Act requires updating.

## THE REFORM PROPOSALS

### Who may be partners?

- 4.15 As we recommend below, in order to constitute a partnership, there must be an agreement between persons to carry on business together with the object of making a profit and those persons must have started to carry on the business together.<sup>15</sup> The persons who can be partners may be individuals, companies, partnerships and other legal entities, provided such legal entities have power to enter into partnership. The draft Bill (like the 1890 Act) uses the word “persons” to describe the partners.<sup>16</sup>

### Definition of partnership

- 4.16 We have considered whether to include a definition of “partnership” in the draft Bill and how best to define it in the context of a default rule of continuity of partnership on a change of membership. We think that a partnership is best described as an association of persons. This description is consistent with a partnership which continues in existence on changes of its membership. There are precedents for so describing a partnership in the Revised Uniform Partnership Act (RUPA)<sup>17</sup> and in Scottish Institutional writing.<sup>18</sup>
- 4.17 **We therefore recommend that a partnership should be defined for the purposes of the draft Bill as “an association formed when two or more persons start to carry on a business together under a partnership agreement”.**<sup>19</sup> (Draft Bill, cl 1(2))

<sup>15</sup> See para 4.20 below. As we state in para 4.21 below, in this context the partners can begin to carry on business when they fit out their shop; they do not need to be trading for the partnership to come into existence.

<sup>16</sup> See the draft Bill, cl 1(1), (2) and (7).

<sup>17</sup> RUPA was finalised by the National Conference of Commissioners on Uniform State Laws in 1994.

<sup>18</sup> See RUPA, s 101(6), which describes partnership as “an association of two or more persons to carry on as co-owners a business for profit”. See also Bell *Principles*, s 351.

<sup>19</sup> We have used the expression “*under* a partnership agreement” rather than “as a result of” or “in accordance with” a partnership agreement. It was suggested to us that “as a result of” could be interpreted so that there required to be a pre-existing agreement for a partnership to come into existence and that this would militate against a partnership coming about by

### **The need for agreement to constitute a partnership**

- 4.18 We think that the draft Bill should make it clear that a partnership must be constituted by agreement.
- 4.19 We are aware of an argument that such a definition may mislead because it may give the impression that express agreement is required. It may also mislead by seeming to support those who enter into agreements which state that they are not partners when it is clear from their conduct that they are. To avoid the first risk and to reduce the second, we recommend that the definition should make it clear that the necessary agreement may be constituted expressly or inferred from conduct, or may be partly express and partly inferred from conduct. This would be consistent with existing partnership law: where persons agree to carry on business together with the object of making a profit and do so carry on business, they are a partnership. The law looks to the substance and reality of the agreement and “no ‘phrasing of it’ by dextrous draftsmen ... will avail to avert the legal consequences of the contract”.<sup>20</sup>
- 4.20 **We recommend that the definition of partnership should make it clear that a partnership must be constituted by agreement. That agreement may be express, inferred from conduct or may be partly express and partly inferred from conduct.** (Draft Bill, cls 1(1) and (2) and 76(2))

### **The commencement of the partnership**

- 4.21 In *Khan v Miah*<sup>21</sup> the House of Lords has made it clear that a partnership commences when the parties embark on the venture on which they have agreed. It is not necessary that they should be trading. Where partners are collaborating in preparation for trading, for example in fitting out a shop or an office, they have embarked upon their venture and will be treated as being in partnership.
- 4.22 We see no need to be more specific. In particular we are not persuaded that there is benefit in the formula that the commencement date is either (a) the date of the agreement to enter into business or (b) if no such agreement was made, the date when the business itself commences. The first leg of the formulation is flawed, as an agreement to enter into business may specify that the business will commence at a future date.<sup>22</sup> The second leg of the formulation adds nothing to the existing law. We are not persuaded that it is appropriate to define more precisely when a

actions. The expression “in accordance with” was criticised as carrying the implication that the partners would have to comply with every term of their agreement for a partnership to come into existence. As we wished to avoid any implication of temporal sequence or of mandatory conformity to the agreement we have used the neutral word “under”.

<sup>20</sup> *Adam v Newbigging* (1888) 13 App Cas 308, 315 per Lord Halsbury. In *Weiner v Harris* [1910] 1 KB 285, 290 Cozens-Hardy MR stated: “Two parties enter into a transaction and say “It is hereby declared there is no partnership between us”. The Court pays no regard to that. The Court looks at the transaction and says “Is this, in point of law, really a partnership?” It is not in the least conclusive that the parties have used a term or language intended to indicate that the transaction is not that which in law it is.”

<sup>21</sup> [2000] 1 WLR 2123.

<sup>22</sup> See *Dickinson v Valpy* (1829) 10 B & C 128, Parke J at 141-142.

partnership begins. Any formula, however good, runs the risk of failing to cover all the circumstances which may arise.

4.23 We favour an approach which allows the decision of the House of Lords in *Khan v Miah*<sup>23</sup> to be applied to the facts of a particular case.

4.24 **We therefore recommend that a partnership should commence when two or more persons start to carry on a business together with the object of making a profit.** (Draft Bill, cl 1(1) and (2))

#### **Partners carrying on the business of the partnership**

4.25 Since receiving the responses to the Joint Consultation Paper, we have reconsidered our provisional proposal that if a partnership were to have legal personality the definition should refer to the business being carried on by the partnership rather than by the partners.<sup>24</sup> The justification for that proposal was that in law it would be the partnership as a separate person which holds property (including contractual rights) and incurs liabilities. The partners would be agents of the partnership and act on its behalf.<sup>25</sup> As the partnership would be the principal and the partners would be its agents it may be argued that it is the partnership that carries on the business.

4.26 However, if we were so to provide, there would be a striking difference in this context between legal form and economic reality. It is the partners who undertake the practical tasks of carrying on the business. They enter into contracts on behalf of the partnership and bind it. It is the partners who ultimately benefit from the success of the partnership business and who are liable, without limit, for its obligations. The division between management and ownership, which is a paradigm of company law, does not apply in partnership law. The involvement of the partners in carrying on the business is at the heart of partnership. The economic and practical reality of partnership (whether or not the partnership has separate legal personality) is that it depends for its existence on the involvement of the partners in the business.

4.27 In Part V we recommend that all general partnerships should have separate legal personality.<sup>26</sup> In recommending separate legal personality we are not seeking to alter the fundamental nature of partnership which has at its heart the involvement of the partners in the business. Rather, we are promoting a device which makes the law simpler and closer to the long-established commercial view of partnership and which assists our central policy of continuity of partnership. The partnership as an entity facilitates the carrying on of business by the partners; it does not supplant them in carrying on the business.

<sup>23</sup> [2000] 1 WLR 2123.

<sup>24</sup> Joint Consultation Paper, para 5.26(4).

<sup>25</sup> See para 6.22 below.

<sup>26</sup> We recommend in Part V that the legal personality of a partnership should be *sui generis*. It would not be a body corporate. So the law of corporations which separates the liability of the corporation and restricts the liability of the members of the corporation will not be relevant.

4.28 There is also another practical reason for providing that it is the partners who carry on the business. It is important to most partnerships in the United Kingdom that they are treated by the Inland Revenue as tax transparent, so that income and gains of the partnership are taxed as the income and gains of the individual partners. The Inland Revenue justify their approach to UK partnerships<sup>27</sup> by reference to the following three characteristics:

- (1) the partners carry on the business of the partnership with a view to profit;
- (2) every partner is liable jointly or jointly and severally with the other partners for all the debts and obligations of the partnership; and
- (3) the partners own the business, each having at least an indirect share in the net assets of the partnership.<sup>28</sup>

It is clearly in the commercial interests of UK partnerships to preserve the existing tax treatment.

4.29 At the same time we recognise the importance of clarity in legal analysis, particularly when the introduction of separate legal personality will be a novelty in English law.<sup>29</sup> We would not wish to create unnecessary doubts about the nature of partnership or to encourage arguments that the partners were in law the principals and the partnership their agent. As a matter of legal analysis, the rights and obligations of a partnership will be the rights and obligations of the partnership as an entity. By entering into transactions in the course of partnership business, the partners as agents will bind the partnership as principal. The partners will have immediate liability for the partnership's debts and obligations but their liability as partners will be akin to the liability of a surety or guarantor.<sup>30</sup> These attributes, which we recommend to be included in the draft Bill, will not be affected by the definition of who carries on the business.

4.30 **We therefore recommend that it should be provided that it is the partners who carry on the business of the partnership.** (Draft Bill, cl 6(1))

4.31 We discuss in Part V below the reasons why we recommend the introduction of legal personality into the English law of partnership. In addition to conceptual clarity and the resolution of practical problems, we see separate personality as an important component of continuity of partnership, which we recommend as a default rule. As a new entity is to be created we think it appropriate to state its main functions in the draft Bill. While the partners carry on the business, it is the

<sup>27</sup> This covers both the English law partnership and the Scots law partnership notwithstanding that the former has no separate legal personality and the latter has separate legal personality.

<sup>28</sup> See *Memec plc v Commissioners of Inland Revenue* (1998) 71 TC 77 and in particular Peter Gibson LJ at pp 111-113. Neither the separate personality of the Scottish partnership nor the absence of mutual agency in Scots law prevented the conclusion that in substance the position of the partners in a Scottish partnership in relation to the profits was the same as in an English partnership (p 113B-C).

<sup>29</sup> In making the recommendation in paragraph 4.30 below we recognise that we are departing from the views of the majority of consultees (see para 4.12 above).

<sup>30</sup> See paras 6.59 and 6.62 below.

partnership which enters into contracts. The partnership can hold property. Separate legal personality also facilitates continuity of partnership for those firms which adopt the default code or where the partnership agreement provides alternative rules for continuity of partnership.

- 4.32 **We therefore recommend that it should be provided that the main functions of the partnership are to enter into contracts and own or hold property for the purposes of the partnership business, and (subject to the partnership agreement) to provide continuity for the partnership business despite a change in the partners.** (Draft Bill, cl 6(2))

#### **Partnership as a business vehicle**

- 4.33 We do not favour extending the definition of partnership to include ventures other than business ventures. One consultee suggested that the definition should be expanded so that a partnership could include trustees who conduct business for the benefit of the trust estate and not for personal profit. In our view the definition in the draft Bill is wide enough to encompass a partnership which included partners who were trustees.
- 4.34 Another consultee suggested that the definition of business in section 45 of the 1890 Act should be extended to include investment activities. Consultees who responded to the Joint Consultation Paper on limited partnerships were divided in their response to a question asking them whether the 1890 Act was adequate for the purpose of limited partnerships. Several argued that there was sufficient doubt about the definition to justify express reference to investment activity. Others, including the Inland Revenue and KPMG suggested that the existing definition included investment carried on as a commercial venture. We agree. We think that the existing definition is sufficiently broad to cover investment carried on as a commercial venture. One consultee suggested that there is no disadvantage in including investment in the definition. But any extension of the definition might create its own problems of interpretation. There is no consensus for change. The Inland Revenue have taken a position on the issue with which we agree. We therefore do not recommend any change to the definition of “business” in the 1890 Act for partnerships generally or for limited partnerships.<sup>31</sup>
- 4.35 **We therefore recommend that in the draft Bill “business” should include every trade, profession and occupation.** (Draft Bill, cl 1(6))

#### **Division of profits**

- 4.36 In the draft Bill a partnership agreement is defined as “an agreement between two or more persons for carrying on a business together with the object of making a profit”.<sup>32</sup> A partnership is formed when two or more persons start to carry on a business together under a partnership agreement.<sup>33</sup> This, we believe, is consistent with existing law. If A, B, C and D enter into, and carry on business in pursuance

<sup>31</sup> See paras 16.24 – 16.26 below.

<sup>32</sup> Draft Bill, cl 1(1).

<sup>33</sup> Draft Bill, cl 1(2).

of a partnership agreement which provides that the profits are to be shared between A, B and C, while D receives a fixed remuneration, D's receipt of a fixed sum rather than a sum which varies according to the level of the firm's profit does not prevent there being a partnership.<sup>34</sup>

### **Who is a partner?**

- 4.37 We have considered whether it is possible to provide some statutory guidance on the criteria which determine whether a person is a partner.<sup>35</sup> Case law on such questions as whether a person is a lender or a partner or whether he is an employee or a partner does not reveal any single determining criterion.
- 4.38 A person can be a partner although he does not, and is not allowed to, take part in management.<sup>36</sup> The dormant partner does not even require to contribute any capital.<sup>37</sup> An entitlement to receive a share of the profits of a business is a cogent indication of partnership but it is not conclusive.<sup>38</sup> A "salaried partner" may, depending on the circumstances, be either a partner or an employee.<sup>39</sup> In every case the court must look at the substance of the relationship between the parties and not the mere label attached to the relationship in order to ascertain whether the person is a partner<sup>40</sup> or a lender<sup>41</sup> or an employee.<sup>42</sup> Ultimately, the question is: 'are you carrying on business together with your partners?' or, where an alleged partner is a dormant partner, 'are the partners carrying on business also on your behalf?'
- 4.39 We do not think that it would be helpful to have a statutory formulation of a test which is wide enough to encompass the circumstances which may arise in particular partnerships. Nor do we see advantage in altering the test to restrict the circumstances in which a partnership comes into existence. As a dormant partner is still a partner, we cannot use the test of involvement in management.<sup>43</sup> We also

<sup>34</sup> In this example, the partners would have contracted out of the default code to provide that D, although a partner, would receive a fixed sum rather than a proportional share of the profits. See paras 4.37 – 4.39 below.

<sup>35</sup> The difficulty to which the informality of partnership gives rise has long been recognised. In a parliamentary debate in 1828 Henry Brougham stated: "It would be difficult to point out greater uncertainty or more caprice in any branch of the system than are to be found in the law of Partnership. A man can hardly tell whether he is a partner or not; being a partner, the extent of his liability is scarcely less difficult to ascertain; and he will often find it in vain to consult his lawyer on these important matters" (Parliamentary Debates, 2<sup>nd</sup> Series, Vol 18, 1828, column 241). While case law since 1828 may have reduced the caprice, the uncertainty arising from informality may remain.

<sup>36</sup> *Pooley v Driver* (1877) 5 Ch D, 458, 477.

<sup>37</sup> *Ibid*, at p 473.

<sup>38</sup> *Cox v Hickman* [1860] 8 HL Cas 268; *Mollwo, March & Co v Court of Wards* (1872) LR 4 PC 419.

<sup>39</sup> See *Stekel v Ellice* [1973] 1 WLR 191, 198 - 199.

<sup>40</sup> As in *Pooley v Driver* (1877) 5 Ch D 458 and *Stekel v Ellice* [1973] 1 WLR 191.

<sup>41</sup> As in *Mollwo, March & Co v Court of Wards* (1872) LR 4 PC 419.

<sup>42</sup> As in *Walker v Hirsch* (1884) 27 Ch D 460.

<sup>43</sup> Such a test would also be unsuitable in a limited partnership.

would not want to use the receipt of a share of the profits as a determining criterion. That would have at least two adverse consequences. First, it would prevent a lender from assisting in the start up or rescue of a firm by taking a variable rate of interest on his loan by reference to the level of profits or in the form of a share of those profits. Secondly, it would prevent partnerships such as a family partnership, in which a partner who is a parent may receive a fixed remuneration or no remuneration while sharing responsibility for losses with the children who are also partners and who receive the profits. Similarly, the contribution of capital should not be a decisive criterion as that would prejudice persons who wished to enter into partnership where one person provided capital and another provided skill and labour. We therefore do not propose to define the criteria which determine whether a person is a partner.

### **What are not partnerships?**

- 4.40 The draft Bill contains a provision<sup>44</sup> which replaces section 1(2) of the 1890 Act by providing that companies incorporated under the Companies Acts and by other means and certain other bodies are not partnerships.<sup>45</sup> This provision is simply an adaptation of the existing sub-section of the 1890 Act using updated language. Partnerships constituted under the law of a country or territory outside Great Britain also are not partnerships falling within the scope of the British partnership law.<sup>46</sup>

### **A statement of a partnership's capacity**

- 4.41 We think that there should be a statement that a partnership has unlimited capacity to act. Consultees generally supported the proposal. It avoids the application of the rules of *ultra vires* to partnerships which (if our recommendations are implemented) will have separate legal personality.<sup>47</sup> For example, suppose a partnership called A & B Builders bought a circus: we would not wish to countenance an argument that because the partnership was initially established to carry on business as builders it could not diversify into the circus business. The APP suggested that such a statement would be helpful in dealing with overseas jurisdictions.<sup>48</sup>
- 4.42 **We therefore recommend that there should be a statement that the partnership's capacity as a legal person is unlimited.** (Draft Bill, cl 7(1))

<sup>44</sup> Draft Bill, cl 2.

<sup>45</sup> Although a company cannot be a partnership it can be a partner.

<sup>46</sup> Draft Bill, cl 2.

<sup>47</sup> There is also a precedent in relation to limited liability partnerships in the Limited Liability Partnerships Act 2000, s 1(3): "A limited liability partnership has unlimited capacity".

<sup>48</sup> It is not simply a question of vires; it is also a question of legal capacity: for example cl 7(2) which allows a partnership to sue and be sued in the partnership name falls into the latter category.

### ***Criminal capacity (England and Wales)***

- 4.43 Whether a partnership governed by English law can commit a criminal offence is rather obscure. There are some judicial dicta which indicate that it cannot.<sup>49</sup> On the other hand, our researches have revealed some old statutes which show or appear to show an intention or assumption that a partnership can commit an offence under the statutes in question. The courts have not explored the matter in recent years and we are not aware of any modern prosecutions of a partnership in England and Wales.
- 4.44 Our policy is that a partnership should not be capable of committing an offence unless an Act expressly or by necessary implication provides that it can. Examples of where a statute may show an intention, by necessary implication, that a partnership can commit an offence include certain obligations backed by criminal sanctions which are imposed on an employer or on the registered owner of property. If an employer or owner of a vehicle commits an offence by failure to perform the statutory obligation, the statute would have to apply to a partnership if the partnership were the employer or owner as the case may be. Otherwise the criminal sanction would be ineffective.
- 4.45 At the same time, we do not intend that a partner, who is otherwise within the scope of the criminal law, should be able to avoid criminal liability by asserting that he was acting on behalf of the partnership. We consider that no such implication arises through the introduction of separate legal personality.
- 4.46 The question whether the criminal law should apply more generally to partnerships raises issues of criminal law policy on which we have not consulted. It is something which ought to be considered on a wider basis as it raises, among others, the issue of what principles should apply to make a partnership guilty of offences which involve *mens rea*. This is beyond the scope of this project. What we propose is a workable holding position pending a more thorough consideration of the criminal law in relation to partnerships.<sup>50</sup>
- 4.47 **We therefore recommend that except so far as is provided by or under any enactment, whether expressly or by necessary implication, a partnership should not be capable of committing an offence.** (Draft Bill, cl 8)

### **RULES FOR DETERMINING THE EXISTENCE OF A PARTNERSHIP**

- 4.48 In the Joint Consultation Paper,<sup>51</sup> we provisionally proposed that section 2 of the 1890 Act, which contains rules for determining the existence of a partnership, should be repealed. We justified our proposal on the basis that the section had served a historical purpose in clarifying some doubts which had arisen in particular cases but that the section was no longer required. We suggested that whether a partnership existed depended on an inference as to the true intentions of the

<sup>49</sup> See, for example, *Davey v Shawcroft* [1948] 1 All ER 827, 828 d-h, *per* Lord Goddard CJ.

<sup>50</sup> We do not propose to make provision for Scotland where the partnership already has a form of separate personality and is capable of committing certain criminal offences.

<sup>51</sup> Joint Consultation Paper, para 5.43(1).

partners as ascertained by examining the substance of their agreement.<sup>52</sup> To determine this it was necessary to consider all the circumstances of the case. The rules in section 2 merely provided guidance, by stating the weight to be attached to the facts mentioned, when such facts stood alone. We were not clear that the section served a useful function.

4.49 Consultees were divided on the proposal to repeal section 2. While a small majority of consultees agreed with the proposal, a significant number of consultees stated that they found the guidance useful or otherwise argued for its retention.

4.50 On further consideration, we have departed from our provisional proposal. We recognise that many practitioners continue to find the guidance useful. We note that RUPA has preserved similar rules.<sup>53</sup> We recommend that the guidance should be included in the draft Bill but in modern language.

4.51 In so doing, we aim to retain the substance of section 2 of the 1890 Act.<sup>54</sup> The ultimate test of the existence of a partnership is whether the persons are carrying on a business with the object of making a profit. In applying this test, the court looks at all the circumstances to ascertain the real agreement between the parties. The value of section 2 of the 1890 Act is that it gives a list of indications as to the existence or non-existence of partnership. Thus the receipt by the alleged partners of a share of the profits of a business, if it is the only fact in the case, is sufficient of itself to establish a partnership.<sup>55</sup> But if other facts are established which point in another direction, the sharing of profits is not of itself sufficient to establish a partnership. It will be very rare that the only relevant fact which is established is the sharing of profits. What may be more valuable as guidance is a statement of examples of circumstances which do not by themselves give rise to a partnership. For example, in contrast to the sharing of profits, neither co-ownership nor the sharing of gross returns is sufficient in itself to establish a partnership.<sup>56</sup>

4.52 Consultees supported the repeal of the requirement, in section 2(3)(d),<sup>57</sup> that for a lender to rely on the provision that the mere receipt of a share of the profits as consideration for the loan did not make him a partner, the loan contract had to be in writing and signed by or on behalf of all the parties.

4.53 **We therefore recommend that the guidance in section 2 of the 1890 Act for determining the existence of a partnership should be re-enacted in**

<sup>52</sup> See para 4.19 above.

<sup>53</sup> RUPA, s 202.

<sup>54</sup> The wording of s 2 has been criticised and can be improved. See Lindley on Partnership (5<sup>th</sup> ed 1888) Supplement pp 18-19 and G. Morse, *Partnership Law* (5<sup>th</sup> ed 2001) pp 49-57.

<sup>55</sup> 1890 Act, s 2(3); *Badeley v Consolidated Bank* (1888) 38 Ch D 238, 258 *per* Lord Lindley.

<sup>56</sup> 1890 Act, s 2(1) and (2).

<sup>57</sup> “The advance of money by way of loan to a person engaged or about to engage in any business on a contract with that person that the lender shall receive a rate of interest varying with the profits, or shall receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such. *Provided that the contract is in writing, and signed by or on behalf of all the parties thereto...*” The words in italics are the proviso which we recommend should not be re-enacted.

**modern language subject to the repeal of the proviso to section 2(3)(d).**  
(Draft Bill, cl 1(7) and Schedule 1)

## **CONCEPTS IN THE DRAFT BILL**

### **Partnership agreements**

- 4.54 We discussed above the need for an agreement to constitute a partnership and we emphasised that the agreement or any of its terms may be express or inferred from conduct.<sup>58</sup> The partnership agreement which constituted the partnership also provides the constitution which governs the partnership and the relationship between the partners. The agreement may contain a mechanism for the amendment of certain of its terms, for example by a special majority vote. In the absence of such a provision it requires the agreement of all the proposed partners or, after the partnership has been formed, all the partners to vary the partnership agreement. We consider that the draft Bill should contain a provision to this effect.
- 4.55 **We therefore recommend that a partnership agreement may be varied in accordance with its terms or with the agreement of all existing partners (or before the formation of the partnership with the agreement of all proposed partners).** (Draft Bill, cl 4)

### **Default partnership rules**

- 4.56 The flexibility of partnership law depends on allowing partners to determine the terms of their agreement. The 1890 Act, by creating default rules which govern the relationship between the partners subject to any contrary agreement, preserves this flexibility. Section 19 of the 1890 Act provides:
- The mutual rights and duties of partners, whether ascertained by agreement or defined in this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.
- 4.57 We aim to preserve this flexibility and also to make clear which of the rules in the draft Bill are default rules and which are not. This we do by stating in each clause whether or not it is a default rule. We consider that it would be useful also to define a default rule as a rule which applies in relation to a partnership if the point dealt with in the rule is not dealt with in the partnership agreement. As default rules confer rights and duties on partners which the partners may wish to enforce against each other, we think that there should be a statement of the status of the default rules as terms of the partnership agreement. They perform the function of statutorily implied terms and we propose that a default rule should be treated as if it were a term of the partnership agreement so that partners may enforce their rights against each other in contract.<sup>59</sup> Finally, we think that it should be provided

<sup>58</sup> Paras 4.18 – 4.20 above.

<sup>59</sup> This is subject to the exclusion of contract law doctrines as grounds for breaking up a partnership. See para 8.124 below.

that partners may modify or exclude a default rule in accordance with the terms of the partnership agreement or if all the partners agree.<sup>60</sup>

4.58 **We therefore recommend that:**

- (1) A default rule should be defined as a rule which applies in relation to a partnership if the point dealt with in the rule is not dealt with in the partnership agreement;**
- (2) If a default rule applies in relation to a partnership it should be treated as if it were a term of the partnership agreement; and**
- (3) The partners may modify or exclude the application of a default rule in relation to a partnership in accordance with the partnership agreement or if all the partners agree. (Draft Bill, cl 5)**

<sup>60</sup> Partners will not be able to modify or exclude default rules which have conferred rights on a former partner without his consent. See para 8.81 below.

# **PART V**

## **SEPARATE LEGAL PERSONALITY**

### **INTRODUCTION**

- 5.1 One can look at a partnership either as an aggregation of the individual partners or as an entity separate from its partners. English law has adopted the aggregate approach and many Commonwealth countries have adopted or adapted the English law of partnership. Scots law has an entity approach. The United States of America have recently moved from the aggregate approach to an entity approach in the enactment of the Revised Uniform Partnership Act (RUPA).<sup>1</sup>
- 5.2 Partnership operates in similar ways whichever approach is adopted. Although the conceptual bases are different, English law and Scots law tend to reach the same result in practical terms on most issues of partnership law.<sup>2</sup> For example, the liability of partners for partnership debts arises in English law through a partner's status as agent for the other partners: the partners are liable as principals for the obligations incurred by their agent. In Scots law the partners are the agents of the partnership and are liable for the partnership's debts. In substance the same result is achieved.

### **CONSULTATION**

- 5.3 Our proposal in the Joint Consultation Paper that English law should adopt an entity approach to partnership received support from many prominent consultees who represented a wide range of interests.<sup>3</sup> But several distinguished and influential legal bodies opposed it.<sup>4</sup> Having reached the view that it is appropriate to recommend the adoption of the entity approach, we set out in this Part the reasons for our decision and the characteristics of separate personality in the draft Bill.
- 5.4 As all of the Scottish consultees supported the retention of separate legal personality in Scots law, the discussion of the reasons for recommending separate legal personality concentrates on English law.

<sup>1</sup> RUPA was finalised by the National Conference of Commissioners on Uniform State Laws in 1994.

<sup>2</sup> English and Scottish partnerships are governed by the same legislation, the 1890 Act.

<sup>3</sup> They included the Association of Partnership Practitioners, the Institute of Chartered Accountants in England & Wales, the Association of Chartered and Certified Accountants, the Architecture and Surveying Institute, the Association of Consulting Actuaries, the Association of District Judges, the Construction Industry Council, the Institute of Directors, the City of Westminster Law Society and Holborn Law Societies, Clifford Chance LLP, Professor Geoffrey Morse and Roderick Banks. The Royal Institution of Chartered Surveyors and the British Bankers' Association favoured the introduction of legal personality through the registered partnership.

<sup>4</sup> They included the Chancery Bar Association and the Law Reform Committee of the Bar Council. The Law Society and Michael Twomey considered that legal personality was unnecessary.

## THE REASONS FOR RECOMMENDING SEPARATE PERSONALITY

### Clarity and commercial perception

5.5 We believe that separate legal personality is the clearest way of explaining the nature of partnership, particularly if our recommendations for continuity of partnership are adopted.<sup>5</sup> The suggestion that English partnership law should adopt legal personality is not new.<sup>6</sup>

5.6 Many people in partnerships view the partnership as an entity. Many clients of partnerships take a similar view. As one consultee<sup>7</sup> stated:

Partnerships often operate as though they were an entity. ... Not only will [independent legal personality] bring the law into line with practice, it will make a legal reality of the relationship assumed by clients.

5.7 This has long been recognised. Lord Lindley summarised the commercial view of partnership in these words:

The partners are the agents and sureties of the firm: its agents for the transaction of its business; its sureties for the liquidation of its liabilities so far as the assets of the firm are insufficient to meet them. The liabilities of the firm are regarded as the liabilities of the partners only in case they cannot be met by the firm and discharged out of its assets.<sup>8</sup>

English law provides otherwise.

5.8 By adopting the aggregate approach English law hinders continuity of partnership: a partnership, which is seen as a relationship between individuals or as a contract between individuals, ceases when the identity of the partners changes. A partnership comprising different individuals is a different relationship. But the commercial client who dealt with a partnership over time would be surprised to learn that a partnership had ceased to exist and that a new partnership had been created on each occasion when a partner retired or a new partner was admitted. The client would be surprised to learn that he had transacted with several different partnerships over time and that he might require to pursue legal remedies for past wrongs against different aggregations of persons. There is a gulf between the commercial perception of, and the legal characterisation of, partnerships.

<sup>5</sup> See Part VIII below.

<sup>6</sup> In 1855 the Mercantile Law Amendment Committee in their Second Report suggested that English law should adopt separate legal personality. Lord Lindley in his Supplement on the 1890 Act appears to have regretted a lost opportunity to make this innovation: *Lindley & Banks*, para 1-10.

<sup>7</sup> The Construction Industry Council.

<sup>8</sup> Quoted in *Lindley & Banks*, para 3-02. Under our recommendations a creditor of a partnership can enforce a claim against the partners who are liable for that claim without first exhausting enforcement against the assets of the partnership. This contrasts with the approach in RUPA. See paras 7.51 and 7.53 below.

- 5.9 The contrast between the commercial view and the legal view of partnership is borne out by the consultation responses which we received. It is notable that representative bodies of professions and businesses which operate in partnerships generally supported the introduction of separate legal personality.

### **A solution to practical problems**

- 5.10 There is a widespread practice by which partners agree in their partnership agreements to continue in partnership on the withdrawal of a partner or the assumption of a partner. The introduction of continuity of partnership as a default rule would reflect this practice. English law, while retaining the aggregate approach, has adopted pragmatic solutions to overcome the incompatibility of the aggregate approach with continuity of partnership. The following are examples.

### ***Existing pragmatic solutions***

- 5.11 In litigation, the Civil Procedure Rules (CPR) allow a court action by or against a partnership to be in the name in which the partners carried on business when the cause of action accrued.<sup>9</sup> The Rules also provide that the creditor obtaining judgment against the partnership may enforce the judgment against any property of the partnership within the jurisdiction.<sup>10</sup> While the drafters of the Rules may not have had in mind enforcement after a change in membership of a firm, it appears from the wording of the Rule that if there has been a change in partners since the cause of action accrued, the Rules allow enforcement against the assets of the “new” partnership or at least the assets of the “old” partnership which can be traced in the hands of the “new” partnership.
- 5.12 The English partnership is treated as if it were a separate legal entity for the purposes of Value Added Tax. Section 45 of the Value Added Tax Act 1994 provides that persons carrying on business in partnership may register for VAT in the name of the partnership and that no account is to be taken of changes in the membership of the partnership. H M Customs and Excise thus administer VAT as if partnerships already have continuing separate legal personality. By contrast, the Inland Revenue taxes partners as individuals and ignores the existence of the partnership for the purposes of income tax and capital gains tax. We understand that this approach<sup>11</sup> will continue if our recommendations are implemented.<sup>12</sup>
- 5.13 The 1890 Act itself attempts to reconcile the aggregate approach with economic reality, particularly where a partnership business continues on a change of members, in several provisions which appear to assume that the partnership is something different from the members at any one time. Thus sections 10 and 11 of the 1890 Act speak of the “liability of the firm” for certain losses; section 17(1) of a person being admitted as a partner “into an existing firm”; section 17(2) of a person who “retires from a firm”. But the Act is not consistent: other provisions

<sup>9</sup> CPR, Sched 1, RSC O 81, r 1.

<sup>10</sup> CPR, Sched 1, RSC O 81, r 5(1) provides “where a judgment is given or order made against a firm, execution to enforce the judgment or order may, subject to rule 6, issue against any property of the firm within the jurisdiction”.

<sup>11</sup> Which is also followed in Scotland.

<sup>12</sup> See the statement of the Inland Revenue quoted in para 3.53 above.

suggest that a new partnership is constituted on a change in membership.<sup>13</sup> While the 1890 Act may be pragmatic, we doubt whether that is a satisfactory solution.

### ***Practical problems***

#### (A) THE APPROACH OF LEADING TEXTBOOKS

- 5.14 Leading textbook writers on partnership law have identified many practical problems resulting from the aggregate approach and the lack of legal personality.<sup>14</sup> Professor Morse<sup>15</sup> states:

There are many problems associated with this lack of legal personality. Not least are the practical difficulties in relation to the ownership of property and the continuation of contractual rights and obligations of the partners when there is a change in the membership. If X contracts with A, B and C as partners, how does that continue if, say, either A leaves the firm or D joins it?<sup>16</sup>

- 5.15 *Lindley & Banks* also focuses on the problems which can occur on a change in the partners:

Because the firm name represents no more than a convenient means of describing the partners who for the time being make up the firm, whenever the partners change that name must take on a new meaning. This can lead to a number of complications.<sup>17</sup>

- 5.16 The current editor then lists a number of examples of such complications,<sup>18</sup> including the problems of authority given to or on behalf of a partnership:

An authority given to two partners to take out insurance in their names does not authorise them to insure in the names of themselves and a third party whom they subsequently take into partnership. Similarly, if a firm, A, B and C, has an agent D, and C retires, D may continue to be agent of the firm but he will in reality be the agent of A and B, but not C.

- 5.17 Higgins and Fletcher, in their textbook on partnership in Australia and New Zealand, suggest that the refusal to recognise the partnership as a legal entity, distinct from its constituent members, has in the past caused many difficulties some of which, such as the rules relating to partnership litigation, have been solved by legislation. They criticise the aggregate approach as leading to “a high degree of artificiality” when it is necessary to distinguish the property of the individual

<sup>13</sup> See the 1890 Act, ss 17(3) and 18.

<sup>14</sup> We have referred to Michael Twomey on the drawbacks of the partnership at will (para 3.8 above) and to Lord Lindley’s support for separate legal personality (para 5.5, footnote 6).

<sup>15</sup> Morse, *Partnership Law* (5<sup>th</sup> ed 2001) p 4.

<sup>16</sup> We discuss the problems relating to property and contracts in paras 5.18 – 5.23 below.

<sup>17</sup> *Lindley & Banks*, para 3-08.

<sup>18</sup> *Ibid*, paras 3-09 – 3-16.

partner from the common property of the partnership and for creating intricate problems on insolvency.<sup>19</sup>

#### (B) THE APPROACH OF THE COURTS

- 5.18 The courts have tried to reconcile the law with commercial reality. A good example of the modern attitude of the courts is *Sheppard & Cooper Ltd v TSB Bank plc*.<sup>20</sup> A bank sought to appoint two partners of a firm of accountants as receivers of the plaintiff company, notwithstanding a previous agreement that the firm would take no part in management of the company's affairs then or in the future. The Court of Appeal dismissed the bank's argument that the agreement did not apply because one of the partners had joined since the date of the agreement. The Court stated:

... it is submitted that we should so construe this agreement that it relates only to the persons who were the partners of the firm at the date of the letter. ... I do not believe that that is a realistic construction of the letter in accordance with normal commercial practice today. When you have a big firm of accountants, or solicitors for that matter, a reference in a contract of this nature to "the firm" must, in my view, be taken to mean the partners for the time being of the firm, whenever the time arises.<sup>21</sup>

- 5.19 This approach to the construction of contracts with a partnership, which is sometimes called a contract "with the house", avoids absurdity where the parties must have intended that the contract would survive changes in the membership of a partnership.<sup>22</sup> As one of the principal reforms which we recommend in this report is the introduction of a default rule of continuity of partnership, the introduction of separate legal personality gives a much firmer conceptual basis for the practical result which the courts seek to achieve.<sup>23</sup>

#### ENFORCEMENT OF PARTNERSHIP DEBTS

- 5.20 The rules on the liability for, and enforcement of, partnership debts where there is a continuing partnership business would be much simpler in relation to a partnership with separate legal personality which adopted our default rule of continuity of partnership. The creditor of a continuing partnership would be able to enforce a judgment against the assets of the partnership as well as against the assets of the partners who were partners at the time when the obligation was

<sup>19</sup> Higgins & Fletcher, *The Law of Partnership in Australia & New Zealand* (8<sup>th</sup> ed 2001) pp 11 – 12.

<sup>20</sup> [1997] 2 BCLC 222.

<sup>21</sup> *Ibid* at p 227 *per* Sir John Balcombe.

<sup>22</sup> We discussed the contract "with the house" in the Joint Consultation Paper, paras 4.41 – 4.42 and identified the conceptual difficulty as to how the "new" partnership (or new partner) which had not entered into the contract was bound by it.

<sup>23</sup> At the same time if a third party wishes to have a contractual relationship with a partnership only so long as the membership of that partnership does not change, he will be able to do so under our recommended scheme just as he can in the existing law.

entered into or the wrong occurred.<sup>24</sup> The partners who had joined the partnership since the date when the relevant contract was entered into or a wrong occurred would not be liable to meet the judgment out of their personal assets but the capital which they invested in the partnership would be at risk.<sup>25</sup> This has been the approach of partnership law in the United States since 1914.<sup>26</sup>

#### TRANSFER OF PARTNERSHIP PROPERTY

- 5.21 There may be some doubt as to how English law provides for the transfer of property on a change of membership in a continuing partnership. In theory at least, the aggregate approach to partnership creates a problem for a continuing partnership. Where a partnership is initially the aggregate of A, B and C but A resigns and D is admitted as a partner, a new partnership comes into being as the aggregate of B, C and D.<sup>27</sup> The problem is how the property of the “old” partnership comes to be transferred to the “new” partnership. Nor is the problem merely theoretical. In the United States a court has held that a successor partnership did not have title to enforce a title insurance policy that had been issued to an “old” partnership.<sup>28</sup> It is clearly important to ensure that on a change of membership the “new” partnership is able to take the benefit of contracts which the “old” partnership has entered into. Continuity of partnership and an entity approach is a transparent way of achieving this.
- 5.22 Section 20 of the 1890 Act provides that partners are to hold and apply partnership property exclusively for the purposes of the partnership and that land is held in trust for those beneficially interested in the land. Complications can arise on a change in membership of a firm. Where land is held in trust for the partnership, the incoming partner need not become a trustee but would on joining the firm become entitled beneficially as tenant in common. A retiring partner normally ceases to be beneficially entitled on retirement. He may also choose to retire as trustee as well. In some circumstances, where there have been significant changes in the membership of the firm, it may be desirable to transfer the land to new trustees.
- 5.23 Again, separate legal personality would simplify this: the continuing partnership could hold property, including land, in its own name or be the beneficiary of a

<sup>24</sup> The persons may no longer be members of the partnership when the claim is made. In our recommendations the date at which secondary liability is incurred in relation to a tort or delict is the date of the act or omission. See paras 6.79 – 6.80 below.

<sup>25</sup> See our discussion of the liability of the incoming and outgoing partner in Part VI below. The incoming partner’s capital would be an asset of the continuing partnership and would thus be available to the creditor of the partnership. The new partner could also expose his personal assets indirectly if the continuing firm gives an indemnity to an outgoing partner in relation to the partnership’s obligations.

<sup>26</sup> UPA 1914, s 17 and now RUPA 1994, s 306.

<sup>27</sup> See *Income Tax Commissioners for the City of London v Gibbs* [1942] AC 402. See also Lord Lindley, quoted in *Lindley & Banks* at para 3-04, who states “The law, ignoring the firm, looks to the partners composing it; any change amongst them destroys the identity of the firm; what is called the property of the firm is their property, and what are called the debts and liabilities of the firm are their debts and their liabilities.”

<sup>28</sup> *Fairway Development Co v Title Insurance Co* 621 F Supp 120 (ND Ohio 1985). This case influenced the drafters of RUPA to adopt a default rule of continuing legal personality.

trust in which trustees hold property for it.<sup>29</sup> It would also make the legal mechanisms by which a continuing partnership holds property easier for a non-specialist to understand.<sup>30</sup>

#### PARTNERSHIP INSOLVENCY

- 5.24 The adoption of an entity approach which allows a partnership to hold property in its own name or to have property held in trust for it should also help to clarify what belongs to the partnership and what comprises the partners' separate estates. This should simplify the reform of partnership insolvency in England and Wales. It is proposed that there will be a review of the Insolvent Partnerships Order 1994 in the light of our recommendations in this report.<sup>31</sup>

#### **Conceptual clarity**

- 5.25 We have been struck by the lack of clarity in English law on the conceptual basis of partnership. In particular, the recent case of *Hurst v Bryk* has revealed considerable uncertainty as to the respective roles of contract law and equity in partnership law.<sup>32</sup> In that case, the judge at first instance and the Court of Appeal decided that the contractual doctrine of repudiation of contract applied to partnerships with the effect that an acceptance by the innocent parties of a repudiation of a partnership agreement dissolved the partnership. In the House of Lords, Lord Millett<sup>33</sup> called into question this approach and suggested that such contractual doctrines did not apply to partnership. He argued that while a contract is necessary to bring a partnership into being, the partnership once created is subject to the control of the courts of equity. Unless the partnership was dissolved by agreement, it was for the courts of equity to control its dissolution. On this approach contractual doctrines such as repudiation of contract and frustration would not, by themselves, bring about a dissolution. Neuberger J in *Mullins v Laughton*<sup>34</sup> has followed Lord Millett's approach.
- 5.26 The introduction of separate legal personality will give statutory form to this approach. The draft Partnerships Bill will provide the framework in which a partnership comes into existence and is terminated. The grounds of termination will be those, if any, which the partners agree upon in their partnership agreement and those set out in the Bill.<sup>35</sup> The partnership will not be terminated by the

<sup>29</sup> See Part IX below. It has been suggested to us that a constructive trust would operate to allow the partnership property to be held for the new firm. Whether or not this is the case, there is scope to simplify the holding and transfer of partnership property.

<sup>30</sup> It would also deal with the complications caused by a change in the partners which *Lindley & Banks* list in paras 3-08 to 3-16.

<sup>31</sup> See para 12.82 below.

<sup>32</sup> *Hurst v Bryk* is unreported at first instance (Carnwath J 11 April 1995); the Court of Appeal's decision is reported in [1999] 1 Ch 1 and the House of Lords' in [2002] 1 AC 185.

<sup>33</sup> Lord Millett's speech provided the reasons for the decision with which the other Law Lords concurred. The House of Lords did not decide the question whether an innocent partner's acceptance of repudiatory breach automatically dissolved a partnership.

<sup>34</sup> [2003] Ch 250.

<sup>35</sup> See Part VIII below.

operation of contractual doctrines such as frustration and repudiation of contract but by agreement or by order of court.

- 5.27 Although we recommend curtailing the use of contractual doctrine as a means of terminating a partnership, the partnership agreement, which will either be the terms agreed by the partners or the implied terms of the default code, will provide a constitution for the partnership. In addition, the rules of equity,<sup>36</sup> on which Lord Millett places such emphasis, will continue to have a major role in delineating the rights, duties and responsibilities of the partners.<sup>37</sup>

### ***Consistency with other developments in partnership law***

#### SCOTLAND

- 5.28 Scotland has long had an entity-based partnership law which in practice operates in a very similar way to English law. The entity approach has not caused difficulty except in the failure of Scots law to provide clearly for continuity of personality on changes in the membership of a partnership. Our recommendations in this report seek to remedy that lack of follow-through in the Scottish entity approach.
- 5.29 The adoption of an entity approach in English law enables us to recommend a coherent approach to partnership in the two British jurisdictions. But while that is a desirable end in itself, it is a secondary consideration beside the practical benefits which the entity approach can provide.

#### EUROPE

- 5.30 Many European jurisdictions confer some degree of legal personality on commercial partnerships in a variety of ways. The jurisdictions include France, Luxembourg, Norway and Sweden. Belgium, Germany, the Netherlands and Switzerland have partnerships which do not have legal personality but have certain attributes which are consistent with legal personality such as the ability to sue and be sued, the right to hold property, or the postponement of a creditor's recourse against the partners until he has exhausted his remedies against partnership assets. In December 2002 a Bill was introduced in the Netherlands Parliament to replace their ordinary partnership,<sup>38</sup> which does not have legal personality, with a public partnership<sup>39</sup> in respect of which the partners may opt for legal personality.<sup>40</sup> The

<sup>36</sup> In Scots law, which does not have separate rules of equity, the duty of good faith as between the partners together with the contractual duties of the partners under the partnership agreement or in the implied contractual terms of the default code will enable the court to achieve similar results to those achieved in English law by application of the rules of equity.

<sup>37</sup> We discuss in Part XI below the fiduciary duties of partners. Contractual doctrines such as mutuality of obligation and the fiduciary duties of the partners which enable the partners to regulate each other's conduct where a partner is acting in breach of contract or in breach of his fiduciary duty will continue to apply. See para 8.123 below.

<sup>38</sup> Vennootschap onder firma or VOF.

<sup>39</sup> Openbare vennootschap.

<sup>40</sup> In addition the Bill introduces the silent partnership or stille vennootschap. It has also been announced that the new partnerships will be transparent for the purposes of individual and company income tax.

United Kingdom itself has introduced a partnership with separate legal personality in legislating for the limited liability partnership.<sup>41</sup>

#### THE UNITED STATES' EXPERIENCE

5.31 The law of partnership in the United States is closer to the partnership models in the British jurisdictions than the European models and we have derived much help from persons who were involved in drafting RUPA.

5.32 In the United States, the debate between the “entity” and “aggregate” schools has a long history.<sup>42</sup> The roots of partnership law were based in the common law, and the Uniform Partnership Law of 1914 drew on the model of the 1890 Act.<sup>43</sup> However, it seems to have been pure chance (the death of the original chief drafter) that the Uniform Partnership Act of 1914 (UPA) adopted the aggregate approach:

The UPA did not settle the nature of partnership. Its original chief drafter, Dean Ames, would have defined a partnership as “a legal person” in the act. Dean Lewis who became the chief drafter after the death of Ames, was unwilling to go so far and said that the act did not embody the legal person theory. He did retain most of the specific entity-based provisions ... since these solved the major problems that motivated the act.<sup>44</sup>

5.33 In 1994, in RUPA, the issue was unambiguously resolved in favour of the entity theory. Section 201 provides simply:

A partnership is an entity distinct from its partners.

5.34 From our study of the commentaries, and discussion with those involved,<sup>45</sup> it seems that this provision was adopted because it was seen as a logical development of the existing law rather than a radically new solution. The reporters have commented that it was introduced towards the end of the revision project, in

<sup>41</sup> The Limited Liability Partnerships Act 2000.

<sup>42</sup> See Bromberg and Ribstein on *Partnership* para 1.03 “Partnership as a legal entity” (We are very grateful to Larry Ribstein for persuading his publishers to give us a free copy of this authoritative, four volume work on Partnership Law). The authors note that in Louisiana and Puerto Rico, which followed the civil law, partnerships were characterised as separate entities: para 1.03(b) n 3.

<sup>43</sup> For a comparative historical treatment, see Deborah DeMott, “Transatlantic perspectives on Partnership Law: Risk and Instability”, *Journal of Corporation Law* *loc cit* pp 879, 882-3. She records that the draftsman of the 1914 Act took “particular authorial pride in having reduced, to 12 lines, the Partnership Act’s one-page treatment of when a recipient of a share in profits is not a partner.” (cf 1890 Act s 2)

<sup>44</sup> Bromberg and Ribstein *op cit* para 1.03(b); see also De Mott *op cit*.

<sup>45</sup> These and other issues raised by RUPA were discussed at a conference (attended by the then Chairman of the Law Commission) at Tillburg University, Holland, in May 2001: “International Conference on Close Corporation and Partnership Law Reform in Europe and the United States”. Some of the papers have been published in the *Journal of Corporation Law* *loc cit*.

recognition that the single entity approach “provides simpler rules and is consistent with RUPA’s attempt to give partnerships greater stability”.<sup>46</sup>

- 5.35 This aspect of RUPA has not proved controversial. Bromberg and Ribstein<sup>47</sup> comment:

The aggregate/entity question has led to much confusion in partnership cases ... RUPA’s forthright entity characterisation is helpful for two reasons. First, it is an accurate description of partnership law (although it does not completely square with partners’ individual liability for partnership debts). Second, clear adoption of the entity theory should help to end the courts’ flip-flopping from one theory to another when they attempt to justify results with reference to the nature of partnership.<sup>48</sup>

- 5.36 Since 1994 most States have adopted RUPA. While the treatment of partners’ duties in RUPA has given rise to some controversy, we are not aware of any problems arising from the introduction of the entity approach into United States partnership law.<sup>49</sup> On the contrary, our discussions with American lawyers confirm our belief that it is possible to introduce greater clarity into the law by the entity approach without sacrificing the flexibility and informality which are attributes of partnership law in the British jurisdictions. Further, our recommendations preserve the right of creditors of a partnership to have recourse against the personal assets of the partners without first exhausting their remedies against the partnership estate, and protect the personal assets of the incoming partner against prior claims. We think that these recommendations should allay the fears of some consultees that an entity approach would alter fundamentally the rights of creditors and the liabilities of the incoming partner.<sup>50</sup>

### Summary

- 5.37 In summary we consider that the entity approach brings the law closer to the commercial perception of how a partnership works. We see it as an effective solution to practical problems. It is also much easier to understand and explain to

<sup>46</sup> Weidner and Larson: *The Revised Uniform Partnership Act: The Reporters’ Overview* (1993) 49 *The Business Lawyer* p 1.

<sup>47</sup> Ribstein has been a strong critic of other aspects of RUPA (notably its treatment of fiduciary duties): see eg Ribstein, “RUPA, not ready for prime time” (1993) 49 *The Business Lawyer* 45.

<sup>48</sup> Bromberg and Ribstein *op cit* para 103(d). Prof Allan Vestal, another critic of RUPA (see eg “The mess we have made of partnership law” (1997) 54 *Washington and Lee Law Review* 487) has commented (in an email of 11/6/01, responding to the suggestion that the change to entity status had proved “relatively uncontroversial”): “Your reading of the reception given the adoption of the entity theory is quite correct. There has been little if any controversy about it, in part I suspect because various courts had years ago fashioned common law fixes for the worst implications of the aggregate theory. So the move to the entity theory did not change many aspects of how lawyers handle day to day problems.”

<sup>49</sup> See Donald J Weidner “Pitfalls in Partnership Law Reform: Some United States Experience” [2001] Vol 26 *Journal of Corporation Law*, 1031.

<sup>50</sup> The Law Society expressed concern that the exposure of the personal assets of an incoming partner to prior partnership liabilities might damage professional partnerships by deterring people from becoming partners. Our recommendation in para 6.80 below should avoid this mischief, at least in the default code.

non-experts than some of the pragmatic solutions which English law has adopted to problems which are created by the aggregate approach. That is an important consideration in law reform particularly in relation to small business ventures. We observe that the entity approach has worked for over two centuries in Scotland without causing problems.<sup>51</sup> Adoption of the entity approach in English law will create a more coherent partnership law in the two British jurisdictions. We have been assisted by the more recent experience of the United States where the entity approach was adopted as the best means of achieving a similar policy result to that which we pursue, namely greater stability and continuity in partnerships. For these reasons, we recommend the adoption of an entity approach in English law.

### ***Partnership – a sui generis entity***

5.38 Adopting an entity approach to partnership does not mean that a partnership becomes a body corporate. We do not wish to import the often-antiquated rules of the common law of corporations into partnership law.<sup>52</sup> Partnership has its own rules relating to its formation, internal management, legal relations with third parties and termination.

5.39 A partnership will be a sui generis entity. Its characteristics will be determined by (a) the draft Partnerships Bill except so far as the provisions of that Bill are variable and varied by contract, (b) the terms of the partnership contract (if different from the default code in the Bill) and (c) the rules of common law and equity so far as not inconsistent with the express provisions of the Partnerships Bill. Although the draft Partnerships Bill does not include this formulation, it underpins our approach to partnership law reform and it is appropriate that we include it as a formal recommendation.

5.40 **We recommend that:**

**(1) A partnership should have legal personality separate from the partners but should not be a body corporate; (Draft Bill, cl 1(3)).**

**(2) A partnership should be viewed as a legal person whose characteristics are determined by (a) the draft Partnerships Bill except so far as varied by contract, (b) the terms of the partnership contract (if different from the default rules of the Bill) and (c) the rules of common law and equity so far as not inconsistent with the express provisions of the draft Partnerships Bill.**

### **Certain consequences**

#### ***The partnership as a partner***

5.41 A partnership which is a separate legal entity (partnership A) will be able to be a partner in another partnership (partnership B), just as a registered company can

<sup>51</sup> Apart from those occasioned by the uncertainty about continuity of personality.

<sup>52</sup> We refer here not to companies registered under the Companies Act 1985 but to the often ancient law of corporations: *Halsbury's Laws of England* (Fourth edition Reissue Vol 9(2)).

be. Instead of each of the partners in partnership A being partners in partnership B, partnership A itself will be the partner.<sup>53</sup>

***A statement of capacity***

- 5.42 As a partnership will be a separate legal entity, and to avoid the application of the rules of *ultra vires*, we have recommended that the draft Bill should contain a statement that the partnership, as a legal person, has unlimited capacity to act.<sup>54</sup>

***Transitional provisions***

- 5.43 As the introduction of separate personality and, more significantly, the introduction of continuity of partnership as a default rule, could alter the existing contractual rights of partners and third parties, we recommend that transitional provisions be included in the draft Bill to allow parties to consider their position and, if appropriate, to renegotiate their agreements.<sup>55</sup>

<sup>53</sup> See *Major v Brodie* [1998] STC 491, 510. The result would be that the partners in partnership A would not be partners in partnership B. Their involvement in carrying on the business of partnership B would be in their capacity as partners in partnership A. They would have secondary liability for partnership A's obligations arising out of its status as a partner in partnership B.

<sup>54</sup> See paras 4.41 – 4.42 above.

<sup>55</sup> See Part XIV below.

# **PART VI**

## **THE AGENCY AND LIABILITY OF A PARTNER**

### **INTRODUCTION**

- 6.1 This Part deals with six issues relating to the way in which a partner binds the partnership and the secondary liability of partners for the debts and obligations of the partnership. The issues are (1) the agency of a partner, (2) the liability of the partnership for obligations incurred by a partner, (3) the nature of a partner's liability for partnership obligations, (4) the liability of the incoming partner, (5) the liability of the outgoing partner and (6) the liability of a person who appears to be, but is not, a partner - the apparent partner.
- 6.2 In our recommendations, we adapt the existing law to the introduction of separate legal personality. In so doing we seek to preserve the intimate involvement of partners in the partnership business and their immediate liability for partnership obligations. Apart from the changes which flow from continuity of partnership, the recommendations to modernise and clarify the law do not alter substantially the law relating to the agency and liability of a partner. We recommend however that several provisions of the 1890 Act relating to the agency of a partner and the liability of the firm should not be re-enacted as it is appropriate to leave such matters to the general law of agency which has developed since 1890.

### **THE AGENCY OF A PARTNER**

#### **Existing law**

- 6.3 In English law a partner is the agent of the other partners.<sup>1</sup> In Scots law a partner is the agent of the partnership.<sup>2</sup> The difference is a consequence of the adoption of the aggregate approach in England and the entity approach in Scotland. The agency of a partner is a special form of agency which arises out of his status as partner and not out of a contract of agency with his principal.
- 6.4 The 1890 Act contains several provisions which specify the characteristics of the agency of a partner. Section 5 sets out the basic rules. A partner who acts within the scope of his actual authority (express or implied) will bind the partnership. A partner has implied authority to bind the partnership when he does anything which would be usual in the course of carrying on partnership business. Even if that implied authority has been revoked or limited, the partner will have apparent authority when he does things which amount to no more than carrying on the

<sup>1</sup> The partner's agency or power to bind the partnership arises from the status as partner and not from an agency contract. The current editor of *Lindley & Banks* (at para 12-05) suggests that a partner acts in a dual capacity, ie as agent for the partners collectively and as agent of the other partners in their individual and separate capacities. This, he suggests, is the pure form of mutual agency, but he notes that Lord Lindley did not recognise this dual capacity.

<sup>2</sup> The 1890 Act, s 5 obscures the differences between English law and Scots law by providing that "every partner is an agent of the firm and his other partners...".

partnership business in the usual way unless the third party has knowledge of the lack of authority.<sup>3</sup>

- 6.5 Section 6 provides that a partnership is bound by an act or instrument relating to the business of the partnership and done or executed in the firm-name by a partner or other person who is authorised to do so.<sup>4</sup> Section 7 provides that a partnership is not bound by a partner's pledging the credit of the partnership for a purpose apparently not connected with the partnership's ordinary course of business, unless the partner was authorised to do so. Section 8 provides that a partnership may effectually restrict the power of a partner to bind the partnership by giving notice of the restriction to third parties. Section 15 provides that an admission or representation made by a partner concerning partnership affairs and in the ordinary course of its business is evidence against the partnership. Section 16 establishes a general rule that notice to a partner who acts in the partnership business of any matter relating to partnership affairs operates as notice to the partnership. That general rule does not apply, however, where the partner in question commits or consents to a fraud on the partnership.

### **Our provisional proposals**

- 6.6 In the Joint Consultation Paper we proposed that where a partnership had separate legal personality a partner should be the agent of the partnership.<sup>5</sup> We also proposed the re-enactment of the other provisions relating to agency with certain minor amendments.

### **Consultation**

- 6.7 There was general support for the proposal to make a partner the agent of the partnership where the partnership had separate legal personality. The Inland Revenue, however, suggested that mutual agency was the justification for the existing rules on the taxation of partnerships and stated that it might be necessary to enact provisions similar to those in the Limited Liability Partnerships Act 2000 in order to preserve tax transparency. One consultee opposed the recommendation, arguing that the existing formula reflected the collective liability and the several liability of partners for partnership debts.
- 6.8 Several consultees suggested improvements to the presentation of the legal rules but only one of our recommendations for the re-enactment of the provisions provoked substantive comment.

<sup>3</sup> See *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 503 per Diplock LJ.

<sup>4</sup> This appears to refer to actual authority. See *Re Briggs & Co, ex p Wright* [1906] 2 KB 209.

<sup>5</sup> See the Joint Consultation Paper, para 9.7. This would involve the rewording of s 5 of the 1890 Act to remove the formula that a partner is "an agent of the firm and his other partners". The Partnership Bill initially referred to the partner as an agent of the other partners but an amendment in Standing Committee introduced the words "the firm and his" into cl 5 of the Partnership Bill after Lord Watson proposed amendments in order to include Scottish partnerships in the Bill viz *Hansard* (HC) 1 July 1890, third series, vol 346, col 417 and the amendments reported by the Standing Committee.

- 6.9 The Institute of Chartered Accountants in England & Wales (ICAEW) took issue with our proposal to re-enact section 16 (which provides that notice to a partner is notice to the partnership). They expressed concern that section 16 had been interpreted in a way which caused problems to accountants' professional practice.<sup>6</sup> They suggested that section 16 should be confined to legal notice given to the partnership and that it should exclude knowledge acquired by partners in the conduct of the partnership's professional and other activities. The Scottish Institute (ICAS) expressed similar concerns and pointed out that it was undesirable that all partners be deemed to be aware of confidential information about one client when dealing with another client's affairs. They suggested that the problems were particularly acute in audit and forensic investigation.

### **Reform recommendations**

- 6.10 We recommend that a partner should be the agent of the partnership. We believe that mutual agency is not consistent with separate legal personality. Our approach is consistent with the Limited Liability Partnerships Act 2000<sup>7</sup> and with RUPA.<sup>8</sup> This achieves conceptual clarity. However, partners will continue to be liable to third parties, as they are now, for partnership debts and obligations.<sup>9</sup> In particular, as discussed in Part VII below, we recommend that a creditor of a partnership may enforce a claim against the assets of a partner without first having to exhaust his remedies against the assets of the partnership.<sup>10</sup>
- 6.11 We have taken the opportunity in preparing this report and the draft Bill to review the need for several of the provisions in the 1890 Act relating to the agency of a partner. Although there is an argument that it is convenient to include provisions of the general law of agency which affect partnerships, there have been developments in the law of agency since 1890 and we do not think that it would be either necessary or appropriate to try to reproduce within the Bill a full statement of the law of agency as it applies to partnerships.
- 6.12 Section 5 of the 1890 Act provides that every partner is an agent of the firm and his other partners and sets out the usual authority of the partner. We think that it is desirable to set out the ordinary scope of authority of a partner; and to state that, while the partners can limit that authority, such a limitation will be ineffective against those dealing with the partner unless brought to their attention. Section 6 is, as we have suggested, concerned with the actual authority of a partner. In our

<sup>6</sup> They referred to a report by the Irish Review Group on Auditing which suggested that all partners were assumed to know everything known to their fellow partners. While the ICAEW doubted this interpretation they expressed concern that it would undermine the Chinese Walls which accountancy partnerships establish to prevent the dissemination of knowledge. Accountancy partnerships use Chinese Walls in an attempt to get round conflicts of interest when acting for different clients.

<sup>7</sup> The Limited Liability Partnerships Act 2000, s 6(1) provides that every member of a limited liability partnership is the agent of the limited liability partnership.

<sup>8</sup> RUPA, s 301(1) provides that each partner is an agent of the partnership for the purpose of its business.

<sup>9</sup> See para 6.59 below.

<sup>10</sup> See para 7.64(2) below.

view, there is no need to re-enact this provision which can be left to the general law of agency and to the particular agreements which partners make with each other.

- 6.13 We have reconsidered our proposal to re-enact section 7 of the 1890 Act, which regulates the liability of a partnership where a partner uses the credit of the partnership for private purposes.<sup>11</sup> We think that the provision is unnecessary. A partner has no implied authority to grant securities over partnership property to secure borrowing for his own purposes. Nor is such an act within a partner's apparent authority under section 5 of the 1890 Act as it would not be an act for carrying on in the usual way business of the kind carried on by the partnership. The rules in section 5 of the 1890 Act achieve the same result as section 7.
- 6.14 We think that there is no need to re-enact sections 8 and 15 of the 1890 Act. Section 8 provides that where a third person has notice that the partners have restricted the authority of a partner to bind the firm, any act by the partner in contravention of that restriction will not bind the firm in a question with that third person. In the modern law of agency this is simply an aspect of the rules relating to apparent authority: a third party who knows that an agent has no authority to transact cannot hold the principal bound as he has not relied on any representation of the agent's authority.<sup>12</sup> Section 15 of the 1890 Act, which provides that a partner's admission or representation concerning the partnership affairs and made in the ordinary course of its business is evidence against the firm, may be viewed either as a special rule of evidence or as an aspect of the apparent authority of a partner. On either view the section does not take matters very far, and we do not consider that it needs to be repeated. It provides merely that the representation or admission is evidence against the firm. It was enacted at a time when there were strict rules against hearsay evidence which might have made the admissibility of such an admission questionable. Under the present rules of evidence both in England and Wales and in Scotland there can be no doubt about the admissibility of such a statement.
- 6.15 We have also reviewed our provisional proposal to re-enact section 16 of the 1890 Act in the light of the concerns which the two Chartered Accountants' Institutes have expressed. Section 16 provides:

Notice to any partner who habitually acts in the partnership business of any matter relating to partnership affairs operates as notice to the firm, except in the case of a fraud on the firm committed by or with the consent of that partner.

- 6.16 It appears that the provision is not confined to formal notice given to the partnership but can operate to impute to a partnership knowledge gained by a

<sup>11</sup> Section 7 provides: "Where one partner pledges the credit of the firm for a purpose apparently not connected with the firm's ordinary course of business, the firm is not bound, unless he is in fact specially authorised by the other partners; but this section does not affect any personal liability incurred by an individual partner." The section enacted the common law set out in *Kendal v Wood* (1871) LR 6 Ex 243; see *Lindley on Partnership* (5<sup>th</sup> ed 1888) p 172 and the Supplement on the 1890 Act, p 29.

<sup>12</sup> Apparent authority is not actual authority but results from the operation of estoppel, or in Scotland, personal bar. See *Freeman & Lockyer v Buckhurst Properties (Mangal) Ltd* [1964] 2 QB 480, 502-503 *per* Diplock LJ.

partner while acting in the partnership business. A literal reading of section 16 would support such a view and justify the concerns of the two Institutes. On a strict reading of section 16 unfortunate results could occur. Thus suppose that one partner in a professional firm gained knowledge while acting for client A. That knowledge would, as it happens, be very useful to client B. Another partner in the firm is responsible for client B's affairs and does not know that information. If a literal interpretation of section 16 were adopted, knowledge of that information would be imputed to the second partner, giving client B a claim in negligence against him, if the second partner did not advise him in the light of it. This cannot be right.

- 6.17 The courts have attempted to restrict the imputation to other partners of knowledge gained by one partner of his client's affairs. A partnership may, with its clients' express or implied consent, act for different clients while respecting the confidentiality of each.<sup>13</sup> The courts have also sought to draw a distinction between knowledge "relating to partnership affairs" and knowledge relating to a client's affairs.<sup>14</sup>
- 6.18 There is also some uncertainty about the scope of the fraud exception at the end of section 16. It is consistent with the general law of agency that the knowledge of a partner who is guilty of a fraud on the firm is not imputed to the partnership.<sup>15</sup> But two questions arise. First, it is not clear why a formal notification made by a third party to a partner should not be effective notice to the firm where the third party was unaware that the partner was fraudulent.<sup>16</sup> Secondly, even on a broad interpretation of "fraud", it is unlikely that the term would cover circumstances where a partner was acting beyond his powers or was in breach of his duty to disclose to his partners what he had done.<sup>17</sup> It appears therefore that section 16, which was intended to reflect the general rules of agency,<sup>18</sup> has thus separated partnership from the continuing development of the general principles of agency by confining the exception to fraud. As a result textbook writers on partnership law have warned that one must be cautious about treating cases on agency outside the ambit of partnership as authoritative in partnership law.<sup>19</sup>
- 6.19 The general law of agency takes a more nuanced approach to the imputation of knowledge. It makes allowance for confidential information and it would more readily allow the distinction to be drawn between knowledge relating to

<sup>13</sup> See *Kelly v Cooper* [1993] AC 205, *Bolkiah v KPMG* [1999] 2 AC 222.

<sup>14</sup> See *Campbell v McCreath* 1975 SLT (Notes) 5, *Northumberland v Alexander* (1984) 8 ACLR 882, 904-905.

<sup>15</sup> See *Bowstead & Reynolds*, para 8-204.

<sup>16</sup> Notice of a fact given by a third party to a partner is not notice to the firm if the third party knew that the partner would fraudulently conceal the information from his partners: see *Bowstead & Reynolds*, para 8.204(1); *Lacey v Hill* (1876) 4 Ch D 537, 549 per Jessel MR.

<sup>17</sup> Lord Lindley (5<sup>th</sup> ed 1888) suggested that these were circumstances in which there would be no imputation of knowledge to the partnership but the current editor of *Lindley & Banks* (para 12-30) suggests that Lord Lindley's statement should be approached with caution as s 16 excepts only cases of fraud. See also Blackett-Ord, *Partnership*, (2<sup>nd</sup> ed) para 16.104.

<sup>18</sup> *Lindley on Partnership* (5<sup>th</sup> ed 1888) p 141 and Supplement pp 41 and 42.

<sup>19</sup> *Lindley & Banks*, para 12-30; Blackett-Ord, *Partnership* (2<sup>nd</sup> ed 2002) para 16.104.

partnership affairs and knowledge relating to a client's affairs and thus avoid the absurdity to which we referred above.<sup>20</sup>

6.20 *Bowstead & Reynolds* summarise the law on the imputation to a principal of knowledge gained by an agent in the following terms:<sup>21</sup>

(1) A notification given to an agent is effective as such if the agent receives it within the scope of his actual or apparent authority, whether or not it is subsequently transmitted to the principal, unless the person seeking to charge the principal with notice knew that the agent intended to conceal his knowledge from the principal.

(2) The law imputes to the principal and charges him with all notice or knowledge relating to the subject-matter of the agency which his agent acquires or obtains while acting as such agent.<sup>22</sup>

(3) Where an agent is authorised to enter into a transaction in which his own knowledge is material, or where the principal has a duty to investigate or make disclosure, the knowledge of the agent may be attributed to the principal whether it was acquired in connection with the agency or not.

6.21 We have come to the view that a re-enactment of section 16 of the 1890 Act would do more harm than good: it would preserve both the problem that a literal interpretation would lead to unacceptable results and the separation of partnership law from the general law of agency in relation to the imputation of knowledge. We see no need to re-enact section 16 and believe that the giving of notice and imputation of knowledge to a partnership are best left to the general law of agency.<sup>23</sup>

6.22 **We therefore recommend:**

- (1) That a partner should be the agent of the partnership and not the partners;** (Draft Bill, cl 6(3))
- (2) That a partnership should be bound by anything done by a partner for carrying on in the usual way business of the kind carried on by the partners;** (Draft Bill, cl 16(1))
- (3) But that a partnership should not be bound if the partner has no authority to do the thing on behalf of the partnership, and the**

<sup>20</sup> See para 6.16 above. See also the criticism of the fraud exception in agency law in Peter Watts "Imputed Knowledge in Agency Law" [2001] 117 LQR 300.

<sup>21</sup> *Bowstead & Reynolds*, Art 97, para 8-204.

<sup>22</sup> This principle is general but not unqualified. See paras 6.17 and 6.18 above.

<sup>23</sup> We do not think that there is a need to include in the draft Bill a provision in relation to the circumstances in which a partner is authorised to receive notices or information on behalf of a partnership. The general rules set out in cl 16 of the draft Bill relating to the agency (actual or apparent) of a partner should suffice: knowledge acquired by an agent while acting within the scope of his authority will normally be imputed to the principal. See *Taylor v Yorkshire Insurance Co Ltd* [1913] 2 IR 1, 21 *per* Palles CB.

**person with whom he is dealing has notice of his lack of authority or does not know or believe him to be a partner in the partnership;**  
(Draft Bill, cl 16(2))

- (4) That the rules in (2) and (3) above are subject to the provisions of the draft Bill on the execution of deeds in England and Wales.<sup>24</sup>**  
(Draft Bill, cl 16(3))

## **THE LIABILITY OF THE PARTNERSHIP FOR OBLIGATIONS INCURRED BY A PARTNER**

### **Existing law**

- 6.23 A partnership is bound by the acts of a partner through the agency of a partner as discussed in the preceding paragraphs. The 1890 Act also contains provisions on the liability of the partnership: (a) for wrongs committed by a partner (s 10); (b) for the misapplication of money or property received for the partnership or in its custody (s 11); and (c) in relation to the improper employment of trust property for partnership purposes (s 13).
- 6.24 The liability of a partnership for the wrongs committed by a partner does not extend to liability for loss or injury caused to another partner in the same partnership.<sup>25</sup>

### **Our provisional proposals**

- 6.25 In the Joint Consultation Paper we did not suggest radical changes to these provisions. We provisionally proposed however that it should no longer be the law that a partnership is not liable for loss or injury caused by one partner, acting with authority or in the ordinary course of the partnership's business, to another partner.<sup>26</sup> We also proposed a minor alteration to section 13 to cater for the separate legal personality of a partnership.

### **Consultation**

- 6.26 There was broad support for the proposal to extend the liability of a partnership to wrongs committed by one partner which caused loss and injury to another partner. But several consultees expressed concern over possible circularity as a wronged partner would ultimately bear a share of the liability to himself. One consultee expressed concern over insurance arrangements of a partnership. Another consultee suggested that it was sufficient that the partner who committed the wrong was liable.
- 6.27 Among the consultees who addressed the issue there was almost unanimous support for the proposal to amend section 13<sup>27</sup> to cater for separate personality.

<sup>24</sup> See the draft Bill, cl 20 and para 9.98 below.

<sup>25</sup> 1890 Act, s 10 refers to liability for loss and injury caused to "any person not being a partner in the firm".

<sup>26</sup> Joint Consultation Paper, para 10.26.

<sup>27</sup> Section 13 of the 1890 Act provides: "If a partner, being a trustee, improperly employs trust property in the business or on the account of the partnership, no other partner is liable for

One consultee, however, pointed out that section 13 addressed only English law and was not apt for the equivalent Scots law rules of unjustified enrichment and delict.

### **Reform recommendations**

- 6.28 We have reconsidered our approach to the liability of the partnership for wrongs committed by a partner on another partner. The issue is closely linked to the nature of the duty of care which a partner owes to the partnership and to his partners. Since the consultation exercise we have revised our views on whether there should be a statutory default rule defining the duty of care which a partner owes to the partnership and his partners. We now recommend that there should not be a statutory statement and that the issue of the duty of care should be left to the general law.<sup>28</sup>

### ***Vicarious liability of the partnership in tort or delict***

- 6.29 We think that the partnership should be liable for the wrongs committed by a partner which cause loss or injury to any person who is not a partner in that partnership.<sup>29</sup> This is the existing law.<sup>30</sup> In addition we think that the partnership should also be vicariously liable for loss and injury, which is so caused, to a partner in the partnership.

### ***Liability for loss to a partner***

- 6.30 The types of loss for which a partnership should be vicariously liable will be determined by the general law. They include a partner's personal injury or death caused by another partner acting in the ordinary course of the partnership's business or with the authority of the partnership.<sup>31</sup> In addition there is no reason why a partnership should not be liable for physical damage done by one partner in the course of partnership business to the private property of another partner. For example, a partner might damage another partner's car through carelessness in parking his car in the partnership's car park.<sup>32</sup> Similarly there is no reason why a partnership should not be liable for economic loss caused to a partner, other than loss to the value of the partner's share in the partnership. It would, however, be incongruous to make the partnership vicariously liable for a wrong committed by a partner against the partnership or the other partners where the loss caused by the wrong was simply a reduction in the value of the other partners' shares in the partnership. There the loss would be that of the partnership and the partner's loss

the trust property to the persons beneficially interested therein: provided as follows: (1) This section shall not affect any liability incurred by any partner by reason of his having notice of a breach of trust; and (2) Nothing in this section shall prevent trust money from being followed and recovered from the firm if still in its possession or under its control."

<sup>28</sup> See para 11.66 below.

<sup>29</sup> The partnership, of course, would not be liable for wrongs committed by a partner which caused loss only to the partnership itself.

<sup>30</sup> 1890 Act, s 10.

<sup>31</sup> This would reverse the result of the 1890 Act, s 10 and *Mair v Wood* 1948 SC 83.

<sup>32</sup> This example assumes that the use of the car was in the ordinary course of the partnership's business.

would be derived from the firm's loss. We think therefore that the vicarious liability of the partnership for damage to the property of another partner would not include financial loss through the diminution of the other partner's interest in the partnership.

### ***The provision of free or cut-price services***

- 6.31 Circumstances may arise where one partner undertakes professional services for another partner, for example in providing advice or selling and conveying his home. Why, it is asked, should the partnership not be liable for professional negligence which causes economic loss to the other partner in that context? We think that liability would depend on a proper analysis of the basis on which the services were provided on the particular facts of the case.<sup>33</sup>
- 6.32 For example, if one partner gets another to carry out work on his behalf gratuitously and as a favour, it is not evident that the partner carrying out the work is assuming personal responsibility to his partner for the work in question. But where the partner instructing the work asks his partner to treat him as if he were a client and the partner carrying out the work agrees to do so, it is easier to infer that the partner carrying out the work has undertaken a duty of care to his partner in carrying out the transaction. This duty would be different from those which arise as a result of the parties' relationship as partners. In such circumstances we think that the partnership would be vicariously liable for the economic loss which one partner causes the other through lack of reasonable care in advising him or carrying out the transaction. This, in turn, is because the partner in the ordinary course of business or with the authority of the partnership has taken on a duty of care to the other partner.<sup>34</sup>
- 6.33 We propose that the unlimited liability of partners for the obligations of the firm should exclude only liability for purely internal obligations of the partnership to present and former partners (liabilities of the partnership to a partner in his capacity as such); and that the internal rights of indemnity or contribution of a partner against the firm and other partners should be the subject of default rules. These are discussed below.<sup>35</sup>

### ***Liability for penalties***

- 6.34 Section 10 of the 1890 Act also provides that the partnership is liable for any penalty incurred by the wrongful acts and omissions of a partner acting in the ordinary course of business or with the authority of the partners. These penalties could cover both professional disciplinary penalties and also criminal penalties. We have considered whether it is appropriate that a partnership under English law

<sup>33</sup> In each case, for the partnership to be vicariously liable the partner's act or omission would have to occur either in the ordinary course of the partnership business or with the firm's authority.

<sup>34</sup> It has been pointed out that there is an element of circularity in this approach as the injured partner himself would incur secondary liability through the vicarious liability of the firm. We do not think that this matters as (a) he has a claim against the wrongdoing partner and (b) the vicarious liability of the firm gives him another person against whom he can seek at least partial reparation.

<sup>35</sup> See paras 6.60 – 6.65 below.

should be capable of committing a criminal offence and have concluded that it should not unless a statute expressly provides otherwise.<sup>36</sup> If therefore the norm is that a partnership is not criminally responsible, it would be odd for it to be responsible for penalties imposed on partners who were so responsible. While there are penalties which are not connected to criminal offences, for example penalties imposed by professional and other regulatory bodies, it will be a matter for the construction of the individual regulation as to how it impacts on a partnership and the partners. In these circumstances we do not recommend re-enactment of section 10.<sup>37</sup>

- 6.35 **We recommend therefore that a partnership should be vicariously liable to another person for loss or injury caused by the wrongful act or omission of any partner acting in the ordinary course of the partnership business or with the actual authority of the partnership.** (Draft Bill, cl 22)

***Vicarious liability of the partnership for misapplication of property by a partner***

- 6.36 Since the preparation of the Joint Consultation Paper we have reconsidered judicial decisions on the liability of a partnership for wrongs and for money and property received and have revised our views on whether it is necessary to re-enact sections 11 and 13 of the 1890 Act.
- 6.37 In *Bass Brewers Ltd v Appleby*,<sup>38</sup> Millett LJ explained the difference between sections 11 and 13 of the 1890 Act as follows:

Section 11 deals with money which is properly received by the firm (or by one of the partners acting within the scope of his apparent authority) for and on behalf of the third party but which is subsequently misapplied. The firm is liable to make good the loss. Section 13 is concerned with money held by a partner in some other capacity, such as trustee, which is misapplied by him and then improperly and in breach of trust employed by him in the partnership business. His partners can be made liable only in accordance with the ordinary principles of knowing receipt.<sup>39</sup>

- 6.38 In *Dubai Aluminium Company Limited v Salaam*,<sup>40</sup> the Court of Appeal held that a partnership's liability for wrongful acts and omissions under section 10 of the 1890 Act extended to knowing assistance of breach of trust and that it was not restricted to torts.<sup>41</sup> In the House of Lords,<sup>42</sup> Lord Millett agreed with the Court of Appeal in

<sup>36</sup> See para 4.47 above.

<sup>37</sup> The removal of the firm's liability for penalties is not intended to call into question Lord Millett's interpretation of s 10 of the 1890 Act – that it is not confined to tort/delict but covers every kind of wrong capable of causing damage to non-partners. See para 6.38 below. Clause 22 of the draft Bill is intended to have similar effect – but covers damage to partners as well as non-partners.

<sup>38</sup> [1997] 2 BCLC 700.

<sup>39</sup> *Ibid*, at p 711.

<sup>40</sup> [2001] QB 113.

<sup>41</sup> See also *Agip (Africa) Ltd v Jackson* [1990] Ch 265, Millett J at p 296.

rejecting the argument that section 10 was confined to torts or other common law wrongs. He emphasised that section 10 assimilated the vicarious liability of partners to that of employers and suggested that it would be absurd if a professional firm were vicariously liable for the acts of an employee but would not be liable if the same acts had been committed by a partner. He stated:

Wisely, and no doubt deliberately, section 10 was drafted in the widest terms to embrace every kind of wrong capable of causing damage to non-partners, so that there was no danger that the vicarious liability of partners (unlike that of employers) might be ossified by the terms of the statute and fail to keep step with future developments.<sup>43</sup>

6.39 Lord Millett rejected the appellants' argument that section 10 was concerned with liability in tort while sections 11 and 13 dealt with liability in equity. He said:

Sections 11 and 13 are not concerned with wrongdoing or with vicarious liability but with the original liability of the firm to account for receipts. I explained the difference between the two sections in *Bass Brewers Ltd v Appleby* [1997] 2 BCLC 700 at 711. Section 11 deals with money which is properly received by the firm in the ordinary course of its business and is afterwards misappropriated by one of the partners. The firm is not vicariously liable for the misappropriation; it is liable to account for the money it received, and cannot plead the partner's wrongdoing as an excuse for its failure to do so. Section 13 deals with money which is misappropriated by a trustee who happens to be a partner and who in breach of trust or fiduciary duty afterwards pays it to his firm or otherwise improperly employs it in the partnership business. The innocent partners are not vicariously liable for the misappropriation, which will have occurred outside the ordinary course of the firm's business. But they are liable to restore the money if the requirements of the general law of knowing receipt are satisfied.

...The critical distinction between section 10 on the one hand and sections 11 and 13 on the other is not between liability at common law and liability in equity, but between vicarious liability for wrongdoing and original liability for receipts. The firm (section 10) and its innocent partners (section 12) are vicariously liable for a partner's conduct provided that three conditions are satisfied: (i) his conduct must be wrongful, that is to say it must give rise to fault-based liability and not, for example, merely receipt-based liability in unjust enrichment; (ii) it must cause damage to the claimant; and (iii) it must be carried out in the ordinary course of the firm's business.<sup>44</sup>

6.40 We consider that the circumstances which section 11 covers – the receipt by a partner acting within the scope of his apparent authority or the receipt by the firm in the course of its business and the subsequent misapplication by a partner of the received money or property – are circumstances which would give rise to liability

<sup>42</sup> [2002] UKHL 48, [2003] 1 All ER 97, [2002] 3 WLR 1913 and [2003] 1 Lloyd's Rep 65.

<sup>43</sup> *Ibid*, at para 108.

<sup>44</sup> *Ibid*, at paras 110 and 111.

on the part of the firm in the general law. In each case the partnership will be answerable for the money or property which it or its agent received. We see no need to re-enact section 11.

- 6.41 In *Walker v Stones*<sup>45</sup> the Court of Appeal decided that it was not possible for a partnership to be vicariously liable under section 10 for breach of an express trust by one partner as this would contradict section 13; breaches of trust must fall outside the ordinary business of any partnership. If section 10 were to apply, it would presuppose that individual trusteeships which a partner may undertake are in the ordinary course of the business of a partnership and that would cover the exact situation described in section 13. The Court of Appeal recognised that it might appear anomalous that when a partner acts as a trustee he is not necessarily treated as acting in the ordinary course of business but pointed out that sections 10 to 13 applied to all partnerships and not merely solicitors' partnerships.<sup>46</sup>
- 6.42 In so far as the Court in *Walker v Stones* has held that breaches of trust by a partner are outside section 10, we respectfully disagree. The Court of Appeal felt constrained to reach what we regard as an unfortunate result because of its reading of section 13. We think that many breaches of trust give rise to fault-based liability. Section 13 applies only where a partner who is a trustee takes money in breach of trust and introduces it into the partnership. We think that it is unlikely that such a breach of trust would be committed "in the ordinary course of business" and give rise to vicarious liability of the partnership under section 10.<sup>47</sup> Section 13 does not apply where money is held by the partnership, one partner becomes a trustee of it and then breaches the trust.<sup>48</sup>
- 6.43 We see no need to re-enact section 13. Either (as we think) it merely states the law of knowing receipt, in which case it is unnecessary, or (contrary to our view) it produces the result which the Court of Appeal felt constrained to reach in *Walker v Stones*, in which case it is undesirable. Nor is the re-enactment of section 13 necessary for the purposes of Scots law.
- 6.44 In Scots law the obligation to make restitution is a duty imposed by law to reverse unjustified enrichment. In *Shilliday v Smith*,<sup>49</sup> the Lord President (Rodger) stated:

A person may be said to be unjustly enriched at another's expense when he has obtained a benefit from the other's actings or expenditure, without there being a legal ground which would justify him in retaining that benefit. The significance of one person being unjustly enriched at the expense of another is that in general terms it

<sup>45</sup> [2001] QB 902.

<sup>46</sup> *Ibid*, Sir Christopher Slade at p 950.

<sup>47</sup> Section 13 of the 1890 Act is also unnecessary because under the draft Bill the partners are not agents of each other (but rather, are agents of the partnership). As such there is no reason that one partner's breach of trust should result in liability for another partner unless the conditions in section 10 are fulfilled. Vicarious liability of the section 10 type is dealt with in cl 22 of the draft Bill.

<sup>48</sup> We note that *Walker v Stones* has been appealed to the House of Lords and our understanding is that it is likely to be heard in December 2003.

<sup>49</sup> 1998 SC 725.

constitutes an event which triggers a right in that other person to have the enrichment reversed.<sup>50</sup>

- 6.45 Where such unjustified enrichment arises, Scots law allows remedies to be devised to reverse the enrichment.<sup>51</sup> It has not developed detailed doctrines such as knowing assistance and knowing receipt.<sup>52</sup>
- 6.46 In English law the doctrines of knowing assistance and knowing receipt have been developing in recent years and may undergo further change. In Scotland also the law relating to unjustified enrichment has recently developed.<sup>53</sup> We think that it would not be appropriate to crystallise in statutory words the present state of the law as that would hamper further development in these fields.

## **THE LIABILITY OF PARTNERS FOR THE OBLIGATIONS OF THE PARTNERSHIP**

### **Existing law**

- 6.47 In English law partners are jointly liable with one another for the obligations of a partnership.<sup>54</sup> In Scots law they are jointly and severally liable.<sup>55</sup> In both jurisdictions a creditor of the partnership can recover a partnership debt by enforcement against a partner's assets without first enforcing against and exhausting the assets of the partnership.
- 6.48 In Scotland, where a partnership has separate personality, in theory the partnership is the primary obligant and the partners have a subsidiary liability. In *Mair v Wood*<sup>56</sup> the Lord President (Cooper) gave this description of partners' liability:

Partners are of course liable jointly and severally in a question with a firm creditor for the obligations of the firm, but the theory of Scots law views them as being so liable only *subsidiarie*, the partners being in substance guarantors or cautioners for the firm's obligations, and each being entitled on payment of a firm debt to relief *pro rata* from the others.

<sup>50</sup> *Ibid*, at p 727B-D. See also *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1996 SC 331, 348-349 *per* Lord Cullen.

<sup>51</sup> *Shilliday v Smith* 1998 SC 725, the Lord President (Rodger) at pp 727D-728C, *Morgan Guaranty Trust Co of New York v Lothian Regional Council* 1995 SC 151, the Lord President (Hope) at p 155B-D.

<sup>52</sup> In Scots law liability also arises where a person has knowingly profited from another's breach of trust. See *Clydesdale Bank v Paul* (1877) 4R 626; *Bank of Scotland v MacLeod Paxton Woolard & Co* 1998 SLT 258. We would suggest that in many circumstances this could be seen as fault-based liability.

<sup>53</sup> See, for example, *Shilliday v Smith* 1998 SC 725.

<sup>54</sup> 1890 Act, s 9. In English law the position is substantially similar if the liability is joint and several. See the Joint Consultation Paper, para 10.4.

<sup>55</sup> 1890 Act, s 9.

<sup>56</sup> 1948 SC 83, 86.

### **Our provisional proposals**

- 6.49 In the Joint Consultation Paper we proposed that partners in both jurisdictions should be jointly and severally liable for the debts and obligations of the partnership. We also proposed the abolition of the anomalous rule of English law that the liability of the estate of a deceased partner for partnership debts is subject to the prior payment of the deceased partner's separate debts.<sup>57</sup>
- 6.50 Our major proposals were:
- (1) that if separate legal personality were introduced the partnership should have primary liability and the partners' liability should be secondary;
  - (2) that creditors of a partnership should normally be required to obtain a judgment against a partnership before enforcing their claims against the assets of a partner but that they should not have to litigate twice nor should they be required to exhaust enforcement remedies against the assets of the partnership before enforcing the judgment against the partner's assets; and
  - (3) that a partner satisfying a claim against the partnership should have the right to be indemnified by the partnership, failing which, to the extent that he has paid more than his due proportion, he should have the right to a *pro rata* contribution from the other partners.<sup>58</sup>

### **Consultation**

- 6.51 Among English consultees there was strong support for making partners' liability joint and several and for the abolition of the anomalous postponement of partnership creditors' claims against the estate of a deceased partner.
- 6.52 There was also strong support for the introduction of subsidiary liability of partners in the context of separate legal personality in English law. But some consultees, who were opposed to legal personality, thought that the issues raised showed the unnecessary complexity of the entity approach to partnership. One consultee suggested that a requirement to look first to the entity before pursuing a partner might enable a miscreant partner to use separate personality to defeat the claim. Some consultees suggested that there should be procedural safeguards to protect the interests of partners.<sup>59</sup> We address these issues in more detail in Part VII below.<sup>60</sup>

<sup>57</sup> 1890 Act, s 9. Separate debts are a partner's debts which are not partnership debts: *Re Barnard* (1886) 32 Ch D 447.

<sup>58</sup> Joint Consultation Paper, para 10.20. We also made proposals about the enforcement of judgments against partners which we discuss in Part VII below.

<sup>59</sup> It was suggested that a former partner should have an opportunity to participate in proceedings against a partnership. Two Scottish consultees expressed similar concerns, attacking the proposal that a creditor could enforce a judgment against a partnership directly against the assets of a partner without it being necessary to obtain judgment against that partner.

<sup>60</sup> See paras 7.55 – 7.64 below.

6.53 Our proposal that the partnership creditor should not have to exhaust enforcement remedies against the assets of the partnership before enforcing the judgment against the assets of a partner is an important attribute of the separate legal personality which we proposed.<sup>61</sup> Almost all Scottish consultees supported it. It was also generally supported by English consultees, although some consultees thought that it undermined the separate personality of the partnership. Again we discuss this in more detail in Part VII below.

### **Reform recommendations**

6.54 We have considered the concerns of the minority of consultees about the nature of a partner's liability for partnership debts and obligations. The introduction of separate legal personality with the characteristics which we proposed will not give a partner a basis either for defeating a claim against him or for seeking postponement of enforcement against his assets. Our proposals will allow a creditor to proceed directly against the assets of a partner without first having to exhaust his remedies against the assets of the firm. In Part VII we propose that a creditor of a firm who seeks to enforce the debt against the assets of a partner or former partner should obtain judgment against that partner or former partner. The creditor can do this either by calling the partners as defendants in the action against the firm or by making a subsequent claim. That apart, creditors will have immediate recourse against partners' assets to enforce partnership debts.

6.55 We have not followed the approach of RUPA which requires a creditor of a partnership to enforce judgment against and exhaust partnership assets before levying execution against a partner's assets unless the court otherwise grants permission.<sup>62</sup> RUPA provides that a partnership creditor may not levy execution against the assets of a partner unless either (a) the partnership has failed to satisfy a writ of execution against it, (b) the partnership is bankrupt, (c) the partner has agreed that the creditor need not exhaust partnership assets or (d) the court in its discretion grants permission to do so.<sup>63</sup>

6.56 In our view, it is consistent with partnership law and practice in both of the British jurisdictions, and with the expectations both of partners and partnership creditors, that a creditor should have immediate recourse against a partner's assets. There was very limited support among consultees for changing this. To do so would significantly alter an important characteristic of partnership law in Great Britain. In the absence of demand to do so, we see no need for reform. It is against this background that we make our recommendations on the nature of a partner's liability for partnership debts and obligations.

<sup>61</sup> We attach importance to this attribute as it emphasises the intimate involvement of partners in the partnership business in both jurisdictions and confirms that the introduction of separate legal personality is not designed to alter the commercial reality of English law partnerships.

<sup>62</sup> RUPA, s 307(d).

<sup>63</sup> RUPA, s 307(d)(1) – (4). The court has an equitable discretion to grant permission. Specified grounds include a finding that the partnership's assets subject to execution are clearly insufficient to satisfy the judgment and that exhaustion of partnership assets is excessively burdensome.

6.57 It is a fundamental concept that the partners in a general partnership have unlimited liability for the obligations incurred by the partnership while they are partners. By contrast a limited partnership must have one or more general partners each of whom has unlimited liability and one or more limited partners each of whom has limited liability. We discuss the liability of the general partner and the limited partner in Parts XVI and XVII below. As the draft Bill covers both general partnerships and limited partnerships,<sup>64</sup> we think that it is appropriate to have a statement of the liability of partners early in the Bill.

### ***Partners' liability***

6.58 We think that each partner should be liable for the whole amount of all debts and obligations of the partnership. Under our recommendations relating to contribution and indemnity, the liability of the partners for partnership obligations is joint and several liability.<sup>65</sup> However, although a partnership creditor may seek payment in full from the firm or from any one of the partners, so that from the viewpoint of the creditor there is joint and several liability,<sup>66</sup> the relationship between the partners and the firm has certain special features. There are three aspects to this. First, as we discuss in Part VII, the liability of a partner is secondary: the partnership creditor must establish the existence and amount of the firm's liability in the same or earlier proceedings. Secondly, the partner who pays the firm's debt is entitled to an indemnity from the partnership. The firm on the other hand is not entitled to an indemnity from the partners. Thirdly, while the partner who pays the firm's debt is entitled to contribution from the other partners who had secondary liability for that debt, the firm on paying its debt would not be entitled to contribution from the partners.

6.59 **We recommend therefore that:**

- (1) It should be provided (a) that each of the partners in a general partnership has unlimited liability and (b) that a limited partnership must have one or more general partners, each of whom has unlimited liability, and one or more limited partners, each of whom has limited liability;** (Draft Bill, cl 3)
- (2) Each partner who has unlimited liability is personally liable for the whole amount of the debts and obligations of the partnership and his payment in discharge of that liability discharges the firm's obligation and the personal liability of any other partner for that obligation to the same extent.** (Draft Bill, cl 23(1), (3), (4) and (5))

### ***A partner's right to indemnity from the partnership***

6.60 As a default rule, a partner who meets a partnership liability will be entitled to indemnity from the partnership. This is the position under the existing law.<sup>67</sup> We

<sup>64</sup> As well as the special limited partnership in Part XIX below.

<sup>65</sup> See paras 6.60 – 6.65 below.

<sup>66</sup> The creditor may thus sue the firm and the partners jointly and severally.

<sup>67</sup> 1890 Act, s 24(2).

consider that a partner should be entitled to be indemnified by the partnership where he reasonably and in good faith discharges a debt which he believes to be a partnership obligation. This is probably the existing law.<sup>68</sup> We discuss this in Part X below.<sup>69</sup> Similar rules should apply where a partner pays out money in the proper conduct of the partnership business, for example, in using his private funds to purchase stock for the partnership, or expends funds to preserve the partnership business or property. This is again the existing law.<sup>70</sup> The paying partner should be entitled to an indemnity from the firm. The indemnity should not prevent the firm and the other partners from pursuing claims against the paying partner in relation to any wrong he may have committed against them.

### ***A partner's right to contribution from other partners***

- 6.61 We also have to consider the question of the mutual rights and liabilities of the partners between themselves if the partnership does not meet a liability which it owes to a partner. Examples include where the firm fails to pay an indemnity to which a partner is entitled (as discussed in the previous paragraph) or where a partner has a claim against the partnership in respect of a loan to the firm or his undrawn share of the profits of the firm and the partnership is unable to pay the debt.
- 6.62 The general rule that a partner has personal liability for the whole of any partnership obligation incurred while he is a partner requires to be qualified in relation to partnership obligations owed to a partner or former partner. Otherwise the general rule would clash with the agreements entered into between the partners or between partners and former partners for contribution and indemnity in relation to partnership obligations and the sharing of partnership losses.<sup>71</sup> Partners should be free to determine such matters as between themselves. Thus to ascertain the liability of a partner to make contribution to or indemnify another partner or a former partner one looks to the contract between the parties, failing which to the default code.
- 6.63 Where a partner makes a payment in settlement of a partnership obligation to a third party (including a payment in reasonable settlement of his alleged personal liability for a partnership obligation) but is not repaid or fully repaid by the partnership, the partner will – as a default rule – be entitled to contribution from the other partners who were liable for the obligation in question. While the firm is able to indemnify the partner, he will normally seek reimbursement of his outlays from the partnership's assets without having to call on his partners to contribute. However, where, for example, the firm is temporarily short of cash or the partners think it expedient not to withdraw funds from the partnership, the partner who has paid should be able to demand a contribution from the other partners who were

<sup>68</sup> See *McIlreath v Margetson* (1785) 4 Doug KB 278, 99 ER 880.

<sup>69</sup> See paras 10.29 – 10.30 below.

<sup>70</sup> 1890 Act, s 24(2).

<sup>71</sup> For example, under the default regime, if partner A pays a partnership obligation, the firm will be under an obligation to indemnify him. If the firm is not then able to do so, A may seek contribution from B and C. A, B and C can later seek indemnity from the firm when the firm has the wherewithal to pay. But A will not be able to use the personal liability of B and C for partnership obligations (see para 6.59 above) to obtain an indemnity from them.

liable for the obligation. The partner who meets the partnership liability (A) will be entitled to contribution from the other partners (B and C) in the same proportions as B and C are liable to bear partnership losses. If those partners (B and C) make a contribution to the partner who has paid (A), they in turn should be entitled, in the default regime, to indemnity from the firm in respect of their contribution and A, B and C can obtain reimbursement of their contributions when the firm has the means to pay. But if C is insolvent, A should be entitled to fifty per cent contribution from B, but A and B would both retain the right to contribution from C. This is the same rule as applies between co-guarantors where a guarantor is insolvent.<sup>72</sup>

6.64 Similarly if a partner pays out money in the proper conduct of the partnership business but is not repaid by the partnership, or if the partnership fails to pay to a partner any other amount for which it is liable to account to him, the other partners should be liable - as a default rule - to contribute in the same proportions as if the amount were a partnership loss.

6.65 **We therefore recommend that:**

**(1) There should be the following default rules:**

- (a) That a partner should be entitled to an indemnity from the partnership in respect of (i) any payment made by him in the proper conduct of the partnership business or in connection with anything necessarily done to preserve the partnership business or property and (ii) any payment which he has made towards the discharge of his personal liability for a partnership obligation or in reasonable settlement of an alleged personal liability for a partnership obligation; (Draft Bill, cl 12(3))**
- (b) That the indemnity under (a) above should not affect any claim which the partnership or another partner may have against the partner; (Draft Bill, cl 12(4))**
- (c) That if the partnership does not pay the indemnity under (a) above, the partner should be entitled to contribution from any other liable partner on the same basis as if the amount unpaid were a debt for which he and each other liable partner were co-guarantors in the same proportions as they would be liable to pay any partnership losses; (Draft Bill, cl 12(5))**
- (d) That partner A may claim against partner B as an “other liable partner” under (c) above (i) in the case of A’s liability (or alleged liability) for a partnership obligation, if B was a**

<sup>72</sup> See *Chitty on Contracts* (28<sup>th</sup> ed 1999) Para 44-109, *Snell’s Equity* (30<sup>th</sup> ed 2000) para 29-20 and in Scotland, *Gloag and Irvine, The Law of Rights in Security, Heritable and Moveable, Including Cautionary Obligations* (1897) pp 836-839.

**partner when the payment was made and was liable with A for the obligation (or, in the case of settlement of an alleged liability, would have been liable if the alleged liability had been established) or (ii) otherwise, if B was a partner when the payment was made;** (Draft Bill, cl 12(6))

**(e) That if a firm wrongly fails to pay to a partner any other amount (for example, a loan due to the partner) for which it is liable to account to him, the partner should be entitled to contribution from the other partners in the same proportions as if the amount were a partnership loss;** (Draft Bill, cl 12(7))

**(f) That the personal liability for a partnership obligation in respect of which a partner may claim indemnity or contribution should include not only the partner's liability under (a)(ii) above but also his liability to contribute under (c) or (e) above and his liability to indemnify or make a contribution to a former partner;**<sup>73</sup> (Draft Bill, cl 12(8))

**(2) That in order to allow partners to agree their obligations amongst themselves, the rule that a partner is personally responsible for the whole amount of any partnership obligation incurred while he is a partner (clause 23(1) of the draft Bill) should not apply to a partnership obligation owed by a partner (A) to a partner or former partner (B) if the partnership agreement or any other agreement to which A and B are parties makes provision about whether or not B is entitled to indemnity or contribution from A in respect of the obligation;** (Draft Bill, cl 23(2))

## **THE LIABILITY OF THE INCOMING PARTNER**

### **Existing law**

6.66 Under section 17 of the 1890 Act a person who is admitted as a partner into an existing partnership does not thereby become liable to the creditors of the partnership for anything done before he became a partner.

6.67 In practice, however, it is common on a change of membership for a partnership to give an indemnity to an outgoing partner. We understand that it is less common for an incoming partner to give an express indemnity to an outgoing partner who has left the partnership or who leaves at the same time as the incomer joins. But if the "new" partnership, which includes the incoming partner, gives such an indemnity,<sup>74</sup> the incoming partner's assets will therefore indirectly be exposed to a prior creditor's claims. In any event, if the "new" partnership pays prior creditors

<sup>73</sup> See the draft Bill, cl 34(2) and (4) and paras 8.79 - 8.81 below.

<sup>74</sup> Such an indemnity may be implied where the firm's assets are assigned to the "new" partnership: see *Gray v Smith* (1889) 43 Ch D 208, 213 and *Lindley & Banks*, para 10-247.

in the ordinary course of business, the expense of meeting those obligations may reduce the value of the incoming partner's interest in that partnership.

### **Our provisional proposals**

- 6.68 In the Joint Consultation Paper we did not propose any change to section 17(1) of the 1890 Act. We agreed with the principle that a new partner does not become liable for existing obligations merely by being admitted into a partnership. We suggested that the principle was well adapted to a partnership which was a continuing legal personality.<sup>75</sup>
- 6.69 We pointed out that any capital contributed by the incoming partner would be available to meet the partnership's liability. The partnership, as a continuing entity, would be liable to creditors whose claims arose before the incoming partner joined the partnership. Thus the incoming partner's capital contribution, as a partnership asset, would be available to prior creditors but, in accordance with the principle, his personal assets would not.<sup>76</sup>

### **Consultation**

- 6.70 As we proposed no change to the principle, we made no formal proposition and did not ask a question to which consultees could respond. Nevertheless, the issue of the liability of the incoming partner was raised by some consultees in their response to (a) separate legal personality and (b) the default rule under which legal personality continues on a change of partners.
- 6.71 One consultee opposed continuing legal personality and viewed the right of a creditor to enforce against the partnership's assets as a major change in the law because the capital of the incoming partner would be available for the use of pre-admission creditors (that is to say creditors of the "old" partnership). The consultee thought that this would discourage people from taking up offers of partnership. It also said that the proposal would require the incoming partner to conduct an exercise of "due diligence" and suggested that inchoate negligence claims would be a further complication.
- 6.72 Another consultee suggested that if continuing legal personality were introduced the existing partners would have to give an indemnity to the incoming partner to protect his assets from prior claims.<sup>77</sup>

### **Reform recommendations**

- 6.73 We recommend no change to the principle enshrined in section 17(1) of the 1890 Act: admission into a partnership will not, of itself, expose the private assets of the

<sup>75</sup> Joint Consultation Paper, para 10.41.

<sup>76</sup> The incoming partner may incur liability for prior debts if at the same time as or after the new partner joins the partnership an old partner leaves the partnership and under the default rules the partnership grants an indemnity to the outgoing partner.

<sup>77</sup> We think that this is a misunderstanding of our proposals, as the retention of the s 17(1) principle will protect the private assets of the incoming partner.

incoming partner to the claims of creditors in respect of existing obligations.<sup>78</sup> In accordance with the existing law, however, the incomer's private assets will be exposed indirectly to the claims of prior creditors if the partnership of which he is a member grants an indemnity to an outgoing partner.<sup>79</sup>

### ***The incoming partner's capital***

- 6.74 We recognise that the introduction of a default rule of continuing legal personality will place the capital invested by the incoming partner at risk to the claims of prior creditors. But we are not persuaded that this is in reality a major innovation. Under existing English law (and on one view Scots law) the protection of the incoming partner's capital may in many cases be theoretical more than real.
- 6.75 The starting point under the existing law is that the "new" partnership, which is created on a change of membership of the firm, takes over the business of the "old" partnership. This involves the "new" partnership taking over the assets of the "old" partnership and (in most cases) its liabilities. The "new" partnership on paying out the retiring partner will normally have given him an indemnity against all liabilities of the firm when he made over his interest in the partnership to the continuing partners.<sup>80</sup> Even if no indemnity is given in the deal to pay out an outgoing partner, the "new" partnership often pays off the liabilities of the "old" partnership in the ordinary course of business as and when they fall due. It will only be when the "new" partnership is unable to pay those debts from its assets that creditors of the "old" partnership are likely to initiate litigation to pursue their claims against the personal estates of the partners of the "old" partnership. Often some of those partners will also be partners in the "new" partnership.<sup>81</sup> If the partners of the "old" partnership who are also partners in the "new" partnership are not able to meet the claims either of the creditor or of a former partner under his indemnity, the viability of the "new" partnership will be threatened. In that event the incoming partner's capital will be put at risk.<sup>82</sup>

<sup>78</sup> Thus if a partnership has entered into a contract before a person becomes a partner and has not fully performed the contract, the incoming partner does not incur secondary liability under the contract merely by joining the firm. In the absence of any special feature in the contract, the partners who were partners at the date the contract was entered into would have secondary liability for damages incurred by the firm for breach of the contract which occurred after the incomer had joined. But if the breach of contract involved also negligence or another tort or delict, the incoming partner could have secondary liability in respect of that tort or delict.

<sup>79</sup> See para 6.78 below.

<sup>80</sup> See *Gray v Smith* (1889) 43 Ch D 208, 213 and *Lindley & Banks*, para 10-247. If the former partner withdrew before the incoming partner joined the partnership, the indemnity may not be a liability for which the incoming partner is personally liable; but if the partners gave the indemnity when the incoming partner had joined the firm, he may be personally liable for that debt.

<sup>81</sup> Where there is no overlap between the membership of the old partnership and the new partnership the prudent course may be to buy the assets of the old partnership but leave the liabilities with the former partners of the old partnership.

<sup>82</sup> Further it is notable that the rules of court in England appear to envisage that the "old" partnership's assets may in some way be traced in the hands of the "new" partnership. CPR, Sched 1, RSC, O 81, r 5(1) provides: "where a judgment is given or order made against a firm, execution to enforce the judgment or order may, subject to rule 6, issue against any property of the firm within the jurisdiction". In English law the use of the partnership name

- 6.76 There may be circumstances in which partners of the “old” partnership and the partners of the “new” partnership ring-fence the liabilities of the “old” partnership. But even then the problem of the insolvency of the “old” partners who are also partners in the “new” partnership remains, with its adverse effect on the viability of the “new” partnership. If the incoming partner wishes to protect his capital investment in the “new” partnership, the safe way to do so is for there to be a genuine new partnership which purchases the assets of the old partnership which is then wound up. In such circumstances the incoming partner’s capital is safe under both the existing law and the reforms which we recommend.
- 6.77 Nor are we persuaded that the exposure of the incoming partner’s capital will deter people from joining partnerships. Since 1914, partnership law in the United States of America has exposed the capital contribution of incoming partners to the claims of prior creditors.<sup>83</sup> We are not aware from our discussions with American lawyers that this has been a significant disincentive to joining partnerships.
- 6.78 We see no need to provide any further protection to the capital of the incoming partner. In any event, the incoming partner often faces a bigger problem under the existing law when a senior partner retires and is paid out. If the “new” partnership gives the outgoing partner an indemnity either expressly or impliedly when buying out his share, the newly-joined partner takes on liability for the pre-existing debts through the medium of that indemnity.<sup>84</sup>

### ***The date when an obligation is incurred***

- 6.79 Section 17 of the 1890 Act speaks of the incoming partner not incurring liability for “anything done before he became a partner”. We intend to replicate this regime by providing that a partner is personally liable for partnership obligations incurred while he is a partner. Thus if the partnership entered into a contract before he became a partner, he would not incur secondary liability in relation to the contract.<sup>85</sup> Similarly if an act or omission which occurred before he became a partner gave rise to loss and thus to a claim against the partnership after he had joined the firm, he would not incur secondary liability in relation to that claim.<sup>86</sup>

in litigation is simply a convenient expression for the partners entitled or liable as the case may be as partners when the cause of action accrued. See *Ex parte Young* [1881] 19 Ch D 124, *Ellis v Wadeson* [1899] 1 QB 714. By recognising the right to execute against partnership property at the date of judgment the rule appears to envisage a form of enforcement which could affect the economic health of the “new” partnership and thus the interests of the incoming partner.

<sup>83</sup> UPA, s 17 provided that a person admitted as a partner “is liable for all the obligations of the partnership arising before his admission ... except that his liability shall be satisfied only out of partnership property.”

<sup>84</sup> The indemnity is discussed in more detail in paras 8.69 – 8.73 below.

<sup>85</sup> This replicates the existing law: where the partners enter into a contract after the incoming partner has joined the partnership he is liable on the contract. Thus where the partners of a “new” partnership give an indemnity to a former partner after the incoming partner has joined the firm, the incomer is in English law one of the contracting parties and in Scots law has subsidiary liability for the debt so incurred. The incoming partner’s personal assets are therefore available to meet the former partner’s indemnity.

<sup>86</sup> See the draft Bill, cl 23(7): “For the purposes of this Act, a partnership obligation which results from (a) breach of a duty in tort or delict (including quasi-delict), (b) breach of trust

6.80 **We therefore recommend that:**

**(1) The rule in section 17(1) of the 1890 Act that an incoming partner who joins an existing partnership does not thereby become liable to the creditors of the partnership for partnership obligations incurred before he became a partner should be re-enacted (but the capital invested by an incoming partner in an existing partnership will be available to meet prior debts); (Draft Bill, cl 23(1)) and**

**(2) In this context an obligation of the partnership which results from the (a) breach of a duty in tort or delict (including quasi-delict) (b) breach of trust or (c) breach of a fiduciary duty should be treated as having been incurred at the time of the act or omission which gave rise to the breach. (Draft Bill, cl 23(7))**

## THE LIABILITY OF THE OUTGOING PARTNER

### Existing law

#### ***Liability for pre-retirement debts***

6.81 A partner who retires from a partnership does not thereby cease to be liable for partnership debts or obligations incurred before his departure.<sup>87</sup> The outgoing partner can be released from such obligations by agreement with the other partners and the creditors of the partnership.<sup>88</sup>

#### ***Liability for post-retirement debts***

6.82 The operation of the doctrine of apparent authority has the effect that an outgoing partner will be liable for obligations incurred by his former partners after he leaves the partnership unless he gives notice of his withdrawal to any third party with whom the former partners deal. Section 36 of the 1890 Act distinguishes between persons who had dealings with the partnership before the partner withdrew and those who did not. A withdrawing partner removes the apparent authority of his former partners in a question with the latter simply by advertising his withdrawal in the appropriate Gazette.<sup>89</sup> If a person was known by a creditor to be a partner before retirement, the withdrawing partner must give actual notice of retirement if the creditor has had previous dealings with the old partnership.<sup>90</sup>

or (c) breach of a fiduciary duty, is to be treated as having been incurred at the time of the act or omission that gave rise to the breach.” In this subsection we refer to both breach of trust and breach of fiduciary duty as a trustee may be in breach of a duty, such as a duty of skill and care, which is not a fiduciary duty. See *Bristol & West Building Society v Mothew* [1998] Ch 1, 16 – 18, *per* Millett LJ.

<sup>87</sup> 1890 Act, s 17(2).

<sup>88</sup> 1890 Act, s 17(3).

<sup>89</sup> 1890 Act, s 36(2).

<sup>90</sup> *Hamerhaven Pty Ltd v Ogge* [1996] 2 VR 488. See also *Tower Cabinet Co Ltd v Ingram* [1949] 2 KB 397, (CA).

### ***Liability through “holding out”***

- 6.83 A person who has withdrawn from a partnership but who allows himself to be represented as a partner in the partnership may incur liability to anyone who acts in reliance on that representation.<sup>91</sup>

### **Our provisional proposals**

- 6.84 In the Joint Consultation Paper we suggested that the policy of the existing law was sound. We suggested that section 17(2) and (3) of the 1890 Act should apply not just to a retiring partner but to all outgoing partners. We also provisionally proposed that the protection against liability arising out of the continued use of a firm-name or of an outgoing partner’s name as part of a firm-name should be available to all outgoing partners. We discuss this latter issue below.

### **Consultation**

- 6.85 There was overwhelming support for the proposal to extend section 17(2) and (3) to all outgoing partners. Several consultees suggested that this was already the law. One consultee questioned the need for section 17(3) in Scots law. The provision was only required to address the English law doctrine of consideration. Consultees supported the introduction of a provision that an agreement to release an outgoing partner from further liability is not a contract which needs to be supported by valuable consideration.

### **Reform recommendations**

- 6.86 We think that the law on this subject is generally satisfactory but that there is room for modernising the rules in relation to the liability of a former partner which arises as a result of his being held out as a partner. In particular we are not persuaded that advertisement in the appropriate Gazette is an effective means of giving notice of a partner’s withdrawal. We discuss these issues below.<sup>92</sup> In relation to the rules which are currently section 17(2) and (3) of the 1890 Act we recommend two minor changes. We make our recommendation in relation to the use of the firm-name in our discussion of the liability of the apparent partner below.<sup>93</sup>
- 6.87 First, we propose that the rules of section 17(2) and (3) should apply to all outgoing partners. This is probably already the law. Secondly, we think that there is no need to provide that it is possible for an outgoing partner, the continuing partners and creditors of the partnership to agree to discharge the outgoing partner. This is the general law. Rather, the provision should be re-framed as a rule that in English law such a contract does not need to be supported by valuable consideration.<sup>94</sup>

<sup>91</sup> 1890 Act, s 14(1). See discussion of liability arising out of holding out in paras 6.89 – 6.106 below.

<sup>92</sup> See paras 6.96 – 6.106 below.

<sup>93</sup> See para 6.106(6) below.

<sup>94</sup> Treitel, *The Law of Contract* (10<sup>th</sup> ed) (1999) p 142 suggests that there is a problem in treating a discharge of an outgoing partner as a contract in English law where the outgoing

6.88 **We therefore recommend:**

- (1) **That a person who ceases to be a partner does not thereby cease to be liable for partnership obligations incurred while he was a partner;** (Draft Bill, cl 33(1))
- (2) **That, for the purposes of the draft Bill, a partnership obligation which results from a breach of a duty in tort or delict (including quasi-delict), a breach of trust or breach of a fiduciary duty should be treated as having been incurred at the time of the act or omission which gave rise to the breach;** (Draft Bill, cl 23(7)) **and**
- (3) **That a person who ceases to be a partner may be discharged from personal liability for a partnership obligation by an agreement between himself (or his estate), the partnership and the creditor of the partnership without requiring valuable consideration in English law.** (Draft Bill, cl 33(3) and (4))

**THE LIABILITY OF THE APPARENT PARTNER**

**Existing law**

6.89 We have mentioned above the rule that a person who deals with a partnership after a change in its membership is entitled to treat all apparent partners as still being members of the firm until he has notice of the change, and the provision for advertisement in the appropriate Gazette.<sup>95</sup> Both are currently contained in section 36 of the 1890 Act. Section 14(1) of that Act contains further provision on holding out, providing that:

Every one who by words spoken or written or by conduct represents himself, or who knowingly suffers himself to be represented, as a partner in a particular firm, is liable as a partner to anyone who has on the faith of any such representation given credit to the firm, whether the representation has or has not been made or communicated to the person so giving credit by or with the knowledge of the apparent partner making the representation or suffering it to be made.

6.90 This is a statutory application of the doctrine of estoppel or, in Scotland, personal bar.

partner is not replaced by an incoming partner unless (as one case suggests) one treats as invented consideration the fact that the creditor benefits from the release of the outgoing partner. The supposed benefit is that a remedy against a single debtor might be easier to enforce than one against several, all of whom are solvent. We do not find this explanation convincing and prefer to remove the need for valuable consideration.

<sup>95</sup> See paras 6.82 and 6.83 above.

- 6.91 In the Joint Consultation Paper we discussed the difficulty of ascertaining when it could be said that a person “knowingly suffers himself” to be represented as a partner but we did not propose any change in this rule.<sup>96</sup>
- 6.92 Section 14(2) of the 1890 Act also provides that the continued use of a firm-name or of a deceased partner’s name as part of a firm-name of itself does not make his personal representatives liable for any partnership debts contracted after his death.

### **Our provisional proposals**

- 6.93 We provisionally proposed that section 14(2) of the 1890 Act should be extended so that the continued use of a firm-name or of an outgoing partner’s name as part of a firm-name should not of itself make the outgoing partner liable for any partnership debts contracted after he left the partnership.<sup>97</sup>

### **Consultation**

- 6.94 Several consultees expressed views on the expression of the rule on holding out in section 14(1) of the 1890 Act. One consultee suggested that the provision was obscure and should be reworded. He also expressed concern about the effect of holding out on a “salaried partner” who might be unaware of his exposure by such holding out.<sup>98</sup> Another consultee suggested that the provision be extended to cover joint business ventures which were not partnerships but which held themselves out as such. As section 14 presupposes the existence of a partnership, it does not include joint business ventures which are not partnerships but the principle of joint and several liability should apply to the parties to such ventures. Another consultee suggested that the provision did no good and that it could do harm. He advised that the matter be left to the common law of personal bar.
- 6.95 There was general support for the proposal to protect the outgoing partner from liability through holding out by the use of the firm-name after he left the partnership. In England, two consultees opposed the proposal, suggesting that the section 14(2) protection should remain confined to deceased partners as they could not suffer themselves to be represented as anything, while living partners who had withdrawn from the partnership could. In Scotland one consultee opposed the proposal, arguing that the issue could be left to the common law of personal bar.

### **Reform recommendations**

- 6.96 As section 14(1) of the 1890 Act is an application of the law of estoppel or personal bar, we do not see a means of protecting the “salaried partner” who may often be a junior person within a partnership. The general law is available to persons who act in reliance on a representation that persons are carrying on business in partnership. Nonetheless, it is common for partnership statutes to

<sup>96</sup> We proposed the extension of the protection given by s 14(2) of the 1890 Act from a deceased partner to all outgoing partners. See para 6.93 below.

<sup>97</sup> This involved extending the effect of s 14(2) of the 1890 Act from the deceased partner to all outgoing partners.

<sup>98</sup> *Viz Nationwide Building Society v Lewis* [1998] Ch 482.

contain provisions on the liability of a purported partner.<sup>99</sup> We think that it is desirable to include in a partnership statute, which contains several provisions dealing with the liability of a partner, a provision dealing with the liability of an apparent partner arising from holding out. A provision can be worded in general terms so as to avoid restricting the development of the law.

- 6.97 We think that the statute should explain coherently the liability of the apparent partner. The existing rules are based partly on the rules of agency and partly on the law of estoppel or personal bar.<sup>100</sup> With the adoption of an entity approach to partnership, there will be no mutual agency of partners. Accordingly, the liability of the former partner for debts of the partnership incurred after his withdrawal will not be on the basis of any failure by a principal to revoke his agent's authority but will be solely on the basis of estoppel or personal bar. This is, we think, more principled: the person seeking to impose liability on the former partner or any other person represented to him as a partner should have to prove detrimental reliance on the representation.
- 6.98 We do not think that advertisement in the appropriate Gazette is a particularly practical way of giving notice of changes in the membership of a partnership. While it is not uncommon for professional firms to advertise the withdrawal of partners in the Gazette, we doubt whether small commercial partnerships do so and whether those who deal with partnerships consult the Gazette before transacting with them.<sup>101</sup> We therefore favour a new approach to the liability of an apparent partner based on estoppel or personal bar. We note that RUPA<sup>102</sup> provides that a dissociated partner remains liable as a partner for transactions entered into by the partnership within two years after departure, if the other party does not have notice of the partner's dissociation and reasonably believes when entering the transaction that the dissociated partner is still a partner. We think that there is merit in a regime along those lines.
- 6.99 A non-partner (including a former partner) should be liable to a third party as if he were a partner only where he represents himself or knowingly allows himself to be represented as a partner and the third party transacts with the partnership in reliance on that representation. His liability should be treated in the same way as a partner's liability: his payment discharges the partnership of the obligation and payment by the partnership or the partners discharges him, to the extent of the amount paid.

<sup>99</sup> See for example RUPA, s 308. Provisions based on s 14 of the 1890 Act also remain in the partnership statutes in the various Australian jurisdictions and in New Zealand - see Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand* (8<sup>th</sup> ed 2001) p 186f.

<sup>100</sup> The requirement to give notice of retirement to a person who had previously dealt with the firm (1890 Act, s 36(1)) is derived from the rule of agency that a principal must give notice to a third party of revocation of an agent's authority in order to remove the agent's implied authority or apparent authority to bind him. See *Lindley & Banks* para 13-44 and *Bowstead & Reynolds* paras 8-008 and 8-048. Section 14 (holding out) on the other hand is based on estoppel or personal bar and requires detrimental reliance.

<sup>101</sup> We recognise that the Gazette can now be read on-line and that this may increase access to it, but we think that the point remains valid.

<sup>102</sup> RUPA, s 703(b). See Hillman, Vestal and Weidner, *The Revised Uniform Partnership Act* (2003 ed), pp 296-299.

- 6.100 In relation to the former partner, liability should also arise if the representation were made while he was a partner but he had ceased to be a partner at the time when the third party dealt with the firm in reliance on the representation. In such circumstances however we think that it is appropriate to place a limit on the time during which it is reasonable for the third party to rely on a representation in deciding to deal with a partnership and not enquire as to the present composition of the firm. This would give some certainty to the former partner that a representation which, when made, was true would not impose on him liability for partnership debts for an indefinite time after his withdrawal.
- 6.101 We consider that it would be appropriate to confer similar protection on the “salaried partner”, who may have been held out to the world as a partner but who in reality was an employee. Where an employee has been held out as a partner and then leaves the employment of the firm, we see no justification for exposing him to a longer period of potential liability through holding out than that applicable to a partner.
- 6.102 While the fixing of the period during which such a representation can be efficacious is to a degree an arbitrary judgment, we have decided (a) that the period should run from the date of the representation and not the date of withdrawal and (b) that the period should be for one year. Thus if in June of year 1, while A was a partner, a representation was made to B that A was a partner, and A retired from the partnership in September of that year, B would not be entitled to rely on that representation after June in year 2. We prefer this approach, which ties the period into the date of the representation, to that of RUPA in which the period runs from the date of the partner’s dissociation. It is not clear to us why a representation made two years before a partner’s retirement should remain efficacious for the same period after the retirement as a representation which is made on the eve of the retirement.
- 6.103 The outgoing partner (or employee) should also be able to exclude the risk that liability as an apparent partner may arise from a representation while he is a partner by giving notice of his withdrawal to persons who have dealt with the firm before his withdrawal. We propose that a former partner or employee of the firm (“A”) should not be liable through holding out where the representation that A was a partner was made or communicated while he was still a partner or an employee if, before a person (“B”) dealt with the partnership in reliance on the representation, notice was given to B that A had ceased to be a partner. Under this regime the outgoing partner (or employee) can protect himself by giving notice of his retirement (or causing the partnership to give notice) to all persons who had dealings with the firm in the previous twelve months before his resignation.
- 6.104 We also think that it would be advantageous to provide that all outgoing partners will be protected from liability by holding out through the use of the firm-name or of the outgoing partner’s name in the firm-name after they have left the partnership. Where the use of the firm-name is one among several facts which point towards a representation that a former partner remains a partner, that use would still be taken into account. However, of itself the use of the firm-name would not be sufficient to amount to such a representation.

6.105 We consider that the apparent partner should be entitled to the same indemnity from the partnership as that of a partner or outgoing partner.<sup>103</sup>

6.106 **We therefore recommend that:**

- (1) Where a person who is not a partner (“A”) represents himself, or knowingly allows himself to be represented, as one, and another person (“B”) deals with the partnership in reliance on that representation, A should be liable as if he were a partner for the whole amount of any obligation which the partnership incurs to B as a result; (Draft Bill, cl 26(1), (3) and (4))**
- (2) Where A is a partner at the date of the representation but is no longer a partner at the time when B deals with the firm in reliance on the representation, then subject to (4) and (5) below A should be liable to B for the whole amount of any obligation which the partnership incurs to B as a result; (Draft Bill, cl 26(2))**
- (3) If A in (1) or (2) above pays an amount in or towards discharge of his personal liability (or what he reasonably and in good faith believes to be his liability) he should be entitled to be indemnified by the partnership in respect of that amount; (Draft Bill, cl 26(5))**
- (4) If A was still a partner when the representation was made ((2) above), he should not be liable if more than one year has passed since the representation before B deals with the firm in reliance on it; (Draft Bill, cl 35(1) and (2))**
- (5) A should not incur liability under (2) above if notice of his withdrawal from the partnership was given to B or sent to B’s last known address before he dealt with the firm in reliance on the representation; (Draft Bill, cl 35(3))**
- (6) A should not be liable by holding out after he ceases to be a partner if the representation consists merely in the partners continuing to carry on the partnership business in the same partnership name or the partnership name continuing to include A’s name after he ceased to be a partner; (Draft Bill, cl 35(4)) and**
- (7) In order to protect the salaried partner who is an employee, the protections in paragraphs (4) – (6) above should be available to A if he is an employee of the partnership. (Draft Bill, cl 35(5))**

<sup>103</sup> See paras 6.60 – 6.65 above and 10.29 – 10.30 below.

# **PART VII**

## **LITIGATION AND ENFORCING JUDGMENTS**

### **INTRODUCTION**

- 7.1 This Part deals with the methods by which a partnership sues and is sued and the means by which judgments may be enforced against a partnership and its partners.
- 7.2 The recommended introduction of separate personality in English law will not have a major impact on litigation and enforcement of judgments as the existing rules already adopt an approach to partnership litigation which is similar to an entity approach. In Scots law there is a need to modernise the rules relating to litigation as, oddly, they are less oriented towards an entity approach.
- 7.3 We also consider the impact of the Human Rights Act 1998 on litigation and the enforcement of judgments and make recommendations for the protection of the interests of partners and former partners which are designed to meet the requirements of Article 6 of the European Convention on Human Rights and Fundamental Freedoms (ECHR).

### **LITIGATION**

#### **Existing law**

##### ***English law***

- 7.4 In English law proceedings by or against two or more partners who carry on business within the jurisdiction may be commenced in the name under which they carried on business when the cause of action accrued.<sup>1</sup> A person suing or being sued by a partnership can require the partners to disclose the names and places of residence of all persons who were partners at the time the cause of action accrued.<sup>2</sup>
- 7.5 In the absence of any provision to the contrary in a partnership agreement, a partner has implied authority to commence proceedings in the name of the partnership, subject to providing any non-consenting partners with an indemnity for costs.<sup>3</sup> In the absence of a provision in the partnership agreement, a majority of partners can resolve any difference in relation to the legal proceedings.<sup>4</sup> But if the majority act in bad faith in preventing an action by the partnership against a third party, the wronged partners may apply to the court to have the partnership dissolved.

<sup>1</sup> CPR, Sched 1, RSC O 81, r 1. This is a procedural rule for convenience only. See *Lindley & Banks*, para 14-03.

<sup>2</sup> CPR, Sched 1, RSC O 81, r 2. The party to the action serves written notice requiring such disclosure and if the notice is not complied with the court may order the partners to produce the written statement.

<sup>3</sup> *Whitehead v Hughes* (1834) 2 C & M 318; 149 ER 782.

<sup>4</sup> 1890 Act, s 24(8).

- 7.6 The partnership name can still be used after the partnership has ceased to carry on business or has been dissolved. Provided the partners were carrying on business within the jurisdiction when the cause of action accrued, the nationality, domicile or residence of the partners is not relevant. If the partnership is not carrying on business within the jurisdiction, the proceedings should be in the names of the individual partners, unless the partnership is a legal entity under the law of its constitution.<sup>5</sup>

### **Scots law**

- 7.7 The rules of Scots law which govern actions in the name of the partnership are archaic. If the partnership has a social name, which is composed of the names of real people (even though they are no longer partners) it can sue and be sued in its name alone. If the partnership has a descriptive name, such as “Fresh Bread Bakers”, that name can be used in litigation in the Sheriff Court but not in the Court of Session.<sup>6</sup> In the latter court, the names of three partners, or two if there are only two, must be added to the partnership name.
- 7.8 In the absence of any provision of the partnership agreement regulating the matter, a majority of partners normally decides whether or not the partnership should bring or defend an action.<sup>7</sup>
- 7.9 After a partnership is dissolved, Scots law requires that all of the former partners must sue or be sued in its place. To pursue a claim against a dissolved partnership it is necessary to sue all of the former partners who are within the court’s jurisdiction. Otherwise the partners can raise a plea of all parties not called; that is that there are other defenders liable for the debt who have not been cited.<sup>8</sup>

### **Our provisional proposals**

- 7.10 In the Joint Consultation Paper we invited views on two principal issues, namely how a partnership with separate personality could sue and be sued and how to reform the outdated Scots law rules.

### ***A partnership can sue and be sued***

- 7.11 We provisionally proposed that a partnership with separate personality should be able to sue and be sued in its own name so long as the partnership exists and that a creditor of a partnership should be able to sue partners in the same proceedings as the partnership.<sup>9</sup>

<sup>5</sup> See *Dreyfus v IRC* (1929) 14 TC 560 and *Oxnard Financing SA v Rahn and Others* [1998] 1 WLR 1465.

<sup>6</sup> See *Antermony Coal Company v Wingate & Co* (1866) 4 M 1017.

<sup>7</sup> 1890 Act, s 24(8), *Hutcheon and Partners v Hutcheon and Another* 1979 SLT (Sh Ct) 61.

<sup>8</sup> *Muir v Collett* (1862) 24 D 1119.

<sup>9</sup> Joint Consultation Paper, para 17.17 (1) and (2).

### ***Litigation after dissolution of a partnership***

- 7.12 We also proposed that where a partnership has been dissolved, litigation in relation to partnership rights, debts and obligations should be by or against one or more of the former partners, as former partners of the dissolved partnership.<sup>10</sup> As a result, however, of our recommendations in relation to the break up of partnerships and their winding up<sup>11</sup> there will be no need for litigation by or against a dissolved partnership.

### ***Disclosure of the identity of partners***

- 7.13 In order to prevent partners from hiding behind a partnership name we proposed that a new Partnerships Act should provide that any partner or former partner who is sued should have the obligation, if called upon, to furnish information as to the names and addresses of other partners or former partners who may be liable and as to any changes in the constitution of the partnership which might affect liability.<sup>12</sup> We also proposed that other procedural matters relating to litigation by or against partnerships or former partners should be regulated by subordinate legislation.

### ***Whether an account is needed***

- 7.14 On the separate issue of English law only, we invited views on whether there should be an express provision that a partner has a right to pursue a claim for damages against co-partners without first taking an account.<sup>13</sup>

## **Consultation**

### ***A partnership can sue and be sued***

- 7.15 There was general support in both jurisdictions for the proposals that a partnership with separate legal personality should be able to sue and be sued in its own name and that partners can be sued in the same proceedings as the partnership. Those consultees who opposed the introduction of separate legal personality into the English law of partnership did not support the proposals, arguing that the present law was satisfactory. One consultee suggested that a creditor should be able to choose whether to sue the partnership, the partners or both. Another consultee suggested that it was essential that a claim against the partnership should also have effect as a claim against the partners.<sup>14</sup>

<sup>10</sup> Joint Consultation Paper, para 17.17(3). This would remove the rule of Scots law requiring all of the partners within the jurisdiction to be called and would make it clear that the Scots law rule that a partnership debt must first be constituted against the partnership would not apply to a dissolved partnership. See Joint Consultation Paper, para 17.17(5) and (6).

<sup>11</sup> See paras 12.13 – 12.23 below.

<sup>12</sup> Joint Consultation Paper, para 17.17(4).

<sup>13</sup> Joint Consultation Paper, paras 17.18 – 17.27.

<sup>14</sup> We address the issue of limitation of actions, or in Scotland prescription, in paras 7.65 – 7.72 below.

### ***Litigation after dissolution of a partnership***

- 7.16 There was also general support for the proposal that when a partnership had been dissolved,<sup>15</sup> litigation in relation to partnership rights, debts and obligations should be by or against one or more of the former partners, as former partners of the dissolved partnership. However, several consultees qualified their support or voiced concerns over the proposal and urged that the personality of the partnership should continue until the winding up was complete so that it could continue to sue and be sued. It was suggested that a creditor of a partnership would often not know whether a partnership was dissolved and that it should be possible to pursue an action in the partnership name even after dissolution.

### ***Disclosure of the identity of partners***

- 7.17 A large majority of the consultees who addressed the issue whether a partner or former partner should have the obligation, if called upon, to furnish information as to the names and addresses of other partners and former partners who may be liable for partnership debts supported our proposal. One consultee suggested that the address in question should be the last known address of the partners or former partners. Two consultees opposed the proposal. One suggested that the proposal was impractical as a claim in tort might arise decades after the event and the partners in question could not be expected to know about their predecessors. It asked what was the policy reason for requiring present partners to incur expense in assisting claimants against previous partners.

### ***Scots law***

- 7.18 Scottish consultees gave unanimous support for the proposals to alter the rules of Scots law.<sup>16</sup>

### ***Whether an account is needed***

- 7.19 English consultees were divided on the question whether there should be an express provision for English law that a partner has the right to pursue a claim for damages against co-partners without first taking an account. There was support for the proposition from a number of consultees. But an equal number of consultees questioned the need for such a provision.

### **Reform recommendations**

#### ***A partnership can sue and be sued***

- 7.20 We recommend that a partnership should be able to sue and be sued in the partnership name. Where there is continuity of partnership the firm-name refers to the continuing entity which is the partnership. As we discussed in Part VI of this report the partnership's assets are available to meet a claim. Therefore the capital invested by a partner joining the partnership after the date on which the obligation was incurred would be available to meet the claim as the money would be

<sup>15</sup> In this context dissolution refers to the start of the winding up process: see 1890 Act, s 38.

<sup>16</sup> Joint Consultation Paper, para 17.17 (5) and (6).

partnership property.<sup>17</sup> However the private assets of the partner joining the partnership after the relevant date would not be available to the creditor unless the partner had entered into an obligation to the creditor to pay him.<sup>18</sup>

7.21 The partners with secondary liability to meet the creditor's claim are the partners or former partners who were members of the partnership when the obligation was incurred if the claim is in contract or when the relevant act or omission occurred if the obligation results from breach of duty in tort, or delict (including quasi-delict), or breach of trust or fiduciary duty.<sup>19</sup> We recommend that a creditor of a partnership may bring an action against the partnership and all or any of such partners with secondary liability in the same or separate proceedings. We do not favour actions being raised and claims enforced against partners alone. In order to achieve conceptual clarity, we recommend that a creditor may pursue a claim against a partner or former partner only (a) in the same action as he pursues his claim against the partnership or (b) in a separate action after he has established his claim against the partnership by obtaining a judgment against it. The creditor may establish that liability either in judicial proceedings or by arbitration. Liability may also be established by a court order for interim payment. It is the essence of a partner's or former partner's liability that it is a liability to meet an obligation of the partnership. The claim must therefore be constituted against the partnership<sup>20</sup> before it can be enforced against the partner or former partner.<sup>21</sup>

7.22 **We therefore recommend:**

- (1) That a partnership may sue or be sued in its own name;** (Draft Bill, cl 7(2))
- (2) That a creditor of a partnership may pursue claims against a partner or former partner in respect of a partnership obligation only (a) after he has established the amount (or the existence and the amount) of the liability of the partnership for the obligation by obtaining a judgment or decree or arbitral award against it in the same or earlier proceedings; (b) where the court has ordered the partnership to make a payment including an interim payment in respect of the partnership obligation; or (c) in Scotland, when the partnership obligation has been constituted in a document**

<sup>17</sup> See paras 6.73 – 6.80 above.

<sup>18</sup> If the incoming partner or partners had granted (expressly or impliedly) an indemnity to the former partner or partners, the incomers' assets would indirectly be available to pay the creditor if the former partners enforced the indemnity against them.

<sup>19</sup> See para 6.80 above.

<sup>20</sup> In Scotland a claim can be constituted against a person, including a partnership, by registering a contract for execution in the Books of Council and Session, thus avoiding the need for a court order before enforcing the claim against the contracting party's assets.

<sup>21</sup> This is, of course, without prejudice to any personal liability which a partner may have assumed in relation to a third party independently of his status as partner. Thus if the individual partner were himself guilty of negligence in the provision of services to a third party, the third party could sue him directly without relying on the vicarious liability of the partnership or in addition to suing the partnership. See, by way of analogy, *Merrett v Babb* [2001] QB 1174.

**registered for execution in the Books of Council and Session or the sheriff court books.** (Draft Bill, cl 24)

***Method of service on a partnership***

- 7.23 We think that the appropriate method of service of legal proceedings on a partnership is service at a place of business of the partnership, if the partnership is a general partnership.<sup>22</sup> Rules of court should provide for such service and for service on the individual partners of the firm.<sup>23</sup>
- 7.24 **We therefore recommend that rules of court should provide for service of claims and other court documents on a partnership and on the partners of the firm.**

***Establishing the liability of a partner for a partnership obligation***

- 7.25 In our discussion on enforcement of judgments below<sup>24</sup> we recommend that a judgment or arbitral award against a partnership should not be capable of being enforced directly against the assets of a partner or former partner. We recommend that a creditor wishing to enforce a partnership obligation against a partner or former partner must obtain a judgment or arbitral award against the partner or former partner. We recognise, however, that there may be cases where the creditor proceeds against the partnership (and perhaps some of the partners) and obtains judgment against them, in ignorance of the existence of another partner or in the belief that that partner does not have assets. It may be unfair on the creditor to require him again to prove the partnership's liability in proceedings against the other partner if that partner had had an opportunity to participate in the earlier proceedings and did not take it. The court should have a discretion to exclude or restrict the defences which a partner may advance in those circumstances. We think that this is a matter which can be left to rules of court and that the draft Bill should empower the rule making authorities to make such rules.
- 7.26 **We therefore recommend that rules of court may make provision to prevent a partner from defending or to restrict the extent to which, or the way in which, a partner may defend proceedings in respect of his personal liability for a partnership obligation if he has had an opportunity to participate in earlier proceedings in which there has been a judgment or decree against the partnership establishing the existence or amount of the partnership's obligation.** (Draft Bill, cl 25(1) and (2))

***Disclosure of the identity of partners***

- 7.27 We proposed in the Joint Consultation Paper that a partnership which is suing or being sued and its partners should be under a duty to provide to the other party to the litigation the names and addresses of those partners who have secondary liability for the costs/expenses of the litigation or (as the case may be) for meeting

<sup>22</sup> If the partnership is a limited partnership service should be at the limited partnership's registered office. See paras 15.30 - 15.34 and 15.52 below.

<sup>23</sup> See para 7.33 below.

<sup>24</sup> See paras 7.55 - 7.64 below.

the claim against the partnership if it is successful. Under the existing English rules of court the partners of a partnership are required to furnish the other party with a written statement of the names and places of residence of all the persons who were partners at the time when the cause of action accrued.<sup>25</sup> The obligation rests on the partners who were partners at the relevant time because the use of the partnership name is a matter of convenience rather than substance.<sup>26</sup> It is prudent therefore for such partners who continue in a partnership to keep a record of the last known addresses of former partners. What we proposed in the Joint Consultation Paper was not substantially different from the existing English rule. In Scotland the court may order a partnership to disclose documents which reveal who the relevant partners are or were.<sup>27</sup> We do not agree with the suggestion that our proposal is impractical or materially more burdensome than the existing rules in both jurisdictions. It should not be unduly burdensome on the partnership or the partners in question especially as the latter will wish to share any liability established against them with those partners or former partners who also have secondary liability to meet the claim. However we see force in the suggestion that the obligation should be to disclose the last known address of the partner or former partner or an address for service on him.

- 7.28 We therefore think that a partnership which is suing or being sued and its partners should be under a duty to provide to the other party to the litigation on request the names and last known addresses, or addresses for service, of those partners who have secondary liability for the costs/expenses of the litigation or (as the case may be) for meeting the claim against the partnership if it is successful. We also recommend that where a creditor of a partnership also pursues his claim against a former partner, the former partner will be under the same duty to disclose. This regime would substantially reflect existing English procedural rules<sup>28</sup> and would be less formal than the commission and diligence procedure of Scots law. We propose that the duty should be imposed by rules of court in both jurisdictions.

<sup>25</sup> CPR, Sched 1, RSC O 81, r 2.

<sup>26</sup> See para 7.4, footnote 1 above.

<sup>27</sup> *Mitchell v Grangemouth Coal Co* (1894) 2 SLT 104.

<sup>28</sup> CPR, Sched 1, RSC O 81, r 2 provides: "Disclosure of partners' names:

(1) Any defendant to a claim brought by partners in the name of a firm may serve on the claimants or their solicitor a notice requiring them or him forthwith to furnish the defendant with a written statement of the names and places of residence of all the persons who were partners in the firm at the time the cause of action accrued; and if the notice is not complied with the court may order the claimants or their solicitor to furnish the defendant with such a statement and to verify it on oath or otherwise as may be specified in the order, or may order that further proceedings in the claim be stayed on such terms as the court may direct.

(2) When the names of the partners have been declared in compliance with a notice or order given or made under paragraph (1) the proceedings shall continue in the name of the firm but with the same consequences as would have ensued if the persons whose names have been so declared had been named as claimants in the claim form.

(3) Paragraph (1) shall have effect in relation to a claim brought against partners in the name of a firm as it has effect in relation to a claim brought by partners in the name of a firm but with the substitution, for references to the defendant and the claimants, of references to the claimant and the defendants respectively, and with the omission of the words "or may order" to the end."

7.29 **We therefore recommend that rules of court should provide that a partnership which is suing or being sued and its partners should be under a duty to provide to the other party to the litigation, at his request by notice, the names and last known addresses, or addresses for service, of those partners who have secondary liability for the costs or expenses of the litigation or (as the case may be) for meeting the claim against the partnership if it is successful. Former partners who are involved in litigation relating to a partnership should be under a similar obligation.**

7.30 Since the consultation, we have received further representations on the difficulties which consumers face in identifying the names and addresses of partners in a present or former partnership. It has been suggested that the problem is wider than simply the identification of the relevant persons once litigation has commenced.<sup>29</sup> We think that there is scope to assist people who deal with partnerships in a way which is complementary to the Business Names Act 1985 and which is not unreasonably burdensome on partners and former partners.<sup>30</sup> The obligations on the partnership and the partners or former partners will not be subject to a statutory sanction but we propose that the court should have power to make appropriate orders. Thus, if the partnership, partners or former partners failed to disclose relevant information within their knowledge on request from a person entitled to make the request, that person could seek the costs or expenses of his application to the court from the persons in default and disobedience to an order of the court could be punished as a contempt.

7.31 **We therefore recommend that:**

- (1) **A person who deals with a partnership should be entitled, on making a request to the partnership or to any partner, to be told the full names and an address or addresses for service of all the partners; (Draft Bill, cl 74(1))**
- (2) **A person who has a complaint against a partnership arising out of a previous dealing with the firm should be entitled, on making a request to the partnership or to any present or former partner, to be given such information as the partnership or the present or former partner is able to provide, after due inquiry, as to the names of every partner at the relevant time and an address for every partner which is either an address for service or his last known address; (Draft Bill, cl 74(2))**
- (3) **Rules of court should be able to make provision enabling a person having a prospective claim against a partnership, or against a**

<sup>29</sup> In the Joint Consultation Paper (para 20.02), we suggested that the introduction of a registered partnership would assist persons dealing with partnerships by establishing a register which would be both a contemporary and historical record of the identity of the partners in a partnership. In paras 13.27 – 13.29 below we explain why we have not taken forward the proposal for a registered partnership. In its absence we think that we can do more to help the person who deals with a partnership.

<sup>30</sup> We also propose certain amendments to the Business Names Act 1985. See paras 13.23 – 13.24 below.

**present or former partner after he has obtained judgment against the firm, to apply to the court before bringing proceedings in respect of the claim for an order for the supply of the information in paragraph (2) above.** (Draft Bill, cl 74(3))

***Litigation after a partnership is dissolved***

- 7.32 In Part XII we discuss our recommendations on the break up of a partnership and on its winding up. We recommend that the personality of a partnership should continue after the break up until all of the assets of the partnership have been distributed and all the liabilities of the partnership discharged or extinguished. We think that this is a much simpler way of providing for the full winding up of a partnership. We have departed from our earlier proposal to have the winding up completed when all of the assets were distributed and to transfer any existing and future liabilities to those partners who, if the partnership had continued in existence, would have had secondary liability therefor. Thus once the partners (or a third party such as the partnership liquidator) have wound up the partnership and distributed all of the assets, the partnership will continue to exist as an entity so long as any liability (including a liability which only emerges in the future)<sup>31</sup> remains undischarged or has not been extinguished by the passage of time.
- 7.33 We recognise that it is necessary to provide for service on the partnership when a partnership has ceased as a going concern and no longer has a place of business. In such circumstances the rule which we propose in paragraph 7.23 above will not operate. We think that where a third party is not able to ascertain a partnership's place of business, a claim or other court document should be validly served on a partnership if it is served on a partner of that partnership. Again this can be provided for in rules of court. We do not think that this will be problematic. As a claimant against a partnership which has ceased as a going concern will often wish to pursue his remedy against the individual partners as well as any residual assets of the firm, it is likely that he will serve the claim on several if not all of the partners.
- 7.34 This approach should avoid the practical difficulties about which consultees expressed concern. This also has the effect of superseding the Scots law rules about suing partners after a dissolution in accordance with the views expressed by Scottish consultees.<sup>32</sup>

***Whether an account is needed***

- 7.35 The rule of English law that a debt owed by a partner to the partnership and vice versa is normally recoverable only by a partnership account is well established.<sup>33</sup> Nevertheless a different rule may apply in relation to damages: it is thought that English law allows a partner to recover damages from another partner for breach of the partnership agreement without taking an account. We agree with the view of

<sup>31</sup> For example a claim against a firm of solicitors by a disappointed would-be beneficiary (*White v Jones* [1995] 2 AC 207), where the testator is alive when the firm breaks up and when all the assets of the firm are distributed but dies thereafter.

<sup>32</sup> See the Joint Consultation Paper, para 17.17 (5) and (6) and paras 7.9 and 7.18 above.

<sup>33</sup> See *Marshall v Bullock*, (unreported) 27 March 1998, Court of Appeal.

several consultees who suggested that an express provision in the draft Bill to allow a partner to pursue a claim for damages against a co-partner without first taking an account is not necessary. We have therefore not included a provision to this effect in the draft Bill.

## **ENFORCEMENT**

### **Existing law**

#### ***English law***

- 7.36 In English law if a partnership is sued in its name and judgment is obtained against it, the judgment may be enforced against partnership property within the jurisdiction.<sup>34</sup> The judgment may be enforced against anyone:
- (1) who acknowledged service of the claim form as a partner;
  - (2) who having been served as a partner with the claim form, failed to acknowledge service of it;
  - (3) who admitted in his statement of case that he is a partner; or
  - (4) who was adjudged to be a partner.<sup>35</sup>
- 7.37 A judgment cannot be enforced against a partner who was out of the jurisdiction when the claim form was issued, unless the partner was served, or acknowledged service, as a partner.
- 7.38 Where a party has obtained a judgment against a partnership and seeks to enforce it against a person whom he claims is a partner, the party must obtain leave of the court to issue execution against that person unless under the rules set out above it is already established that the person is a partner.<sup>36</sup>
- 7.39 The judgment need not be enforced against the partnership before it is enforced against the partners as the firm does not have separate personality. Enforcement against an individual partner is not restricted to the extent of his pro rata liability for the obligations of the partnership. But the position is modified where the partnership is insolvent and its partners are bankrupt. In an insolvency involving a partnership or a partner it is necessary to distinguish joint (or partnership) estate from separate estate and joint (or partnership) debts from separate debts in order to regulate the competition between creditors of the firm and creditors of the individual partners. The partnership creditors are paid first out of the partnership estate but where the partnership estate is insufficient they may prove their debts against the partners' separate estates in competition with their separate creditors.<sup>37</sup>

<sup>34</sup> CPR, Sched 1, RSC O 81, r 5(1).

<sup>35</sup> CPR, Sched 1, RSC O 81, r 5(2).

<sup>36</sup> CPR, Sched 1, RSC O 81, r 5(4).

<sup>37</sup> See *Lindley & Banks*, para 27-89 ff.

- 7.40 A judgment obtained against a partner, whether in respect of a partnership debt or in respect of a personal debt, cannot be executed against partnership property but can be executed against the partner's share in the partnership by means of a charging order. A charging order does not give the judgment creditor any greater right than that enjoyed by an assignee. The partners may at any time redeem the judgment debtor's share.<sup>38</sup>

### **Scots law**

- 7.41 In Scots law a decree obtained against a partnership can be enforced against the assets of the partnership. The decree can also be enforced against the assets of a partner. Section 4(2) of the 1890 Act provides:

An individual partner may be charged on a decree or diligence directed against the firm, and on payment of the debts is entitled to relief *pro rata* from the firm and its other members.

- 7.42 The ability of a partnership creditor to enforce against the assets of a partner a decree obtained against the partnership is problematic. A person may find that his assets are subjected to diligence without having been given the opportunity to deny that he was a partner or to contest the validity of the claim against the partnership.<sup>39</sup>
- 7.43 Where a creditor obtains a decree against a partner, Scots law allows the creditor to arrest the partner's share in the hands of the partnership. It is not clear however whether the creditor can raise an action of furthcoming to obtain the transfer of the partner's share before the dissolution of the partnership. In English law a creditor of a partner can obtain a court order for the sale of the partner's share in the partnership. An arrester in Scotland cannot obtain such an order.

### **Our provisional proposals**

#### ***The need for a judgment against the partnership***

- 7.44 In the Joint Consultation Paper we provisionally proposed that creditors of a partnership should normally be required to obtain a judgment against the partnership before using execution or diligence to enforce their claim against either the assets of the partnership or the assets of a partner but should be able to obtain satisfaction out of a partner's own assets without having to litigate twice.<sup>40</sup>

#### ***Enforcement against a partner's assets***

- 7.45 We also provisionally proposed that a creditor should be permitted to enforce a judgment obtained against a partnership directly against the assets of a partner without it being necessary to obtain a judgment against that partner.<sup>41</sup>

<sup>38</sup> 1890 Act, s 23.

<sup>39</sup> See *Ewing v McClelland* (1860) 22 D 1347.

<sup>40</sup> Joint Consultation Paper, para 10.20(3).

<sup>41</sup> Joint Consultation Paper, para 10.20(5).

### ***No need to exhaust the partnership's assets***

- 7.46 Thirdly we asked consultees if they agreed that, on the assumption that the creditor had obtained an appropriate judgment, the creditor should not need to exhaust enforcement remedies against the assets of the partnership before enforcing judgment against the assets of a partner.<sup>42</sup>

### ***English law***

- 7.47 If partnerships were to have legal personality in accordance with our provisional proposals, we saw no difficulty in a judgment against the partnership being executed against the assets of the partnership. We also suggested that the scheme of section 23 of the 1890 Act (which provides for a charging order against a partner's interest in partnership property for the partner's separate judgment debt) was already well adapted to the situation where a judgment had been obtained against a partner. We suggested that procedural rules would be needed to regulate such matters as service on the partnership but that it would not be necessary to alter primary legislation.<sup>43</sup>

### ***Scots law***

- 7.48 We also made provisional proposals in relation to Scots law. We proposed that it should be made clear that a decree of furthcoming could be obtained after the arrestment of a partner's share in the partnership and that its effect would be to enable the arrester to obtain payment of any sums due to the partner from the partnership, or on the dissolution of the partnership, as and when they fell due. We also asked whether the creditor of a partner should be able to apply to the court for an order for the sale of the partner's share and whether the other partners should have a right to purchase the share if the court ordered such a sale.<sup>44</sup>

## **Consultation**

### ***The need for a judgment against the partnership***

- 7.49 There was general support among consultees for our proposition that creditors of a partnership should normally be required to obtain a judgment against a partnership before enforcing their claims against the assets of the partnership or the assets of a partner but that the creditors should not normally have to litigate twice.

### ***Informing partners of claims and enforcement against a partner's assets***

- 7.50 Some consultees expressed concerns that former partners should be made aware of legal proceedings against the partnership and given an opportunity to participate in them. Others were concerned that third parties should be allowed to pursue parallel proceedings against the partnership and the partners to avoid suing the wrong person if there was an unknown discontinuity of legal personality. They emphasised the need for a requirement that a partnership when sued should name

<sup>42</sup> Joint Consultation Paper, para 10.20(6).

<sup>43</sup> Joint Consultation Paper, para 18.7.

<sup>44</sup> Joint Consultation Paper, para 18.18.

its partners in its acknowledgement of service.<sup>45</sup> The Chancery Bar Association was concerned that the third party would be prejudiced by having to look to the partnership, which might not have significant assets, before pursuing the partners. Another consultee thought that creditors should sue both the partnership and the partners and that all persons – partners and former partners – who could incur liability as a result of the litigation should have a right to know of the legal proceedings.

- 7.51 There was also general support for our proposals (a) that a creditor should be permitted to enforce a judgment obtained against a partnership against the assets of a partner without it being necessary to obtain a judgment against that partner and (b) that a creditor with a judgment against a partnership need not exhaust enforcement remedies against the assets of a partnership before enforcing the judgment against the assets of a partner. Concerns were expressed about the need to protect partners and former partners by ensuring that they had an opportunity to participate in legal proceedings before they were held liable for a partnership debt. The APP disagreed with proposition (a) and suggested that creditors should have the right to have judgment entered against the relevant partners and that entry of that judgment should always precede enforcement against any partner.
- 7.52 In Scotland both the Faculty of Advocates and Professor Gretton expressed similar concerns about the need to protect partners and former partners. Professor Gretton urged that a decree against a partnership should not be deemed to be a decree against each partner. The proposition might be incompatible with Article 6 of the European Convention on Human Rights and Fundamental Freedoms, and even if it were not, he considered it unacceptable.
- 7.53 Several consultees disagreed with proposition (b), namely that a creditor need not exhaust enforcement remedies against the assets of the partnership before enforcing a judgment against the assets of a partner. Some thought that the proposition diluted the concept of separate personality and preferred the approach of RUPA, which requires as a norm the exhaustion of partnership assets.<sup>46</sup>

***Scots law: the effect of an arrestment***

- 7.54 Among Scottish consultees there was widespread support for our proposal to provide that it was competent after an arrestment to obtain a decree of furthcoming of a partner's share in a partnership. However several consultees had misgivings about the proposal that the court should grant an order for the sale of the partner's share. Why, it was asked, should a creditor have a right which the partner did not have? The Law Society of Scotland also argued that any provision for partnerships should be consistent with the wider law of arrestment and suggested that complex rules were not required as the creditor could sequester the estate of the debtor partner. If a power to order a sale were to be introduced, most consultees supported the proposal that the other partners should have a right to purchase the debtor partner's share.

<sup>45</sup> See our recommendation in para 7.29 above.

<sup>46</sup> RUPA, s 307(d).

## **Reform recommendations**

- 7.55 There is a need to strike a balance between the interests of creditors of a partnership and the interests of the partners and former partners who are liable for the partnership's debts and obligations. As we recommended above, a claim against a partner for a partnership debt should be pursued either in the same action as a claim against the partnership or in separate proceedings after the creditor has established his claim by obtaining judgment or an arbitral award against the partnership.<sup>47</sup> We do not favour the option of allowing actions to proceed against either the partnership or the partners. A creditor can avoid the danger of suing the wrong entity by suing the relevant partners as well as the entity in the same action and using the powers to obtain information which we recommend. Armed with that information the creditor can direct his claim against the correct entity and the correct partners.<sup>48</sup> At the same time, we agree with the Chancery Bar Association that it would put a creditor in a worse position than he enjoys under the existing law if he had to attempt to exhaust the assets of the partnership before enforcing his claim against the assets of the partners. We see no need to follow RUPA by requiring enforcement against partnership assets as a precondition of recovery from the assets of the partners. We do not see the introduction of separate legal personality as altering in any practical way the liability which partners have to meet the debts and obligations of the partnership.
- 7.56 We think that it is important that a creditor of a partnership should not have to litigate twice to enforce his claim, once against the partnership and then against the partners. At the same time we recognise that there is force in the observations of consultees who were concerned to protect the interests of partners and former partners where a creditor of a partnership seeks to enforce a claim against them. It would not be appropriate, and arguably might be a breach of Article 6(1) of the ECHR, if the courts were to enforce against the assets of a person a claim established against a partnership without having given that person the opportunity to defend the claim on its merits or contest the assertion that he was a partner with secondary liability for the particular debt.
- 7.57 We recognise that it may often be easier for a claimant against a partnership if he does not have to join the individual partners in the action. The claimant may sue the partnership alone. If he does so, we propose that he will be able to enforce his judgment only against the assets of the partnership. In many cases, for example where the claim against the partnership is covered by insurance, it may be sufficient to sue only the partnership. In other cases, the claimant may want to have the right to enforce his claim against the assets of the individual partners.
- 7.58 In such cases, a person against whom the claimant seeks to enforce a debt due by the partnership must have the opportunity to contest the assertion that he is a partner who has secondary liability for that debt. The person in question may have no such liability, for example where he had retired from the partnership before the debt or obligation was incurred. Where the person against whom the claimant

<sup>47</sup> See para 7.22 above.

<sup>48</sup> Our recommendations for continuity of personality of a partnership on changes of membership and the continuation of that personality in a winding up should make discontinuity of personality in a continuing partnership business an unusual occurrence.

seeks to enforce his claim is a partner (or former partner), we think that that person should also have the right to contest the merits of the claim. Otherwise a partner, who had been given no opportunity to defend the claim, could be liable for the claim where another partner failed to advance a valid defence.

- 7.59 Under our proposals, the creditor of the partnership will have the option of suing both the partnership and some or all of the partners in the same action. In many cases, especially where the partnership does not have many partners, a creditor will protect himself by suing the partnership and all of the partners whom he believes have secondary liability for the claim. If the creditor sues only the partnership or the partnership and certain of the partners he will not be allowed to enforce the court order against partners not named in the judgment. To enforce his claim against such partners he will require to initiate fresh proceedings. We recognise that a creditor may not know the identity or the addresses of all of the relevant partners when the action is raised. To avoid having to raise separate proceedings the creditor may use the powers which we recommend to require disclosure of the names and last known addresses of the partners with secondary liability for the relevant claim and include them in the legal proceedings.<sup>49</sup>
- 7.60 We recommend that a creditor of a partnership should have to obtain judgment against a partner before he can enforce a partnership obligation against the partner's assets. This is both fairer and more consistent with the requirements of the ECHR than the Scottish common law rule which allows the enforcement of a decree for a partnership debt against the assets of a partner without giving the partner the opportunity to dispute the claim.<sup>50</sup>
- 7.61 In this regard we are generally adopting the approach which the English courts have adopted in their procedural rules.<sup>51</sup> However, we are departing from current English practice which uses service of the claim form or similar actions as sufficient to allow a judgment against a partnership to be enforced against the partner. We do not think that the imposition of a requirement to obtain a judgment against the partner will be problematic for the partnership creditor. There would be a potential for injustice if a partner who was not formally a party to the action against the partnership, but was aware of the proceedings and could have taken part in them if he had wished to do so, were then to seek to challenge findings made in the first action. It may well be that the courts would have an inherent jurisdiction to prevent this from happening, but we think that it would be desirable for the matter to be governed by procedural rules.<sup>52</sup>
- 7.62 We envisage that the necessary procedural rules should be established by rules of court, supported, where appropriate, by practice directions. We understand that the Rules Committee and the Department for Constitutional Affairs (formerly the Lord Chancellor's Department) may wish to review the relevant English rule of court in RSC Order 81 in the light of our report. The Scottish Law Commission

<sup>49</sup> See para 7.29 above.

<sup>50</sup> See paras 7.41 – 7.43 above.

<sup>51</sup> CPR, Sched 1, RSC O 81, rr 5(2) and 5(4).

<sup>52</sup> See our recommendation in para 7.26 above.

will prepare suggested rules of court for submission to the Rules Council in Scotland.

7.63 We also propose the abolition of the rule in Scotland which allows diligence against partners on a decree against the partnership. As the rule is a matter of substantive law, it cannot be abolished by rules of court. We do so by stating as a rule throughout Britain that a judgment against a partnership is not enforceable against the property of a partner.

7.64 **We therefore recommend:**

- (1) That a creditor of a partnership may enforce a claim in respect of a partnership obligation against a partner or former partner by including the partner as a defendant/defender in the action against the partnership or by suing the partner or former partner in a separate action;**<sup>53</sup>
- (2) That the creditor of a partnership may enforce his claim against the assets of the partners who have secondary liability for that claim without first exhausting enforcement remedies against the assets of the partnership.**<sup>54</sup>
- (3) That a judgment, decree or arbitral award against a partnership should not be enforceable, by way of execution, diligence or otherwise, against the property of a partner.** (Draft Bill, cl 25(4))

#### ***Limitation and prescription***

7.65 In striking a fair balance between the interests of creditors of the partnership and those of partners and former partners it is necessary also to address the rules of limitation of actions in English law and in Scots law the rules of prescription. It is important that partners should not be able to avoid liability for partnership debts by hiding their status as partners until a claim becomes unenforceable by limitation or is extinguished by prescription. Were this to happen the benefits of informality and privacy, for which partnership is valued, would result in injustice.

7.66 It is therefore our policy that an undisclosed partner should not benefit from the privacy of his membership of a partnership and the effluxion of time to avoid liability where a judgment has been obtained against the partnership. At the same time we would not wish to preserve stale claims. Accordingly a limitation period is required to extinguish the liability of a partner (or former partner) after judgment has been obtained against the partnership. The law of limitation in England and Wales differs from the law of prescription in Scotland. As a result different rules will apply in each jurisdiction.

<sup>53</sup> See para 7.22 above.

<sup>54</sup> Clauses 23(1) and 24(1) of the draft Bill achieve this result by providing that a partner is personally liable for the whole amount of a partnership obligation and by making the only precondition of a judgment against the partner that the partnership's liability has been established. The draft Bill imposes no restriction on the enforcement of the judgment which the creditor obtains against the partner.

## ENGLAND & WALES

- 7.67 We have recommended above<sup>55</sup> that a creditor may pursue claims against a partner who has secondary liability for a partnership debt or obligation either in the same proceedings as he pursues his claim against the partnership or after he has obtained judgment or an arbitral award against the partnership but not otherwise. In many circumstances it would be fair if the limitation period in relation to the secondary liability of a partner were the same as the limitation period in respect of the partnership. In some circumstances however, the creditor may know of the liability of the firm but be unable to ascertain the identity or address of an undisclosed partner. What is required is a short time after the creditor has obtained a judgment against the partnership in which he may discover a hitherto undisclosed partner and institute proceedings against him.
- 7.68 We think that the Limitation Act 1980 should be amended to introduce a special time limit for the secondary liability of a partner. We propose that that time limit should be (a) the date of the expiration of the period of limitation (if any) applicable to an action against the partnership in respect of the obligation in question or (b) if later, the expiration of two years from the date of judgment against the partnership in relation to that obligation. We think that this regime may readily be adapted to the Law Commission's wider recommendation for the reform of the law on limitation.<sup>56</sup>

## SCOTLAND

- 7.69 We think that it is possible to achieve a satisfactory result, which is consistent with the general law,<sup>57</sup> along lines similar to our recommendations for English law. We are aware of an authority which suggests that a claim against a partner in relation to his secondary liability for a partnership obligation prescribes five years after the date on which decree is obtained against the partnership.<sup>58</sup> We are not satisfied that this is good law. It is inconsistent with the established practice that a creditor of a partnership can sue both the firm and the partners in the same action.

<sup>55</sup> See para 7.22 above.

<sup>56</sup> See Limitation of Actions (2001) Law Com No 270 in which the Law Commission recommended a core limitation period which would apply to most claims for a remedy for a wrong, for the enforcement of a right and for restitution. In summary the recommended regime involves (a) a primary limitation period of three years starting from the date when the claimant had or ought reasonably to have had the requisite knowledge to bring a claim against the defendant and (b) a long-stop limitation period of ten years starting from the date of the accrual of the cause of action or (for claims in tort where loss is an essential element of a cause of action or breach of statutory duty) from the date of the act or omission which gives rise to the cause of action. It should be noted that a partner or former partner will not be able to rely on being clear of any liability after ten years from the starting date in relation to the cause of action: a partner's action for contribution from another partner will have its own limitation period, starting from the date at which the claimant for contribution became liable. The Law Commission also recommended a modified regime for personal injury claims in which the court would have a discretion to disapply the primary limitation period and there would be no long-stop limitation period (see (2001) Law Com No 270, paras 3.101 and 3.169).

<sup>57</sup> We draw on (a) the prescriptive period in relation to the partnership's obligations and (b) the prescriptive period in relation to obligations to make contributions between wrongdoers in section 8A of the Prescription and Limitation (Scotland) Act 1973.

<sup>58</sup> *Highland Engineering Ltd v Anderson* 1979 SLT 122.

7.70 We think that the prescriptive period in relation to a partner's secondary liability for a partnership obligation should be a period which begins with the date when decree is awarded against the partnership in respect of the relevant partnership obligation and which expires on the later of (a) the date when the partnership's obligation would have prescribed but for the relevant claim against the firm and (b) two years after the date of the decree against the partnership.

7.71 The creditors of the partnership would thus be able to pursue a claim against a partnership within the time scale allowed by the law of prescription in relation to the obligation in question. Once proceedings against the partnership have been raised the creditor would have the duration of the proceedings against the firm and also two years after obtaining decree to identify and raise an action against any partners with secondary liability whom he had not sued individually in the initial proceedings against the partnership. In our view this gives third parties sufficient time to identify a latent partner and initiate proceedings against him. We propose to amend the Prescription and Limitation (Scotland) Act 1973 to achieve this result.<sup>59</sup>

7.72 **We therefore recommend:**

- (1) That in English law, a claim against a partner in respect of his secondary liability for a partnership obligation should be subject to a special limitation period. That limitation period should end on the date of the expiration of the period of limitation (if any) applicable to an action against the partnership in respect of the relevant partnership obligation or, if later, the expiration of two years from the date of judgment against the partnership establishing the amount of the partnership's liability for the obligation; (Draft Bill, cl 25(3) and Schedule 2 paras 1-3)**
- (2) That in Scots law, the obligation of a partner in relation to his secondary liability for a partnership obligation should prescribe in accordance with the following special rule. The prescriptive period should begin on the date on which decree (or arbitral award) is awarded against the partnership in respect of the relevant partnership obligation and expire on whichever is the later of the following dates: (a) the date on which the prescriptive period applicable to the partnership obligation would have prescribed but for the relevant claim against the partnership which resulted in the decree (or award) and (b) the second anniversary of the date of**

<sup>59</sup> We have not provided a separate rule for claims, such as personal injury claims, which are subject to a limitation period under Part II of the Prescription and Limitation (Scotland) Act 1973. Such a claim against the partnership must be pursued within the limitation period unless the court exercises its discretion under section 19A of the 1973 Act to over-ride the time limits. Claims under Part II of the 1973 Act are not subject to the five-year or twenty-year prescriptive periods (1973 Act, s 7(2) and Sched 1, para 2). Accordingly, the prescriptive period for a claim against a partner in respect of this sort of partnership obligation will be two years from the date of the decree or award against the partnership. We see no need to provide an alternative long-stop of the expiry of the period of limitation of the action against the partnership as we think that it will be very rare that a claimant obtains decree against a partnership within one year of the commencement of the limitation period.

**that decree (or award).** (Draft Bill, cl 25(3) and Schedule 2 paras 4 – 10)

***Scots law: the effect of arrestment in execution***

7.73 Finally, we require to address the issue, which is one of Scots law, of the methods by which a creditor who has arrested a partner's share in the partnership can realise that share. There was no consensus among consultees in favour of adapting section 23 of the 1890 Act to allow an arresting creditor to apply to the court for an order for sale of the partner's share. It would be very difficult to introduce such a right in the context of the existing law of diligence.

7.74 We think that the existing law of arrestment and furthcoming should be clarified and developed as follows. First, following the arrestment in execution of a partner's share in a partnership, it should be possible to obtain a decree of furthcoming at any time during the subsistence of the partnership whether or not the partner's share or any part of it is then payable to him. Secondly, the arrested debt due by the partnership to the partner may be realised by the arresting creditor only when the partner's share or any part of it which is subject to the arrestment becomes payable. Thus where a share of profits has been arrested, a decree of furthcoming would entitle the creditor to payment when the partner would have been entitled to withdraw his share of the profits. Similarly, where the partner's share has been arrested and a decree of furthcoming obtained, the furthcoming will entitle the creditor to receive the value of the partner's share when the partner withdraws from the partnership and becomes entitled to the financial value of his share.<sup>60</sup> Alternatively, where the partnership breaks up and is wound up, the arresting creditor with a decree of furthcoming may realise the debt in the winding up of the partnership by obtaining payment of the share when the other partners obtain payment of their shares. The arrestment and furthcoming should not entitle the creditor to take part in the management of the partnership business.

7.75 **We therefore recommend that in Scotland the law of arrestment and furthcoming of a partner's share in a partnership should be reformed to the following effect:**

- (1) A creditor of a partner who has arrested in execution a partner's share in the partnership should be entitled to obtain a decree of furthcoming at any time before the dissolution of the partnership;**
- (2) A decree of furthcoming should transfer the partner's share to the creditor;**
- (3) The creditor with a decree of furthcoming should be entitled to obtain payment of that share or part of it only when the share or the relevant part of it would otherwise have become payable to the partner;**

<sup>60</sup> See para 8.75 below.

- (4) In particular the creditor with a decree of furthcoming should be entitled to receive the partner's share of the partnership's profits when that share of profits would otherwise have been payable to the partner; and**
- (5) The creditor with a decree of furthcoming may realise the share either when the partner in question withdraws from the partnership or when the partnership is wound up, by obtaining payment of the share when otherwise it would have been paid to the partner; and**
- (6) The arresting creditor who obtains a decree of furthcoming is not thereby entitled to take part in the management or administration of the partnership business. (Draft Bill, cl 37)**

# **PART VIII**

## **CONTINUITY OF PARTNERSHIP AND THE OUTGOING PARTNER**

### **INTRODUCTION**

- 8.1 In this Part we discuss the proposals to encourage continuity of partnership which we set out in the Joint Consultation Paper, the debate which those proposals generated and our recommendations on continuity and the rights of the outgoing partner.
- 8.2 Many partners conduct business in partnership on the basis that there is continuity of partnership, notwithstanding the existing rule (at least in English law) that a change in the membership of a partnership gives rise to a new partnership. Many partnership agreements commit partners to continue doing business together when one of the partners dies or retires. In this Part we recommend that there should be a default rule that a change in membership should not terminate a partnership. The default rule should be continuity of partnership on change of membership, provided that at least two partners remain in partnership. This has the consequence that in the default regime the outgoing partner would not have a right to insist on a winding up of the partnership. Instead, the partner wishing to leave the partnership would be able to withdraw and would be entitled to receive the value of his share in the partnership. This would promote continuity of partnership and thus the stability of businesses carried on in partnership.
- 8.3 At the same time we recognise the need to protect the legitimate interests of the outgoing partner, and recommend the introduction of new measures to enable the outgoing partner to obtain his financial entitlements on withdrawing from a continuing partnership. We also recommend default rules by which the former partner can obtain indemnity from the continuing firm or contribution from the partners who remained in the partnership on his withdrawal.
- 8.4 The consultation exercise illustrated real uncertainty, particularly in English law, as to the applicability of certain contractual doctrines to the law of partnership. Recent case law appears to have resolved some of this uncertainty. We take the opportunity in this Part to recommend an approach in the draft Bill which will confirm the approach of those cases.

### **Terminology**

- 8.5 It may be useful at the outset to clarify the meaning of terms which we use in this Part. “Continuity of partnership” refers to the continuation of a partnership on changes of its membership. As a result of the introduction of separate legal personality, so long as a partnership continues, it remains the same legal entity notwithstanding changes in its membership. “Dissolution” under the existing law refers to the termination of the partnership, which can and often does occur before

the partnership business has been wound up.<sup>1</sup> In our recommendations for a new partnership regime we give a different meaning to the term “dissolution”. We see the termination of a partnership as a three-step process. The first step is the “break up” of the partnership, which is the commencement of winding up. The second step is the process of “winding up” of the partnership when the assets of the partnership are realised, its debts discharged and any surplus distributed. During this process, under the regime which we recommend, the partnership continues. The final step, which we call “dissolution”, is the termination of the partnership on completion of the winding up. Dissolution will occur only when all of the assets of the partnership have been distributed and all liabilities (including those which have not emerged when the partnership breaks up or when active steps in winding up the partnership have apparently been completed) have been discharged or extinguished by the passage of time. At this stage the partnership ceases to exist.<sup>2</sup> When discussing the existing law in this Part we use “dissolution” in its current sense. But when discussing our reform recommendations in this Part we use the terms “break up”, “winding up” and “dissolution” to describe the three-step process which we discuss in more detail in Part XII below.

## **CONTINUITY OF PARTNERSHIP**

### **Existing law**

- 8.6 In English law a change in the membership of a partnership, whether an admission or a withdrawal, brings into existence a new partnership. A partnership of A, B and C is a different partnership from that of A, B, C and D and a partnership of B, C and D is again a different partnership.<sup>3</sup> *Lindley & Banks* put it thus:

Because the firm name represents no more than a convenient means of describing the partners who for the time being make up the firm, whenever the partners change that name must take on a new meaning.<sup>4</sup>

- 8.7 In Scots law, in which a partnership has separate legal personality, there is uncertainty as to whether a change in membership terminates the personality of the “old” partnership and brings into being a “new” partnership entity.<sup>5</sup>

### ***The partnership at will***

- 8.8 In both jurisdictions the default arrangement is the partnership at will. As its name suggests, a partnership at will is dissolved immediately when any partner gives notice to all the other partners.<sup>6</sup> A partnership at will is created where partners do not define the period during which they are to be in partnership. It may also come

<sup>1</sup> See the 1890 Act, s 38 which provides for the authority of the partners to continue after dissolution so far as necessary to wind up the affairs of the partnership.

<sup>2</sup> See paras 12.13 - 12.23 below.

<sup>3</sup> See eg *Commissioners for General Purposes of Income Tax for City of London v Gibbs* [1942] AC 402, Lord Wright at pp 429-430.

<sup>4</sup> *Lindley & Banks*, para 3-08.

<sup>5</sup> See the Joint Consultation Paper, paras 2.34 – 2.35.

<sup>6</sup> 1890 Act, s 26(1).

into existence on the expiry of a period defined in a partnership agreement,<sup>7</sup> when the partners continue in partnership while negotiating a new partnership agreement<sup>8</sup> or through inadvertence after a change of membership. In many cases this would give a partner power to dissolve the partnership and discontinue the partnership business contrary to the reasonable expectations of the other partners.

### ***The Syers v Syers order***

- 8.9 On dissolution of a partnership, a partner has a statutory right to have the partnership wound up so that the property of the partnership may be applied in paying the liabilities of the partnership and in distributing the surplus of the proceeds of sale of its assets to the partners.<sup>9</sup> Thus in a partnership at will a partner may dissolve a partnership with immediate effect on notice and may insist upon a winding up of the partnership business.
- 8.10 The courts have on occasion acted to prevent the unnecessary winding up of viable businesses where a partner's legitimate interests can be met by less drastic remedies. Thus the court has refused to grant a salaried partner's application to wind up a partnership on the ground that he lacked any proprietary interest in the partnership's capital, goodwill or clients.<sup>10</sup> The court has also held that an outgoing partner has expressly or impliedly waived the right to demand a winding up where the partners have agreed that the partnership will continue.<sup>11</sup> The English courts have retained a discretion to order that on dissolution of a partnership the share of an outgoing partner should be valued and bought out in lieu of having a winding up. Such an order, which is known as a *Syers v Syers* order,<sup>12</sup> is not frequently granted. It has been suggested that it is available only in exceptional cases.<sup>13</sup> The current editor of *Lindley & Banks* considers that the courts may now be better disposed to *Syers v Syers* orders than they were in the past.<sup>14</sup> To that extent our proposals move in the same direction as the courts. But the usual position remains that an outgoing partner has the right to enforce the winding up of the business.

<sup>7</sup> 1890 Act, s 27(1).

<sup>8</sup> In *Walters v Bingham* [1988] 1 FTLR 260 Browne-Wilkinson VC held that an agreement to continue a partnership for an indefinite period ending when a new partnership agreement was executed did not create a partnership at will as an indefinite period is not necessarily an undefined period. This decision achieved a sensible result but the reasoning has been criticised by *Twomey* (para 8.05) for putting too much emphasis on the duration of a partnership as the criterion for excluding a partner's right to dissolve by notice. It may be seen as straining the language of the Act.

<sup>9</sup> 1890 Act, s 39.

<sup>10</sup> *Stekel v Ellice* [1973] 1 WLR 191.

<sup>11</sup> *Sobell v Boston* [1975] 1 WLR 1587.

<sup>12</sup> After the House of Lords decision in *Syers v Syers* (1876) 1 App Cas 174. See also the Privy Council case, *Latchan v Martin* [1984] NLJ 745.

<sup>13</sup> See *Hammond v Brearley and Burnett*, 10 December 1992 (unreported), Hoffmann LJ. On the other hand in *Anselm v Anselm* June 29, 1999 (NLC 2990610701) Hart J considered ordering that one equal partner should buy out the share of the other in partnership properties.

<sup>14</sup> See *Lindley & Banks*, Preface p vii and paras 23.187 – 23.190.

- 8.11 In many cases the partners who wish to continue the business are able to agree with the outgoing partner that it is not necessary to wind up the business. The outgoing partner negotiates and receives a financial settlement in return for the transfer of his share in the partnership to the ongoing partners. This is known as “technical dissolution” as the partnership business is not wound up. But even where the outgoing partner accepts a buy-out in lieu of a winding up, the continuing partnership is a “new” partnership because the membership has changed.
- 8.12 Assets which were held for the “old” partnership require to be transferred to or held for the “new” partnership. While it appears that this has not created difficulty in practice, the basis by which assets come to be held for the “new” partnership is not clear in either jurisdiction.

***Problems of discontinuity: a summary***

- 8.13 The lack of continuity of partnership gives rise to a number of problems. The principal problems include the enforcement of partnership debts against the partnership, the transfer of property from the “old” partnership to the “new” partnership, the right of the “new” partnership to take the benefit of contracts which the “old” partnership has entered into, and the authority as agent conferred on or by an “old” partnership.<sup>15</sup> The principal problem associated with the default rule of the partnership at will is the instability of the partnership as a business association.

***Our provisional proposals***

- 8.14 In the Joint Consultation Paper we proposed that the default rule should be that a change of membership does not dissolve a partnership.<sup>16</sup> When a partner joins a partnership or where two or more partners remain after a partner ceases to be a member, the partnership would remain in existence as an association. Similarly, we proposed that death or bankruptcy of a partner would not dissolve the partnership but would merely dissolve the relationship between the partner in question and the other partners. In other words, the deceased partner or bankrupt partner would be treated as having withdrawn from the partnership.
- 8.15 We also proposed that as a default rule the outgoing partner should lose the right to insist on a winding up of the partnership. Instead, the outgoing partner’s share should be transferred to the remaining partners by operation of law at the moment of departure. As a counterpart of this transfer we proposed that the outgoing partner should become entitled to the value of the share as a debt from the date of departure. We suggested that while the outgoing partner should be entitled to interest at a commercial rate on the value of his share from the date of departure,

<sup>15</sup> See paras 5.11 – 5.23 above in our discussion of the closely related issue of separate legal personality.

<sup>16</sup> In the Joint Consultation Paper we used the words “dissolve a partnership” in their current sense of the termination of the partnership, often at the start of a winding up.

he should no longer be entitled to a share of the profits attributable to his share in the partnership assets.<sup>17</sup>

- 8.16 We recognised and recognise that these proposals are central to our aim to achieve greater stability in partnerships and that the removal of the right to insist in a winding up of a partnership affects the interest of the outgoing partner. We therefore consider measures which may provide appropriate protection to the outgoing partner in detail below.<sup>18</sup>

### **Consultation**

- 8.17 There was strong support in both jurisdictions for our proposals to introduce continuity of partnership on change of membership as a default rule. In England support came from practising lawyers, professional bodies, representative bodies in industry and finance and from academics.<sup>19</sup> We received strong support for our proposals to achieve continuity from the APP which saw these proposals as the central plank to the reform of partnership law.<sup>20</sup> At the same time there was opposition from the Chancery Bar Association and the Law Reform Committee of the General Council of the Bar who were concerned about prejudice to the interests of the outgoing partner. Our consultant, Roderick Banks, also expressed concern that our provisional proposals were unfair on the outgoing partner. We address these concerns below.<sup>21</sup> In Scotland the support for our proposals was unanimous and included support from the Scottish Law Commission's Partnership Law Advisory Group, the Faculty of Advocates and the Law Society of Scotland.
- 8.18 There was general support for our proposal to replace section 42 of the 1890 Act with an entitlement to interest at a commercial rate. Such opposition as there was to the proposal was based on the view that the right to elect to receive a share of profits was a salutary disincentive to the continuing partnership withholding monies due to the former partner.<sup>22</sup>

<sup>17</sup> The present entitlement is contained in the 1890 Act, s 42. There are considerable practical problems in determining what profits (if any) are attributable to an outgoing partner's share of partnership assets for the purpose of that section. We suggested that a commercial rate of interest on the value of the partner's outstanding share was more appropriate. See Joint Consultation Paper, paras 7.18 – 7.26.

<sup>18</sup> See paras 8.40 – 8.48 below.

<sup>19</sup> Supporters of our proposals included the APP, the Association of District Judges, Clifford Chance, the City of Westminster Law Society and Holborn Law Society, the Institute of Chartered Accountants in England & Wales, the Association of Consulting Actuaries, the Construction Industry Council, the Architecture and Surveying Institute, the Institute of Directors, the Manchester Chamber of Commerce, the British Bankers Association, Professor Webb and Professor Morse.

<sup>20</sup> The APP thought the proposed regime was suitable for new partnerships but urged appropriate transitional provisions to protect the expectations of existing partnerships in which people had deliberately adopted the existing default code which allowed the immediate dissolution of a partnership at will. We discuss these concerns in the context of our proposals for transitional provisions in part XIV below.

<sup>21</sup> See paras 8.40 – 8.48 below.

<sup>22</sup> The Law Reform Committee of the Bar Council and the Faculty of Advocates.

### **Reform recommendations**

- 8.19 We remain firmly in favour of the policy of encouraging continuity of partnership by removing the rule that a partnership is dissolved on a change of membership and by restricting the right of an outgoing partner to insist on the winding up of the partnership. We have considered carefully the comments of the influential consultees who have concerns about the position of the outgoing partner. We believe that the measures which we recommend below to protect the interests of the outgoing partner are sufficient to meet those concerns.<sup>23</sup> We think that our recommendations create a fair balance between the interests of the outgoing partner and the interests of those who wish to continue the partnership business. In addition to balancing these interests it is necessary also to bear in mind the public interest in encouraging economic activity and in facilitating continuity of business.

### **More detailed rules**

- 8.20 Although consultees did not suggest that it would be a problem, we recognise that replacing the partnership at will as the basic partnership model will involve the enactment of more rules in the default regime to govern the rights of partners on a change of membership. In formulating the rules, we aim to provide a practical arrangement by which a partnership may deal with the withdrawal of a partner in a way which is fair as between the partners while preserving continuity of partnership. Indeed, the fact that many well-organised partnerships contract out of the default rule of the partnership at will is itself suggestive that more detailed rules are an acceptable price for continuity of partnership. The rules are intended to create a practical mechanism and timetable for a partner to withdraw and for the other partners to respond to the withdrawal. They are default rules and parties are free to agree different arrangements. They do not compromise the flexibility of partnership as a business vehicle.

### **The inadvertent partnership**

- 8.21 Another possible criticism of our recommendations, which we have considered, is that there will be partnerships in which the partners are unaware that they are in partnership. Such partners may not observe the procedures which we prescribe in the default regime. This may well be the case. But we do not think that this consideration is a sufficient reason for forgoing the benefits of continuity of partnership. We have four principal reasons for this view.
- 8.22 First, it is likely that partnerships in which partners are not aware of their status as such will often (but by no means exclusively) be informal two-person partnerships. Such partnerships will break up on the withdrawal of a partner<sup>24</sup> and the rules which we propose for the voluntary withdrawal of partners will therefore not apply.
- 8.23 Secondly, under the existing law the unaware partner owes fiduciary duties,<sup>25</sup> is required to hold and apply property for the purposes of the partnership<sup>26</sup> and is

<sup>23</sup> See paras 8.40 – 8.48 below.

<sup>24</sup> On break up the partnership will continue for the purposes of winding up and dissolve on completion of the winding up. See paras 12.13 – 12.23 below.

<sup>25</sup> 1890 Act, ss 29 and 30.

under a duty to give notice of termination of a partnership at will.<sup>27</sup> The unaware partner and his unaware co-partners may conduct business in a way which contravenes the rules of the 1890 Act or the common law and the courts have to work out the legal consequences of the parties' acts. We recommend below<sup>28</sup> a default rule that partners should give a prescribed period of notice of withdrawal. If an unaware partner fails to give such notice the court can look to the parties' acts to ascertain whether the other partners assented to his withdrawal (and thus novated the agreement) or hold that his withdrawal took effect at the end of the period of notice or that he acted in breach of contract in withdrawing during the period of notice and that he thus exposed himself to a claim for damages. Such problems are no different in kind from those which can arise under the existing law. The inadvertent partnership which continues on the withdrawal of a partner is not likely to occur frequently. When it does occur, a default regime which contains periods of notice does not create insuperable problems.

- 8.24 Thirdly, we think that where parties are genuinely not aware that they are in partnership and have acted on the understanding that any one of them may terminate the arrangement on giving notice, the courts will be able without too much difficulty to infer the existence of an agreement to allow the break up of the partnership on notice. The default regime would not apply in such circumstances.
- 8.25 Fourthly, and in any event, in making recommendations to reform the law of partnership we have to address the interests of persons who know that they are in partnership and wish a workable and efficient default regime as well as the interests of partners in an inadvertent partnership. We think that there is a strong case for the default rule of continuity of partnership to assist the commercial interests of advertent partnerships and in the public interest of continuity of business activity. For the reasons given above, we do not think that the problems which the inadvertent partnership may face are sufficiently serious to militate against our recommendation.

#### ***The loss of vested contractual rights***

- 8.26 A further possible problem, which appears to have influenced the drafters of RUPA, is that removal of a partner's right to insist on a winding up of the partnership could take away the contractual rights of existing partners without their agreement. We do not consider this to be a problem in relation to our recommendations as our recommended transitional provisions<sup>29</sup> will enable an existing partner to preserve his contractual rights.

#### ***The incoming partner's capital***

- 8.27 Another problem which caused some consultees concern was the effect on the incoming partner. We have discussed this issue already.<sup>30</sup> In short, the incoming

<sup>26</sup> 1890 Act, s 21(1).

<sup>27</sup> 1890 Act, s 32(c).

<sup>28</sup> See paras 8.91 – 8.95 below.

<sup>29</sup> See paras 14.18 – 14.21 below.

<sup>30</sup> See paras 6.66 – 6.80 above.

partner's capital contribution will be at risk to debts which predate his joining the continuing partnership but his personal assets will not. This is the rule in the United States and has been since 1914.<sup>31</sup> It does not appear to have been a disincentive to joining partnerships.

8.28 Where after the incoming partner joins the partnership, a partner withdraws and the firm gives him an indemnity when buying out his interest in the partnership, the incoming partner will incur secondary liability to the former partner under that indemnity. His personal assets may thus be affected by prior obligations. But again this arises under the existing law when a "new" partnership takes over an "old" partnership's business and grants an indemnity to an outgoing partner.

8.29 We therefore think that the default rule, which partners can reverse or qualify by agreement, should be that a partnership continues on a change of membership whether that change is a partner joining the partnership or a person ceasing to be a partner, provided that there remain at all times at least two partners. We achieve this result in the draft Bill by defining exclusively the grounds on which a partnership breaks up. In a partnership with only two partners the withdrawal of one partner will break up the partnership.

8.30 **We therefore recommend that it should be a default rule that a partnership continues when a partner joins a partnership or withdraws from a partnership, provided that there remain at all times at least two partners. This is achieved in the draft Bill by providing a comprehensive list of the circumstances in which a partnership breaks up and by excluding from that list a change in the membership of the firm (unless the partnership agreement otherwise provides).** (Draft Bill, cl 38).

8.31 Continuity of partnership where a partnership has separate legal personality means that the same entity will hold the property of the partnership and will be primarily liable for partnership obligations notwithstanding changes in its membership. The secondary liability of partners will be affected by the exits and entrances of partners as discussed in Part VI above.<sup>32</sup>

8.32 We also recommend the abolition of the outgoing partner's right under section 42 of the 1890 Act to opt to receive a share of the profits made after his withdrawal where the continuing partners have not bought out the outgoing partner's share. It is notoriously difficult to attribute a proportion of the profits of a continuing partnership to the use of the outgoing partner's share of the partnership assets.<sup>33</sup> The current editor of *Lindley & Banks* has described the section as "perhaps one of the Act's greatest failings".<sup>34</sup> While the existence of the option to receive a share of profits may occasionally encourage the continuing partners to pay out an

<sup>31</sup> See RUPA, s 306(b) which provides: "A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner".

<sup>32</sup> See paras 6.66 – 6.88 above.

<sup>33</sup> See *Willett v Blanford* (1842) 1 Hare 253, 269 and *Hugh Stevenson and Sons Ltd v Aktiengesellschaft für Cartonnagen-Industrie* [1917] 1 KB 842, 849.

<sup>34</sup> *Lindley & Banks*, para 1-05, footnote 8.

outgoing partner, we do not see it as a practical remedy. Instead we recommend that the outgoing partner will be entitled to the value of his share as a debt due by the partnership from the date of his withdrawal together with interest at a commercial rate from that date.<sup>35</sup>

- 8.33 As the partnership will continue on the withdrawal of a partner it is necessary to provide for the buy-out of the outgoing partner's share. We think that there should be a default rule that where a partner withdraws from a partnership<sup>36</sup> he should become entitled to a financial payment which we discuss below.<sup>37</sup>
- 8.34 If the outgoing partner holds any partnership property in his own name at the time of his withdrawal from the partnership, he (or his estate) should be bound, on request, to transfer title to the partnership or to trustees for the partnership.
- 8.35 **We therefore recommend that there should be a default rule that where a partner withdraws from a partnership, he is bound on request to transfer to the partnership or to trustees for the partnership title to any partnership property which he held in his own name at the time of his withdrawal from the partnership.** (Draft Bill, cl 34(7))

#### **STRIKING A BALANCE: THE RIGHTS OF THE OUTGOING PARTNER**

##### **Our provisional proposals**

- 8.36 In the Joint Consultation Paper we provisionally proposed that the outgoing partner should be entitled to the value of his share as a debt due by the partnership from the date of his withdrawal. We discuss the measure of value and the extent of the indemnity to which the outgoing partner would be entitled in the following section.<sup>38</sup> The outgoing partner would not have the right to require the business to be wound up unless this right was conferred in the partnership agreement. Nonetheless, the outgoing partner would have a right to apply to the court for a winding up on the ground that there was a substantial likelihood that the remaining partners would not be able to pay out his share or that the outgoing partner would not be indemnified against the liabilities of the partnership.

##### **Consultation**

- 8.37 Consultees were divided on the protection which we proposed for the outgoing partner. Those who opposed the removal of the partner's right to insist on a

<sup>35</sup> This also removes any problem of an overlap between ss 29 and 42 of the 1890 Act to which Arden LJ referred in *John Taylors (a firm) v Masons and Willsons* [2001] EWCA Civ 2106, para 38.

<sup>36</sup> Withdrawal includes voluntary withdrawal, death, bankruptcy, withdrawal on the order of the court and expulsion (where expulsion is competent).

<sup>37</sup> We had considered postponing the extinction of the outgoing partner's share until the partner received the value of his share. But as the postponement would not give the outgoing partner any substantive rights, we saw no benefit in doing so. As our consultant said, it would be a lien without teeth. Our policy therefore is that on withdrawal the outgoing partner's share in the continuing partnership is extinguished and replaced with (a) his right to the value of that share and (b) his (implied) indemnity.

<sup>38</sup> See paras 8.69 – 8.73 and 8.75(3) below.

winding up suggested that the protection was inadequate and that the right to wind up the business should remain to prevent the remaining partners “driving the [partnership] business into the ground”. Others suggested that the outgoing partner should not have a right to wind up but that he should be given further protection. Suggestions included giving the court power to order a winding up not only on the ground proposed but also on the “just and equitable” ground. Another suggestion was to lower the threshold from “substantial likelihood” to “a real possibility” or a similar test. The Chancery Bar Association suggested that the outgoing partner should have an unfettered right to apply to the court which should be empowered to order a winding up if that were “just and equitable”.<sup>39</sup>

8.38 Other consultees thought that the proposal gave the outgoing partner too much protection. They did not favour allowing the outgoing partner to seek a winding up order from the court. They argued that it was not necessary as he could recover his debt by normal means of enforcement and that his best chance of payment and indemnity was if the partnership continued in business.<sup>40</sup>

8.39 Some consultees also expressed the view that a partnership should have the right to dissolve itself on the death or bankruptcy of a partner whose membership was essential to the viability of the partnership business.

### **Reform recommendations**

8.40 The question is one of balancing the interests of the outgoing partner on the one hand and the remaining partners on the other. There is also the public interest in preserving businesses and facilitating economic activity.

8.41 We adhere to the view that the primary right of the outgoing partner should be to receive the value of his share in the partnership. As that share is valued by reference to the net assets of the partnership, the outgoing partner in the default regime should be entitled to an indemnity from the continuing partnership at least in relation to the liabilities of the partnership which were taken into account in valuing his share. We discuss the valuation of the outgoing partner’s share and the indemnity below.<sup>41</sup>

8.42 At present, parties negotiating the withdrawal of a partner under English law have to consider on the one hand the right of the outgoing partner to seek the winding up of the partnership and on the other the option available to the continuing partners to seek a *Syers v Syers* order from the court.<sup>42</sup> It has been suggested to us that the possibility of obtaining such an order is a useful counterbalance to the

<sup>39</sup> The Law Reform Advisory Committee for Northern Ireland (NILRAC) advocated a similar approach but suggested that the court should have a discretion either to wind up the partnership or to direct a buy-out having regard to a list of specific issues such as the financial position of the partnership and the remaining partners, the time scale for payment and the value of any security offered. The Scottish Chambers of Commerce also referred to the possibility that the outgoing partner should have a right to seek a winding up on the “just and equitable” ground.

<sup>40</sup> The APP.

<sup>41</sup> Paras 8.62 – 8.68 and 8.75(1) below.

<sup>42</sup> See para 8.10 above.

outgoing partner's right to seek a winding up. Those consultees who opposed our provisional proposals nevertheless saw merit in the statutory codification of the *Syers v Syers* jurisdiction.

- 8.43 We think that it is more appropriate that the default regime presents the balancing factors the other way round. Under our recommendations the outgoing partner's primary right is his financial entitlement. To discourage unscrupulous behaviour by the continuing partners we think that the outgoing partner should have the additional right, both at the time of his withdrawal and thereafter, to apply to the court for the winding up of the partnership.
- 8.44 A former partner who has not been paid his financial entitlement by the continuing partnership or who has good grounds for apprehending that the partnership could not or would not honour the indemnity that it had given would have the right to seek a court order for the winding up of the partnership.<sup>43</sup> Under the existing law the outgoing partner who agrees a financial settlement with his partners and then withdraws from the partnership is not able to seek a dissolution and winding up under sections 35 and 39 of the 1890 Act if his partners then fail to implement the settlement. This is because he is then no longer a partner. He has only the ordinary court remedies for contractual claims against his former partners and if appropriate he can initiate insolvency proceedings.
- 8.45 While a court may in many cases be reluctant to order the winding up of a partnership on the application of a former partner long after he has left the partnership, there may be cases where the former partner can demonstrate that a winding up order is appropriate. A former partner may find it difficult to enforce an indemnity in his favour where the financial health of the continuing partnership is precarious: the indemnity is a continuing obligation and is required so long as debts, for which the former partner has a secondary liability, subsist. The right of a former partner to apply for a winding up at the time of withdrawal and thereafter would be a fact which the continuing partners would require to take into account in their negotiations with an outgoing partner.
- 8.46 We see merit in the suggestion that we should not lay down tests for such applications, for example, by requiring a substantial likelihood that the remaining partners would not meet their financial obligations to the outgoing partner. We think that a former partner should have a statutory right to seek the winding up of the partnership on the ground that the affairs of the partnership are being conducted in a way which prejudices his interests and it is just and equitable that it be wound up. This will provide the continuing partners with a motive to meet the outgoing partner's financial entitlements and will give the court discretion to act justly in the light of all the circumstances.
- 8.47 In dealing with an application by a former partner the court would be able to give such relief as it thought fit. Where the problem was a failure by the remaining partners to provide accounts which established the outgoing partner's financial

<sup>43</sup> This right would give the continuing partners a strong incentive to pay the outgoing partner's financial entitlement. It would also allow the outgoing partner to wind up the partnership where he could demonstrate that it was not able to discharge the debts for which he was liable or to honour the indemnity.

entitlement, the court could order that the requisite accounts be drawn up. In addition, the court could order interim payments or require the remaining partners or the partnership to provide security for the outgoing or former partner's claim. Where necessary, the court could order the break up of the partnership and appoint a liquidator to wind up its business. For example, if the continuing partners had stripped assets out of the partnership to the prejudice of the former partner, the court could take account of such action in granting relief to the former partner. The personal representative of a deceased partner and the insolvency practitioner in relation to a bankrupt partner should also have the right to seek relief, for example where their interests are being prejudiced by the incompetent winding up of a partnership.<sup>44</sup>

- 8.48 **We therefore recommend that a former partner, the personal representative of a deceased former partner and the insolvency practitioner in relation to a former partner should have the right to apply to the court to make an order to give relief on the ground that the partnership affairs are being conducted in a way that is prejudicial to his interests and it is just and equitable to make the order. The court should have a general discretion to make such order as it thinks fit for giving relief, including (without prejudice to the generality of the discretion) (a) requiring accounts to be drawn up, (b) requiring interim payments to be made, (c) requiring security to be provided, (d) breaking up the partnership and (e) giving directions as to the way in which the partnership is to be wound up.** (Draft Bill, cl 53).

## **THE FINANCIAL RIGHTS OF THE OUTGOING PARTNER**

### **Our provisional proposals**

- 8.49 In the Joint Consultation Paper we sought the views of consultees on different measures of valuation of the outgoing partner's share.

### ***The notional sales measure***

- 8.50 The first, the notional sales measure, would measure the outgoing partner's entitlement by reference to the value of the business as a whole on a hypothetical sale. This would include attributing a value to work in progress and (if appropriate) to goodwill.<sup>45</sup> We suggested that this measure should produce a fair valuation because it could take account of all the relevant factors which affect the

<sup>44</sup> A partner who has ceased to be a partner on or after the break up of the partnership, through death or insolvency, will be affected by the winding up as, in the default code, he will be entitled to be paid out under Steps 3 – 5 of cl 44 of the draft Bill. See cl 44(2). If the continuing partners were to dissipate the firm's assets by trading unprofitably during the winding up, the interests of the former partner's estate could be prejudiced.

<sup>45</sup> In many professional partnerships where the partners are not prevented by restrictive covenants from leaving and competing with the partnership there may be little value attached to goodwill as a partnership asset since a would-be purchaser could not be sure of a substantial continuing income flow without tying in the partners who generate that income.

value of the business. But we recognised that this inclusivity could make the measure a costly exercise.<sup>46</sup>

### ***The accounts measure***

- 8.51 The second, the accounts measure, would measure the outgoing partner's entitlement by reference to the accounting practice in the last annual accounts. The accounts could be made up on that basis to the date on which the outgoing partner leaves the partnership. Many partnerships adopt this approach in partnership deeds. It has the advantage of being relatively simple, certain and cheap to apply. The principal difficulty with that measure, however, is that in many partnerships the annual accounts are not compiled for the purpose of valuing the partnership's business and the values attributed to assets may be an inappropriate basis for assessing the value of the outgoing partner's share. We also pointed out that annual accounts often ignore goodwill. They may also treat work in progress in a way which would not be appropriate in this context.<sup>47</sup>

### ***An indemnity***

- 8.52 As on either measure the outgoing partner is being paid a value for his share of the value of the partnership, one looks to the net assets of the partnership after deduction of known liabilities. We therefore proposed as a default rule that the outgoing partner should receive the benefit of an indemnity from the remaining partners. We asked consultees whether the indemnity should be qualified (a) to exclude any liability attributable to the outgoing partner's wrongful acts or omissions; or (b) so that it was without prejudice to any claims which the partners or partnership might have against the outgoing partner for breach of duty to the partnership; or (c) in any other way.<sup>48</sup>

### ***Interest on the value of the unpaid share***

- 8.53 In place of section 42 of the 1890 Act we proposed that the outgoing partner should have a right to interest at a commercial rate on the value of his share in the partnership which remained outstanding after his withdrawal.<sup>49</sup>

### **Consultation**

- 8.54 Most consultees favoured the proposal to introduce a statutory default measure of the value of the partnership to enable partners to value the outgoing partner's share. It was recognised that it was not appropriate to lay down detailed rules of valuation as the circumstances of different partnerships were so varied.

### ***The appropriate measure of value***

- 8.55 The majority of consultees supported the notional sales measure as the fairest default provision. Several consultees pointed out that in many partnerships there

<sup>46</sup> Joint Consultation Paper, para 7.37.

<sup>47</sup> Joint Consultation Paper, paras 7.40 and 7.41.

<sup>48</sup> Joint Consultation Paper, para 7.29.

<sup>49</sup> Joint Consultation Paper, para 7.26.

was little if any value attached to goodwill because the sellers of a partnership business did not usually give covenants against competition. Nor is it usual for the incoming partner to pay for goodwill. The Institute of Chartered Accountants in England and Wales thought that the notional sales measure was too expensive as a default provision.<sup>50</sup> They favoured an adaptation of the accounts measure in order to take account of the market values of tangible fixed assets and individually saleable intangible assets, other than goodwill.

- 8.56 Many consultees opposed the accounts measure, maintaining that it was unfair. It was argued that the partnership's accounts were compiled for a different purpose and might state assets at inaccurate values. There could be a material difference between the written down value of assets in partnership accounts and their market value. The measure was also not suitable for the partnership where a partner withdrew before the first annual accounts had been finalised.
- 8.57 Some consultees suggested that an approach based on "fair value", which was used in Financial Reporting Standards for company accounting, should be adopted. Another suggestion was that partnership law should adopt an approach similar to that adopted by the courts in the valuation of a minority shareholder's interest under section 461 of the Companies Act 1985. Our consultant opposed the use of the concept of "fair value" and emphasised that the critical issue was the need to ascertain the market value of the partnership business or its assets. This involved many factors such as whether the business was to be viewed as a going concern or valued on a break up basis, whether the partners were assumed to be in the market and whether and, if so, how value was to be attributed to goodwill. He suggested that detailed valuation rules were unworkable.

#### ***An indemnity to the outgoing partner***

- 8.58 Most consultees supported the inclusion in the default regime of an indemnity to the outgoing partner. Several consultees suggested that the proposal reflected the position under the existing law. Roderick Banks, our consultant, considered the indemnity to be essential. Several consultees pointed out that the outgoing partner was also entitled to the indemnity when on completion of the withdrawal accounts it was discovered that he was not due to be paid anything by the partnership and when, if there was a balance due by the outgoing partner, he paid that balance to the partnership. We agree. Whoever is due to pay a balance to the other, that balance is calculated by reference to the value of the net assets of the partnership. Accordingly, known liabilities are already taken into account in determining that balance.
- 8.59 There was limited opposition to the proposal for an indemnity. One consultee argued that there should be no general indemnity unless expressly provided for in a partnership agreement. It referred to the risk of "long tail" liabilities in the construction industry where liability could arise from latent defects in work completed by an earlier generation of partners. The risk of such liability would, it suggested, encourage partners to insist on a dissolution of the partnership and the formation of a new one in order to avoid a general indemnity. One consultee

<sup>50</sup> The Institute of Chartered Accountants of Scotland on the other hand favoured the notional sales measure.

preferred to leave indemnity to the discretion of the partnership in order to discourage partners in a partnership in financial difficulty from leaving the partnership in order to burden their fellow partners with the obligation to indemnify them. It also expressed concern over giving an indemnity to a partner who had caused loss to the partnership by his behaviour and suggested that the default regime should allow a partnership by a 75% majority to deprive a partner of his indemnity. Another consultee suggested that the indemnity should be limited to known and ascertained debts taken into account when valuing the outgoing partner's share.

### ***Restrictions on the indemnity***

- 8.60 Consultees expressed differing views on the extent to which the indemnity should be qualified to exclude liability attributable to the outgoing partner's wrongful acts or omissions. Some argued that the indemnity should be limited only by express agreement. Differing views were expressed on whether the indemnity should not cover future liabilities for the outgoing partner's negligence rather than dishonesty or deliberate fault. The Scottish Law Commission's Partnership Advisory Group suggested that the indemnity should be qualified so that it was without prejudice to any claims which the partners or the partnership might have against the outgoing partner for breach of duty but that the draft Bill should not attempt to define other exclusions.

### ***Interest on the value of the outgoing partner's share***

- 8.61 In response to our proposal that the outgoing partner should have a right to interest at a commercial rate on the value of his share in the partnership, consultees expressed different views as to the rate of interest which would be appropriate. The Institute of Chartered Accountants of England and Wales suggested rates of interest which escalated over time so as to impose a penal rate if there was serious delay. Other suggestions included the rate of interest on judgments and a fixed percentage over the Bank of England base rate or London Interbank Offered Rate (LIBOR) to provide an incentive for the debt to be paid without being punitive to the continuing partnership.

## **Reform recommendations**

### ***The measure of value***

- 8.62 We recognise that any default measure of value will have its critics. We also agree that it is inappropriate to lay down detailed statutory rules of valuation: not only will the detailed rules be inappropriate for some partnerships but also accounting practice will change over time.
- 8.63 In our view, the most important consideration in the default regime is to place the outgoing partner and the continuing partners as closely as possible to the financial position in which they would be on a winding up of the business, whether by sale of the business or by the breaking up of its assets. As we recommend that the outgoing partner should lose the right to insist on the winding up of the partnership, it is appropriate to protect his financial position so that he enjoys an equivalent financial right. We agree with Roderick Banks that it is important to ascertain the market value of the partnership business or its assets in the default regime. Partnerships which wish to adopt the accounts measure may contract out

of the default regime to do so. But, applying the “think small first” principle, the default regime should address market value.

- 8.64 We think that this is essentially similar in aim to the “fair value” approach of the Financial Reporting Standards (FRS). FRS 7 (“Fair Values in Acquisition Accounting”) defines “fair value” as “the amount at which an asset or liability could be exchanged in an arm’s length transaction between informed and willing parties, other than in a forced or liquidation sale”. The FRS then sets out detailed principles by which the acquiring company is to value the acquired business in its accounts. In this context the exclusion of a forced or liquidation sale is appropriate. We do not recommend the enactment of detailed valuation rules in a Partnerships Bill or in subordinate legislation. It is not necessary therefore to consider the detailed principles of FRS 7. We also do not think that it is appropriate to use a concept like “fair value” in legislation as that might be a licence for parties to argue that equitable considerations based on the parties’ prior conduct should influence the value to be attributed to an outgoing partner’s share. What we take from FRS 7 is the pursuit of the market value of the assets of the business.
- 8.65 In the context of the valuation of an outgoing partner’s share, the market value of a business may be its value on a sale as a going concern or it may be the break up value of its assets. Some partnership businesses may be capable of sale as a going concern; many may have value which is realisable only through the sale of assets in a winding up.
- 8.66 We have looked again at our proposals for valuation in the light of the consultation responses. We have considered the approach of RUPA, which seeks to encourage the norm of the buy-out of the outgoing partner’s share. In section 701(b) RUPA defines the buy-out price of a dissociated partner’s interest as the amount which would have been distributable to the dissociating partner on a winding up:
- ... if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on the sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date.
- 8.67 We are attracted to this approach as it is an attempt to give the outgoing partner that which he would receive if the partnership were wound up. In some partnerships it may be possible to sell the business as a going concern, particularly where the partnership’s economic activity is not dependent on the work of its individual partners so that other persons could manage the business in their place. In others, for example professional partnerships, it may be more difficult to do so, where the client connection is with the individual partners and where those partners are not contractually constrained from leaving the partnership and competing with it. The hypothetical vendors of the partnership would seek to maximise the sale price by a sale as a going concern if that were possible. In many cases it may not be possible. Where it is not possible, on the RUPA approach, the liquidation value will be the appropriate value.
- 8.68 In many professional partnerships, where the restrictive covenants (if any) in the partnership agreement do not prevent the partners from leaving the partnership and competing with it and where partners are not contractually obliged to remain within the partnership in the long term, it is conventional for valuers to attribute

either no value or only very limited value to goodwill. This is because the hypothetical purchaser will not pay the hypothetical vendor a significant sum for the partnership business in addition to the value of its other assets because the purchaser cannot be sure of the continued contribution of the partners.<sup>51</sup> The price paid for the going concern therefore attributes little if any value to goodwill. The RUPA formula, which refers to the business as a going concern without the dissociated partner, therefore makes no assumption that the purchaser will pay the vendor anything for goodwill since it is not assumed that the other partners are tied into the business. We adopt a similar approach in our recommendation. Our formula refers to the possibility of a sale as a going concern of the partnership business without the outgoing partner. Whether or not such a sale would have been achieved on the balance of probability is a question of inference from the facts in a particular case, as, under the existing law, it is in the valuation of an outgoing partner's share. No assumption is made that the other partners are in any way tied into the partnership in the absence of any contractual terms which so tie them.

### ***The outgoing partner's indemnity***

- 8.69 We consider that an outgoing partner whose share is valued by reference to the net assets of the partnership should be entitled to an indemnity in the default regime. Otherwise he suffers the deduction of known liabilities in the calculation of his share while remaining liable to third parties for those partnership liabilities without the right to be reimbursed by his former partners. The indemnity will not prevent third parties from suing the former partner but so long as the partnership and his former partners are solvent, he can seek reimbursement from them should he be required to pay a partnership debt to a third party.
- 8.70 We have considered carefully whether to provide for a general indemnity against liabilities or to confine the indemnity to known liabilities which were taken into account in determining the outgoing partner's financial entitlement. We are aware of arguments in favour of the latter. RUPA<sup>52</sup> provides a general indemnity against liabilities and has been criticised as giving excessive indemnification in so far as the liabilities are unknown and not taken into account in fixing the buy-out price of the dissociating partner.<sup>53</sup>
- 8.71 On the other hand, it appears to be the present law that an outgoing partner is entitled to a general indemnity from his former partners who choose to continue in partnership and take over the assets of the partnership. Thus in *Gray v Smith*<sup>54</sup> it was held:

<sup>51</sup> The loyalty of the continuing partners is bought by offering them attractive levels of income from the continuing business, not by paying the vendor for their future services. That is a benefit which the vendor usually is not able to offer for sale.

<sup>52</sup> RUPA, s 701(d).

<sup>53</sup> Hillman, Vestal and Weidner, *The Revised Uniform Partnership Act* (2003 ed), p 290-291 state: "Overly-generous indemnification may encourage members of a partnership in an early stage of decline to dissociate and demand indemnification from the partnership for liabilities not fully reflected in the valuation of their interests but later asserted by third parties".

<sup>54</sup> (1889) 43 Ch D 208, 213. See also *Lindley & Banks*, para 10-247.

The withdrawing partner shall make over to the continuing partners all his interest in the partnership and in the partnership assets, whether there be real or personal estate ... Secondly ... the continuing partners shall indemnify the retiring partner against all liabilities of the firm from that time forth.

8.72 We think that we should preserve this existing rule. It achieves finality. By contrast, an indemnity which is confined to known liabilities may not achieve finality in the calculation of the financial entitlement of the outgoing partner and the continuing partners. In some cases it may expose the outgoing partner to an unforeseen liability. For example, a partnership may enter into a lease at market value while partner A is a partner. When partner A resigns from the partnership the lease may have no value and be ignored in the calculation of the outgoing partner's interest. Some time later the partnership assigns the lease to a third party. In English law, if the assignee of a lease went bankrupt the partnership as assignors would incur liability to the landlord. Partner A would retain secondary liability under the lease. If we were to recommend an indemnity which was limited to known liabilities, the former partner would not have an indemnity against such a claim. That appears to be unjust as the continuing partners have chosen to assign the lease to the third party. In addition, an indemnity confined to known liabilities could create significant problems in relation to disputed liabilities where complaints are intimated to a partnership but it is not clear whether any or how many may develop into claims. In addition, where the firm has an insurance policy which operates on a "claims arising" basis the former partner may benefit from the firm's insurance through the indemnity when otherwise he would not. We therefore favour a general indemnity as the default rule.<sup>55</sup>

8.73 We also think that an outgoing partner's entitlement to an indemnity on withdrawal should not prevent the partnership or the other partners from pursuing claims against him for breach of duty, breach of contract, fraud or misrepresentation. Under the existing law the implied indemnity does not cover claims which any of the other partners have against the outgoing partner, such as for breach of duty.<sup>56</sup>

### ***The right to a commercial rate of interest***

8.74 We have already recommended that it is not appropriate to preserve the outgoing partner's option under section 42 of the 1890 Act to seek a share of the profits attributable to the continuing partnership's use of his share of the partnership.<sup>57</sup> While there may be some circumstances in which the right to share in the profits of a continuing partnership would produce a fair result, we think that in most circumstances the right to receive a commercial rate of interest on the debt due by the continuing partnership is sufficient. The rate of interest must provide an incentive to the continuing partnership to pay out the outgoing or former partner without being punitive. We consider that the rate of interest should initially be 3% above the Bank of England base rate but that the Secretary of State should be

<sup>55</sup> As with the indemnity to which a partner is entitled under cl 12 of the draft Bill, this indemnity covers payments made reasonably and in good faith. See para 10.30 below.

<sup>56</sup> See *Lindley & Banks*, para 10-248.

<sup>57</sup> See para 8.32 above.

empowered to prescribe the rate of interest to reflect changing economic circumstances.<sup>58</sup>

**8.75 We recommend therefore that there should be a default rule that on withdrawal from the partnership the outgoing partner (or his estate) has the following financial rights as a debt due by the partnership:**

- (1) To be paid the value of his share in the partnership calculated on the hypothesis that the partnership had broken up and its assets were sold on the date of his withdrawal at a price equal to the greater of (i) the liquidation value and (ii) the value based on a sale of the entire business as a going concern without the outgoing partner.** (Draft Bill, cl 32(1), (2)(a) and (3))
- (2) To be paid interest at a commercial rate on the value of his share from the date of withdrawal. The prescribed rate of interest should initially be three per cent above the Bank of England base rate. The rate should be alterable by statutory instrument to allow for changes in economic conditions.** (Draft Bill, cls 32(2)(b), 76(1))
- (3) To be indemnified against partnership liabilities or payments made in reasonable settlement of an alleged personal liability for a partnership obligation but the indemnity is without prejudice to any claim of the partnership or the other partners against the outgoing partner.** (Draft Bill, cl 34(1), (2) and (3))

8.76 The right set out in paragraph 8.75(1) above will have the effect that the partnership assets are valued as they are at the date of withdrawal but that the price to be paid for the business is on the basis that the partnership will not have the continuing services of the outgoing partner. Whether in the hypothetical sale the purchaser will pay anything to the vendors for the continued services of the partners who remain will depend on the nature of the partnership business and the terms on which those partners participate in the business. As we have said,<sup>59</sup> in many cases where the other partners are not tied in to a partnership by restrictive covenants, no added value will be attributed to the prospect of their continued involvement in the partnership business. The formula in paragraph 8.75(1) above, in its reference to the going concern without the outgoing partner, makes no assumption as to whether the other partners will stay with the partnership.

8.77 It may occur that the valuation exercise set out in paragraph 8.75(1) above results in a sum due by the outgoing partner to the partnership, as the partnership may have a negative value or if it has a positive value, there may in the result be a negative balance on the outgoing partner's account. The default rule should be that the former partner is liable to pay the resulting sum to the partnership.

<sup>58</sup> The Law Commission has consulted on a proposal that the former partner should receive compound interest on his share in the partnership. See Compound Interest, Consultation Paper No 167.

<sup>59</sup> See paras 8.66 – 8.68 above.

8.78 **We therefore recommend that where the valuation of the outgoing partner's share in terms of paragraph 8.75(1) above results in a sum due by the outgoing partner (or his estate) to the partnership, the outgoing partner (or his estate) should be liable to pay that sum to the partnership.** (Draft Bill, cl 32(2) and(3))

***Where the partnership does not honour the indemnity***

8.79 If the firm does not indemnify the former partner who has withdrawn from the firm before the firm breaks up, he should be entitled, in the default regime, to an indemnity from any person who was a partner when he ceased to be a partner and who continued to be a partner thereafter. This is justified by the consideration that the continuing partners have in substance taken over the former partner's interest in the partnership's net assets and it is they who should be responsible to indemnify him against continuing or future liabilities. If the former partner is not so indemnified he should be entitled to contribution from any person, such as another former partner or a continuing partner, who was liable with him for the partnership obligation. As those obliged to make such contributions may not have been partners at the same time in the partnership,<sup>60</sup> it is not possible to use the proportions in which partners are liable to bear partnership losses.<sup>61</sup> We therefore recommend that the contributions should be of such amount as is just and equitable.<sup>62</sup> In the case where a former partner reasonably and in good faith settles an alleged personal liability for a partnership obligation, those liable to contribute should be those who would have been liable with him if the alleged liability had been established.

8.80 **We therefore recommend that if the partnership does not pay all or part of the indemnity the former partner should be entitled to either (a) indemnity from any person who was a partner when he ceased to be a partner and who continued to be a partner thereafter or (b) contribution from any person who was liable with him for the partnership obligation (or, in case of settlement of an alleged liability, would have been liable if the alleged liability had been established) of such amount as is just and equitable.** (Draft Bill, cl 34(4) and (5))

8.81 The former partner's rights to indemnity from the firm and to indemnity or contribution from his former partners are default rules. It is open to partners to agree other terms to govern the rights of an outgoing partner. But the rights of the former partner once conferred cannot be removed without his consent. It is not necessary therefore to state in the draft Bill that the continuing partners cannot retrospectively alter the rights of a former partner without that person's consent.

<sup>60</sup> For example, where a claim is made both in contract and in tort (delict) and the partners with secondary liability in contract (ie the partners at the date of the contract) are not the same as those liable in tort (ie those who were partners when the act or omission occurred).

<sup>61</sup> See draft Bill, cls 11(2) and 12(7).

<sup>62</sup> This is consistent with the approach of English law in the Civil Liability (Contribution) Act 1978.

## THE MECHANISMS FOR WITHDRAWAL FROM A PARTNERSHIP AND THE POWERS OF THE COURT

### Introduction

- 8.82 In this section we consider the mechanisms for withdrawal from a partnership. We consider first voluntary withdrawal, where a partner chooses to retire from a partnership. We then consider involuntary withdrawal, which may occur on the death or bankruptcy of a partner. Thirdly, we consider the circumstances in which the court may order the withdrawal of a partner instead of ordering the winding up of the partnership. We also consider the circumstances in which the court may order the break up of a partnership.
- 8.83 The decision of the House of Lords in *Hurst v Bryk*<sup>63</sup> revealed a real uncertainty in the law as to whether the contractual rules on rescission by acceptance of a repudiatory breach of contract apply to dissolve a partnership.<sup>64</sup> Lord Millett's approach (that the contractual rules do not apply) has been followed by Neuberger J in *Mullins v Laughton*.<sup>65</sup> It is also uncertain whether the contractual doctrine of frustration applies so as to bring about the dissolution of a partnership.
- 8.84 Our suggested reform of partnership law provides an opportunity to clarify the role of contractual doctrines in the dissolution of partnerships in order to remove the uncertainties which we have mentioned. We have concluded that the law can be simplified by defining in the draft Bill the grounds upon which a partnership may be brought to an end by the intervention of the court and by thus excluding the application of the doctrine of repudiatory breach in line with Lord Millett's reasoning in *Hurst v Bryk*.<sup>66</sup> We do this by providing in the draft Bill comprehensive lists of the events which break up a partnership and of the circumstances in which a person ceases to be a partner in a partnership.<sup>67</sup>

### (1) THE MECHANISMS FOR VOLUNTARY WITHDRAWAL

#### The mischief

- 8.85 The introduction of continuity of partnership requires us to address the mechanisms by which a partner may withdraw in a manner which protects both his interest and also the interests of the remaining partners. Since the consultation exercise we have benefited from further discussions on this matter with amongst others the APP and have developed our policy as a result.
- 8.86 The APP and our consultant, Roderick Banks, have emphasised the need for a withdrawal mechanism which protects the reasonable expectations of the outgoing partner and the remaining partners. What is required is a more orderly process of

<sup>63</sup> [2002] 1 AC 185. Textbook writers have responded differently to the case: see *Lindley & Banks* (para 24-07) and Blackett-Ord in the preface to his 2<sup>nd</sup> edition.

<sup>64</sup> In this paragraph and in the next paragraph "dissolve" and "dissolution" are used in the sense of the existing law. See para 8.5 above.

<sup>65</sup> [2003] Ch 250.

<sup>66</sup> [2002] 1 AC 185.

<sup>67</sup> See the draft Bill, cls 38 and 28 respectively.

resignation. The outgoing partner requires reasonable certainty as to his entitlement on withdrawing from the partnership. On giving notice of resignation he should be able to know promptly whether he is to be bought out by a continuing partnership or the partnership is to break up. The remaining partners may decide that the withdrawal of a partner compromises the viability of a partnership and that the prudent response to his impending withdrawal is to break up the partnership. They need an opportunity to reach a view on this issue.

- 8.87 Several consultees urged us to provide that the remaining partners could break up a partnership where a partner wishes to retire and the residual partnership would not be large enough to support its continuing liabilities.<sup>68</sup> The APP have suggested to us that there should be a default rule requiring a partner who wished to resign to give a minimum period of notice and laying down a timetable for the other partners to respond to that notice. This would enable the outgoing partner to give his notice in the knowledge that he would withdraw on a fixed date. It would give each of the remaining partners an opportunity to decide whether to resign. And it would give those partners who had not given notice of retirement within the fixed timetable the opportunity to decide to break up the partnership.
- 8.88 The APP have also suggested that in any event it would be reasonable that a partnership of undefined duration should be broken up if at least fifty per cent of the partners wish to break it up (whether or not a partner has decided to resign); but that any partner who has given notice of resignation should be excluded from taking part in such a vote.

#### **Reform recommendations**

- 8.89 We recognise that if we are to meet the concerns of the APP and others we will be creating a more complex default regime than the present simplicity of a dissolution (technical or otherwise) on any change in the membership of a partnership. But that simplicity comes at the price of instability of the partnership.
- 8.90 It would be possible to provide simply for the resignation of a partner on a period of notice and leave it to the partners to respond to that notice by themselves resigning or deciding to break up the partnership. But that would not have the benefit of a default regime which requires those resigning in response to do so with effect from the same day thus enabling the financial rights of all the partners to be ascertained as at the same date. The regime which we recommend will benefit the partnerships whose partners are well aware that they are in partnership but who have not agreed detailed terms. The proposed default rules offer a mechanism for withdrawal which is fair to both the outgoing partner and the other partners. As we have said, the default rules will not assist the inadvertent partnership; but it should be relatively easy for the courts to infer an agreement to disapply the withdrawal mechanism where the parties have envisaged a right to terminate their business association on notice.
- 8.91 We think that there should be a default rule that a partner who wishes to withdraw from a continuing partnership should give notice of his withdrawal which will take

<sup>68</sup> See for example *Sobell & Others v Hooberman* (unreported) 20 December 1993, Court of Appeal.

effect only after the end of the prescribed period. This period of notice will give the other partners the opportunity to consider their position in the light of the intended departure of the withdrawing partner. Some partners may not wish to continue in partnership in the absence of the outgoing partner. During the period of notice the other partners can individually decide whether to withdraw from the partnership or collectively decide to discontinue the partnership.

- 8.92 This is an innovation in partnership law because the default regime to date has provided the partnership at will as the basic partnership structure. On the other hand many well-drawn partnership agreements provide not only for the continuation of the partnership on the retirement of a partner but also for the other partners to dissolve the partnership in response to notice of a partner's proposed retirement. We aim to provide a practical mechanism for withdrawal which fairly balances the interests of the partners.
- 8.93 The APP emphasised the need to avoid the danger of some partners ambushing others by choosing a time to intimate withdrawal from the partnership which injures the other partners. In particular, a last minute intimation of withdrawal by a partner or group of partners could impose on the remaining partners the obligation to pay out the shares of the withdrawing partners and leave the remaining partners with sole responsibility for the continuing liabilities of the partnership. Such a burden may be unsustainable. The APP's suggested default regime of a timetable for resignation would give the remaining partners the opportunity to consider the viability of the partnership business in the light of the intended resignations and, if appropriate, to elect to break up the partnership on the expiry of the first partner's period of notice. The result of such an election would be that all of the partners would receive their entitlement on the winding up of the partnership.
- 8.94 We are persuaded that this is an appropriate regime for the voluntary withdrawal of partners from a continuing partnership and is a sensible reform to avoid unfairness as between partners. The appropriateness of particular periods of notice in the default regime is a matter of judgement. We considered a default notice period of 4 weeks (28 days) but received representations that such a period was too short.<sup>69</sup>
- 8.95 We also agree with the APP that, as a default rule, a partnership should be broken up if at least fifty per cent of the partners vote in favour of a break up; and that any partner who has given notice of resignation prior to such a vote should not be entitled to take part in it.
- 8.96 We have concluded that the following is an appropriate default regime for a partnership of undefined duration:
- (1) A partner wishing to resign from the partnership may give 8 weeks notice of his withdrawal;

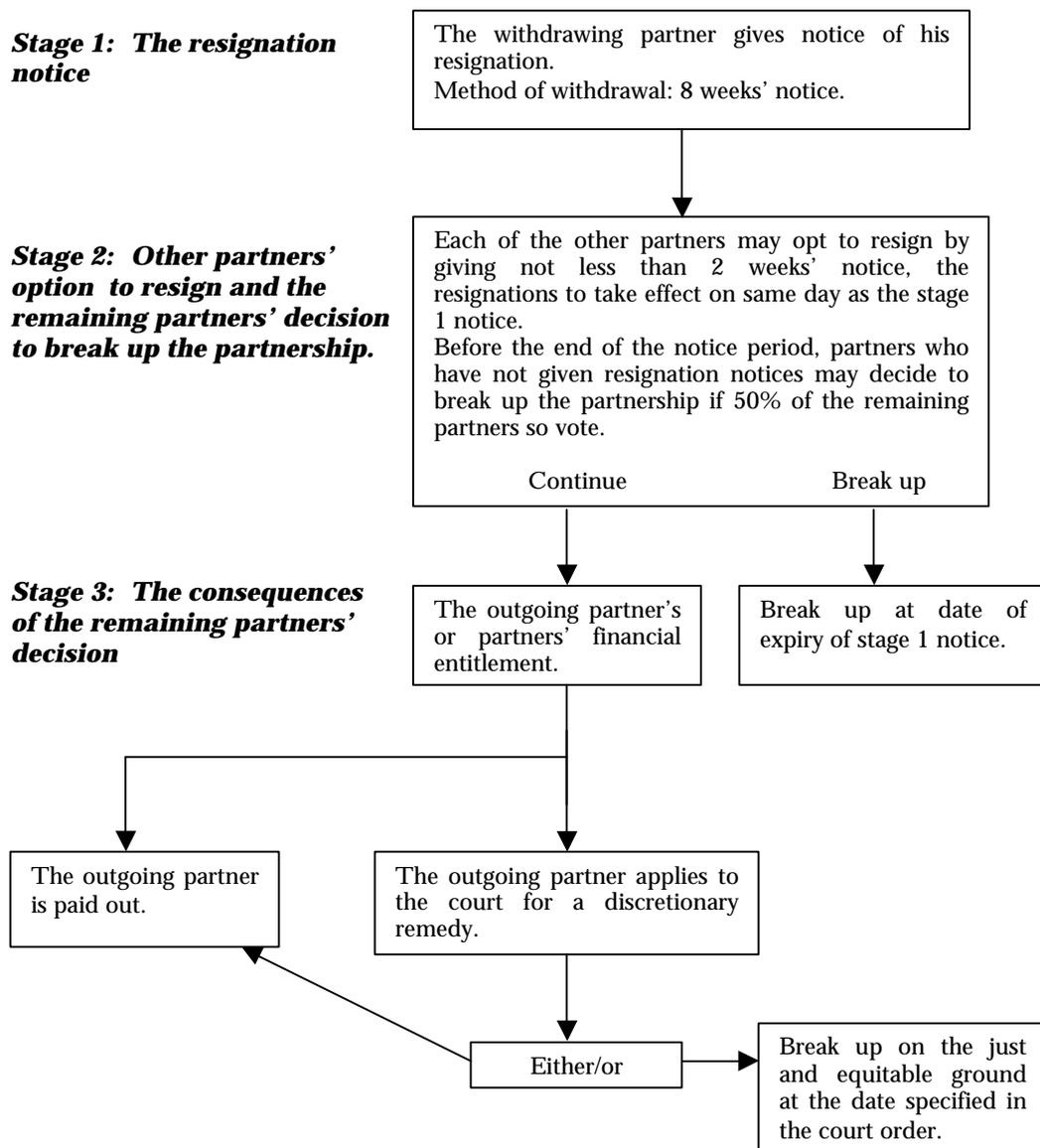
<sup>69</sup> For example if a partner is on holiday, he may have only a limited opportunity to take stock of his position on the imminent withdrawal of a co-partner. A case can be made out for a substantially longer period, say 3 months. But the longer the period of notice, the greater the likelihood that partners in an inadvertent partnership will act in ways which breach the implied terms of the partnership agreement of which they are unaware.

- (2) Each of the other partners has the option of resigning from the partnership at the same time as the partner in (1) above by giving not less than two weeks' notice of his intention to do so; and
- (3) The partnership may be broken up at any time by a vote of not less than fifty per cent of the partners (excluding any partner who has given notice of resignation).

8.97 By requiring the partners who wish to withdraw in response to the first partner's notice of withdrawal to give notice within the first 6 weeks of the first partner's notice period, the timetable gives the remaining partners a minimum of 2 weeks to consider their position and, where appropriate, to resolve to break up the partnership. If 50% of the partners vote to break up the partnership with effect on or before the expiry of the notice period, that decision would override the outgoing partners' resignation notices and all partners would receive the financial entitlements which arise in the winding up.

8.98 Diagram 1 below is a flow chart showing the effect of the default timetable and the consequences of withdrawal including the former partner's right to seek a discretionary remedy from the court.

**DIAGRAM 1**



8.99 Where the partnership is of defined duration a partner will not in most circumstances<sup>70</sup> have a right to resign from the partnership under the default regime nor generally should fifty per cent of the partners have the right to break it up. In such a partnership the partners will have contracted to be in partnership for a defined term. We think that the law should respect that contract. We envisage that if a partner were to withdraw prematurely from a partnership of defined duration the withdrawing partner would place himself in breach of contract and would expose himself to claims by his partners for damages for breach of contract.<sup>71</sup>

**8.100 We therefore recommend that the following rules should be the default rules for resignation from a partnership of undefined duration:**

- (1) A partner wishing to resign from a partnership of undefined duration should give each other partner eight weeks' notice of his resignation;**
- (2) Each of the other partners should then have a right to resign from the partnership by giving not less than two weeks' notice, such notice taking effect on the same date as the expiry of the first partner's notice period;**
- (3) Partners (excluding any partner who has given notice of any resignation) should be entitled to break up a partnership at any time if not less than half of the partners vote to do so. A vote to break up a partnership at the same time as a resignation notice takes effect would supersede the resignation notice and all partners will be entitled to such sums as were due to them on settlement of accounts in the winding up.** (Draft Bill, cls 30, 34(5) and 38(2)–(4)).

**(2) INVOLUNTARY WITHDRAWAL FROM A PARTNERSHIP**

**Reform recommendations**

***Death or bankruptcy***

8.101 The existing default regime provides for the dissolution of a partnership on the death or bankruptcy of a partner<sup>72</sup> or, at the option of the other partners, if any partner suffers his share of the partnership property to be charged for his separate debt.<sup>73</sup> In order to adapt these provisions to a default regime of continuity of partnership, we recommend that the death or bankruptcy of a partner should

<sup>70</sup> We recommend below that partners in a partnership of defined duration may resign if one or more of their partners dies or otherwise involuntarily withdraws from the partnership. See paras 8.101 – 8.106 and 8.110 (3) and (4) below.

<sup>71</sup> Our recommendations leave open the possibility that partners may claim damages from each other for breach of contract. What our recommendations exclude is the break up of the partnership by reason of the acceptance of a repudiatory breach of contract, frustration or rescission for fraud or misrepresentation. See para 8.126 below.

<sup>72</sup> 1890 Act, s 33(1).

<sup>73</sup> 1890 Act, s 33(2).

result in his ceasing to be a partner and that the other partners should have the right to expel from the partnership a partner who allows his share of the partnership to be charged.

- 8.102 Where a partner who is a natural person dies or a corporate partner ceases to exist his estate or its representative will have the same financial rights as he or it would have on resignation from the partnership.<sup>74</sup>
- 8.103 We also recommend for partnerships of defined duration a regime by which the other partners can elect to resign from the partnership in response to the death or bankruptcy and the remaining partners can agree to break up the partnership. Under the present default regime, a partnership, including one of defined duration, is dissolved on the death or insolvency of a partner.<sup>75</sup> Thus if a partner who is essential to the business of the partnership ceases to be a partner through death or insolvency, the other partners are not compelled to continue in partnership until the expiry of the agreed period. It appears sensible to allow partners to withdraw from a partnership whose viability has been undermined by the involuntary departure of an essential partner.
- 8.104 We recommend that a partner should have the right to resign from a partnership of defined duration when one or more persons has ceased to be a partner involuntarily, whether by death, insolvency or in terms of another provision in the partnership agreement. The notice regime will be the same as that for resignation in a partnership of undefined duration.<sup>76</sup> Similarly, in the case of such an event, the partnership may break up if 50% of the remaining partners decide that the partnership should end.<sup>77</sup>
- 8.105 We are aware of the suggestion that where partners respond to the death of a partner by resolving to break up a partnership, we should backdate the break up of the partnership to the date of death. The suggestion is prompted by a concern that the estate of the deceased partner might receive a going concern value of his share while the remaining partners receive only what is left in a winding up. We doubt if this outcome is likely. If the response of the surviving partners to the death of their colleague is to break up the partnership, it is likely that an informed valuation of the partnership at date of death (which takes account of the absence of the dead partner) would not be on a going concern basis. The valuer ought to foresee the likelihood that the partners would not continue in business where the deceased partner was critical to the success of the business.
- 8.106 Where a partner is rendered bankrupt he ceases to be a partner under the proposed default rules from the moment of his bankruptcy. If the other partners' response is to break up the partnership, we think that the date of the break up does not need to be back-dated to the date of bankruptcy in order to be fair to the other

<sup>74</sup> See para 8.75 above.

<sup>75</sup> 1890 Act, s 33(1).

<sup>76</sup> In effect the involuntary withdrawal of a partner from a partnership of defined duration allows partners thereafter to resign from the firm as if it were a partnership of undefined duration.

<sup>77</sup> See the draft Bill, cl 38(3).

partners, again for the reasons stated in the previous paragraph. Thus the bankrupt or insolvent partner (like the deceased partner's estate) will be paid out on a valuation on withdrawal, will not take part in the winding up, nor incur secondary liability in relation to expenses incurred in the winding up.

### ***Expulsion***

- 8.107 We do not support the introduction of any general power to expel a partner.<sup>78</sup> But in the Joint Consultation Paper<sup>79</sup> we proposed that where a partner's share is charged under a charging order there should be a specific power to expel in addition to the option which section 33(2) of the 1890 Act gives to dissolve<sup>80</sup> a partnership. In the Joint Consultation Paper we also asked whether section 33(2) of the 1890 Act should be extended to similar situations such as an arrestment in execution of a share in a partnership under Scots law or a voluntary assignment or assignation.<sup>81</sup> These proposals received general support, with several consultees favouring the remedy of expulsion in place of the option to dissolve the partnership.
- 8.108 We think that there is force in the suggestion that it is not necessary to give an option to dissolve a partnership where a partner has allowed his share in the partnership to be charged if the other partners are given a power to expel the offending partner. We recommend therefore that the option in section 33(2) of the 1890 Act be replaced by an option to expel the offending partner. As expulsion is a serious step in a contract of the utmost good faith, we recommend that exercise of the option should require the unanimity of the other partners. We also recommend that the option to expel should be available when a partner allows his share in the partnership to be charged and where the partner's share is arrested in execution under Scots common law, in respect of a debt which is not a partnership debt. In order to protect the offending partner from immediate expulsion when such an event occurs we also recommend that the offending partner should have a period of grace of three months to remedy the situation before the expulsion notice can take effect.
- 8.109 On reflection we now propose that there should not be a power to expel where a partner voluntarily assigns his share in the partnership. In contrast with the partner whose share is charged or, in Scotland, arrested in execution, the partner who voluntarily assigns his share may not be in financial difficulty and may be able to perform his contractual duties as a partner without difficulty. If he is not able to do so, the partners will have a right to apply to the court for his removal, for example, on the ground that his conduct is adversely affecting the carrying on of the partnership business.<sup>82</sup>

<sup>78</sup> See para 10.40 below.

<sup>79</sup> Joint Consultation Paper, para 6.53(3).

<sup>80</sup> Again, we use "dissolve" in this paragraph and the next paragraph in the sense of the existing law. See para 8.5 above.

<sup>81</sup> Joint Consultation Paper paras 6.49 – 6.53.

<sup>82</sup> See para 8.126 below.

**8.110 We recommend that the following rules should be default rules for involuntary withdrawal from a partnership:**

- (1) If a partner dies (or if a non-natural legal person ceases to exist) or goes bankrupt (or if a non-natural person, an insolvent winding up order or an award of sequestration is made) the partner ceases to be a partner on the date of death or bankruptcy; (Draft Bill, cl 28(1)(c) and 29)**
- (2) The partner in question (or his estate) has the same financial rights as on voluntary withdrawal; (Draft Bill, cl 32)**
- (3) Where in a partnership of defined duration one or more persons has involuntarily ceased to be a partner, any other partner may resign from the partnership by giving each other partner not less than eight weeks' notice; (Draft Bill, cl 30)**
- (4) In response to the notice in (3) above each of the other partners should have a right to resign; (Draft Bill, cl 30(3))**
- (5) After the death or bankruptcy of a partner, the remaining partners should be entitled to break up the partnership as in paragraph 8.100 above; (Draft Bill, cl 38(2)–(4))**
- (6) In place of the existing right to dissolve the firm, the partners will have an option to expel a partner by unanimous vote (other than the offending partner) where: (a) (in English law) the partner allows his share in the partnership to be charged and (b) (in Scots law) a partner's share is arrested in execution. In each case the offending partner will have a period of grace of three months before the expulsion notice takes effect. The expulsion notice will be treated as having no effect if during the three-month period the charging order or the arrestment ceases to have effect. (Draft Bill, cl 31).**

**(3) THE INTERVENTION OF THE COURT: REMOVAL OF A PARTNER OR WINDING UP**

**The mischief**

- 8.111 The power of the court under section 35 of the 1890 Act to order dissolution of a partnership is not matched by a statutory power to order the withdrawal of a partner while allowing the business of the partnership to continue. Where a partner or partners invoke the jurisdiction of the court under this section the usual result is the dissolution of the partnership.<sup>83</sup>

<sup>83</sup> In English law, there is the *Syers v Syers* jurisdiction: see para 8.10 above.

8.112 In addition, as mentioned above,<sup>84</sup> there has been uncertainty as to whether doctrines of contract law, such as rescission by acceptance of repudiatory breach and frustration apply in partnership law to bring a partnership to an end.<sup>85</sup>

### **Our provisional proposals**

8.113 In the Joint Consultation Paper we proposed that in the replacement of section 35 of the 1890 Act the court should have the additional power, where a partnership consists of three or more partners, to dissolve only the relationship between the partner in question and the other partners, while leaving the partnership relationship in being as between the rest.

8.114 We also addressed the controversy surrounding *Hurst v Bryk*<sup>86</sup> and suggested that acceptance of repudiatory breach should not terminate the partnership contract and dissolve the partnership but that the “innocent” partners should apply to the court for dissolution under section 35. We proposed a similar approach in relation to fraud and misrepresentation: the “innocent” partners would not be able to rescind the contract and terminate the partnership but would have to apply to the court for an order of rescission.

8.115 Thirdly, we addressed the application of the doctrine of frustration to partnerships asking whether dissolution could be restricted to terminating the relationship between the party affected by the frustration and the other partners or whether it was sufficient that cases of frustration should fall within the just and equitable ground of dissolution of partnership under section 35 of the 1890 Act.

### **Consultation**

8.116 There was general support for our proposal to give the court the additional power to dissolve the relationship between the partner in question and the other partners on the grounds set out in section 35. One consultee suggested that it amounted to a codification of the *Syers v Syers*<sup>87</sup> jurisdiction of the English courts and was welcome as such.<sup>88</sup>

8.117 Consultees were divided in their views on the correct approach to the application of contract law doctrines to partnerships. While there was a balance in favour of requiring a court order to terminate a partnership in the context of a repudiatory breach of the partnership contract, several consultees objected to the proposal on the basis that it was inconsistent with the underlying contractual basis of partnership in the agreement between the parties.

8.118 Views were also divided on whether there should be exceptions to the proposed requirement of a court order to terminate a partnership, for example where the

<sup>84</sup> Paras 8.83 – 8.84 above.

<sup>85</sup> *Lindley & Banks*, para 24-12, suggests that the 1890 Act may exclude the doctrine of frustration because it expressly caters for a number of frustrating events.

<sup>86</sup> [2002] 1 AC 185.

<sup>87</sup> (1875) 1 App Cas 174.

<sup>88</sup> See para 8.10 above.

“innocent” partner is excluded from the management and working of the partnership. Consultees were also divided in their views on whether a partner should be able to rescind the partnership contract for fraud or misrepresentation, with a majority favouring the proposal that a court order should be required to terminate the partnership. A majority of consultees favoured the proposal that cases of frustration of contract should fall within the just and equitable ground for court intervention in section 35 of the 1890 Act.

### **Reform recommendations**

- 8.119 We think that the court should have power to remove a partner from a partnership in addition to its power to terminate the partnership where there are grounds similar to those in section 35 of the 1890 Act. The introduction of this power, which is consistent with our policy of encouraging continuity of partnership, will enable the court to provide a proportionate remedy in circumstances which do not call for the winding up of the partnership.
- 8.120 We also see the preparation of the new draft Partnerships Bill as an opportunity to clarify the law by defining comprehensively in the Bill the circumstances in which the court may order the break up of the partnership or the withdrawal of a partner. We recommend that contractual doctrines such as acceptance of repudiatory breach and frustration should not have the effect of terminating a partnership in the absence of either a contractual provision or the intervention of the court.
- 8.121 This approach involves the acceptance of Lord Millett’s opinion in *Hurst v Bryk*<sup>89</sup> and the adaptation of his views to an entity approach to partnership. Lord Millett considers a partnership to be more than a contract once it comes into existence and suggests that the courts of equity in English law control the relationship between the partners. Thus, in his opinion, acceptance of a repudiatory breach does not of itself terminate a partnership; the parties have to invoke the jurisdiction of the courts of equity to order a dissolution.<sup>90</sup> We have recommended that the law of partnership should treat a partnership as an entity: a partnership would be a person whose characteristics are determined by the draft Partnerships Bill except so far as variable and varied by contract, by the partnership contract (if different from the default rules) and by the general law so far as not inconsistent with the terms of the draft Partnerships Bill.<sup>91</sup> A partnership while originating in a contract would become an entity whose demise was governed by the provisions of the draft Partnerships Bill except so far as the partners in their partnership agreement had competently varied those provisions.
- 8.122 This approach is also consistent with the American approach in RUPA which provides that a partnership breaks up and its business must be wound up only on the occurrence of specified events.<sup>92</sup>

<sup>89</sup> [2002] 1 AC 185.

<sup>90</sup> This analysis is not readily adaptable into Scots law as Scotland does not have a tradition of Chancery jurisdiction.

<sup>91</sup> See para 5.40 above.

<sup>92</sup> RUPA, s 801.

8.123 This does not mean that all contractual doctrines will cease to apply to a partnership. In particular a partner may be entitled to withhold performance of an obligation to another partner when the other partner is in breach of his contract. The mutual rights and duties of the partners, and the mutual rights and duties of the partners and the partnership, are subject to overriding duties of good faith.<sup>93</sup> Thus, a partnership may be entitled to protect itself against a partner who is in serious breach of his duty of good faith, for example where the partner is involved in a financial fraud, by suspending his authority immediately and excluding him from the premises. Where partners of a fraudulent partner so act, they will, if challenged by the excluded partner, have to establish the existence of the serious breach of contract or breach of duty in order to exclude a claim for damages. But the partners will be able to act against the fraudulent partner immediately and thus not have to await a court order.<sup>94</sup>

8.124 **We recommend therefore that contractual doctrines such as acceptance of repudiatory breach of contract and frustration and rescission for fraud or misrepresentation should be excluded by a provision which sets out exhaustively the grounds upon which a partnership breaks up and the grounds upon which the court may order the break up of a partnership.** (Draft Bill, cls 38 and 47)

8.125 We propose to draw on section 35 of the 1890 Act for the grounds on which the court may grant an order. We think that the provision should allow a partner to apply to the court for an order either to remove a partner from the partnership or for the break up of the partnership.

**8.126 We recommend that the court should have power:**

**(a) To order the removal of a partner (other than the applicant partner) on the following grounds:-**

- (1) The partner is suffering from a mental or physical condition which renders him incapable of performing his duties under the partnership contract and the incapacity is likely to be permanent;**
- (2) The partner's conduct (which may or may not amount to breach of contract) is such as to affect adversely the carrying on of the partnership business;**
- (3) The partner is in serious or persistent breach of the partnership agreement or a provision of the draft Bill;**
- (4) The partnership agreement was entered into or modified as a result of fraud, misrepresentation or non-disclosure by the partner;**

<sup>93</sup> See the draft Bill, clause 9(1) and (3).

<sup>94</sup> We discuss in paras 8.130 – 8.131 below the option of an interim order in an application to remove a partner.

- (5) An event has occurred which makes it unlawful for the partner to remain a partner;**
  - (6) There is no reasonable prospect of the partnership business being carried on at a profit unless the partner is removed;**
  - (7) It is just and equitable for any other reason to make the order.**
- (b) To order the removal of the applicant partner where any of grounds (a) (1)–(4) above apply to a partner other than the applicant or where it is just and equitable for any other reason to make the order;**
- (c) To order the break up of the partnership on the following grounds:**
- (1) Any of the grounds (a) (1) – (5) above;**
  - (2) An event has occurred making it unlawful for the partnership business to be carried on;**
  - (3) There is no reasonable prospect of the partnership business being carried on at a profit;**
  - (4) It is just and equitable for any other reason to make the order.**  
(Draft Bill, cl 47 and Schedule 3)

8.127 In creating an exhaustive list we have drawn on section 35 of the 1890 Act. Grounds (a)(1) – (3), (6) and (7)<sup>95</sup> are adaptations of the grounds for dissolution under section 35 (including the repealed ground relating to mental incapacity).<sup>96</sup> Ground (a)(4) replaces the remedy of rescission of the partnership contract for fraud or misrepresentation so that the partnership is not dissolved automatically.<sup>97</sup> We have added illegality as a ground for an order and discuss this issue in the next section.<sup>98</sup> We envisage that under this scheme the just and equitable ground would cover, among other things, the circumstances where, in contract law, the doctrine of frustration or the doctrine of fundamental mistake would arise.

### ***Supplementary matters***

8.128 The court order under clause 47 of the draft Bill must specify the date on which a person ceases to be a partner or the partnership breaks up. In order to give the court flexibility to do justice where a partner applies for his own removal from the partnership, for example where he has been the victim of fraud or non-disclosure, we consider that the court should have power to back-date the removal of the applicant to the date on which the applicant became a partner or any later date. If the court backdates the removal of the applicant it should also have power to give

<sup>95</sup> And also grounds (c)(3) and (4).

<sup>96</sup> Section 35(a) of the 1890 Act was repealed in relation to England and Wales by the Mental Health Act 1959, Sched 8.

<sup>97</sup> 1890 Act, s 41 sets out the rights of the party entitled to rescind. This provision is not required in the draft Bill as rescission will cease to be an available remedy.

<sup>98</sup> See paras 8.140 – 8.146 below.

directions to put the applicant and other persons in the position they would have been in if the partner had in fact ceased to be a partner at that date or so near that position as is just and equitable.

8.129 Where the court orders the removal of a partner, the partner would not have to give notice. The removed partner would have the rights which a partner who had resigned would have on the expiry of his notice of withdrawal to realise his share in the partnership, subject to the power of the court to give directions. The court should have power to issue such directions as it sees fit to facilitate the removal, such as specifying the terms of payment to the outgoing partner. Where the court orders the break up of a partnership it should also have power to give directions to give effect to its order and should have power to appoint a liquidator to wind up the affairs of the partnership or a provisional liquidator to preserve the assets of the partnership. Whether the court orders the removal of a partner or the break up of a partnership, its power to give directions should extend to ordering one partner to make a contribution to another where that is just and equitable.

8.130 In addition we think that on an application to remove a partner the court should have power to make an interim order, on cause shown, that the partner should take no part, or only a limited part, in the partnership business pending the outcome of the application. We do not think it necessary that the default code should include a power to suspend a partner. We have already said<sup>99</sup> that we think that a partnership is entitled to take preventive steps to protect itself from being harmed by a partner who is in serious breach of his partnership obligations including, if necessary, suspending his authority and excluding him from the premises. However, we see advantages in giving the court the power to suspend. This court power to suspend a partner would enable the partnership to remove a partner from the partnership premises when that was expedient. Where the partners have already excluded the partner on the ground of his breach of contract or breach of duty,<sup>100</sup> the court order would provide authority for his continued exclusion. The court should also be empowered to attach conditions to the interim order and to issue directions to give effect to that order.

**8.131 We therefore recommend:**

- (1) That, where a partner applies for his own removal from the partnership, the court should have power to backdate the removal and give directions to put the applicant and other persons in the position they would have been in if the partner had ceased to be a partner at that date or so near that position as is just and equitable;** (Draft Bill, cl 47(5) and Schedule 3 paras 1(2) and 3(2))
- (2) That where the court orders the removal of a partner, that partner will, subject to the directions of the court, have the same rights as he would have had to realise his share in the partnership on resigning from the partnership;** (Draft Bill, cls 32, 47(5) and Schedule 3 para 3(1))

<sup>99</sup> See para 8.123 above.

<sup>100</sup> See para 8.123 above.



***Fraud, misrepresentation and non-disclosure***

- 8.133 Where the ground of removal of a partner is that the partnership agreement has been entered into or modified as a result of his fraud or misrepresentation we think that it is appropriate to adapt section 41 of the 1890 Act (which confers certain rights on rescission of the partnership contract) to our recommended regime. Section 41 confers on the rescinding partner (a) a lien over the surplus of the partnership assets for any sum which he may have paid to purchase a share in the partnership or his capital contribution, (b) a right to stand in the place of creditors of the partnership for any payments he made in respect of partnership liabilities and (c) a right to be indemnified by the guilty partner against all debts and liabilities of the partnership.
- 8.134 Under the scheme which we recommend, the remedy of rescission will not exist. Fraud or misrepresentation will be a ground on which the court may remove the partner or break up the partnership. In this context we consider that the appropriate remedies for the innocent partners are (a) an indemnity to the partnership in respect of any of its liabilities which are attributable to the fraud or misrepresentation<sup>101</sup> and (b) if the court orders the break up of the partnership a prior ranking in the distribution of partnership assets over the partner at fault in relation to the purchase money and any advances or capital contribution. These rights would be subject to the court's power to give directions to give effect to its order.
- 8.135 We are persuaded that it would be appropriate to give similar remedies to partners who suffer loss through non-disclosure. We have recommended that a prospective partner should owe a duty of disclosure to other prospective partners.<sup>102</sup> Under our recommendations, a partner will also be under a duty to keep other partners informed of partnership matters<sup>103</sup> and, under the default regime, to ensure that the partnership's accounting records are made available, on request, to the partnership and any other partner.<sup>104</sup> We have recommended that it should be a ground of break up of a partnership, or removal of a partner, that the partnership agreement was entered into or modified as a result of non-disclosure (as in the case of fraud or misrepresentation).<sup>105</sup> We consider that where the court makes such an order, the victim should have the same additional remedies as those available to the victim of fraud or misrepresentation.
- 8.136 We therefore recommend that where the order of the court is on the ground of fraud, misrepresentation or non-disclosure, the following parties should, subject to the directions of the court, have the following rights against the partner at fault:**

<sup>101</sup> We consider it appropriate to confine the indemnity to liabilities attributable to the fraud or misrepresentation as under our recommended regime of continuity of partnership a partnership may exist and incur liabilities without any causal connection with the fraud or misrepresentation.

<sup>102</sup> See paras 11.35 – 11.40 below and draft Bill, cl 10.

<sup>103</sup> Draft Bill, cl 9(2)(a).

<sup>104</sup> Draft Bill, cl 15(2)(b).

<sup>105</sup> Draft Bill, cl 47(2) – (3) and para 8.126 above.

- (1) The applicant partner or partners should be entitled to be indemnified by the partner at fault in respect of any liabilities which are attributable to the fraud, misrepresentation or non-disclosure; and**
- (2) Where the court orders the break up of the partnership, any partner not at fault should be entitled on a distribution of partnership assets to be paid any money paid by him to purchase his share in the partnership and what is due to him from the partnership in respect of loans or capital before any amount is paid to the partner at fault.** (Draft Bill, cls 10(6) and 47(5) and Schedule 3 paras 4 and 5).

#### **(4) ILLEGALITY AND CONTINUITY OF PARTNERSHIP**

##### **Existing law**

- 8.137 Section 34 of the 1890 Act provides that a partnership is dissolved by the happening of any event which makes it unlawful for the business of the partnership to be carried on or for the members of the partnership to carry it on in partnership. A circumstance may arise where one partner may lose or fail to renew a licence or certificate and may be unable to practise lawfully as a partner. Although only one partner was barred from practice, the illegality would dissolve the partnership and threaten the continuance of the partnership business. In one case the court avoided this outcome by holding that where the partners continued in business after and in ignorance of the occurrence of the illegality there was a new partnership which excluded the partner affected by the illegality.<sup>106</sup>

##### **Our provisional proposals and consultation response**

- 8.138 We proposed that in the case of a partnership where two or more partners would remain after the illegality, the consequence of an illegality affecting only the ability of one partner to carry on the business of the partnership should be to dissolve only the relationship between that partner and the others. Unless the partnership agreement provided otherwise, such illegality would not dissolve the partnership itself.<sup>107</sup>
- 8.139 Although there was general support for the proposal in both jurisdictions, the APP argued that the unaffected partners should have the right to treat the illegality as dissolving the partnership. Another consultee suggested that it was appropriate to allow the partners an opportunity to assess their position and to decide whether they could cure the illegality. We have also had the benefit of further advice from our consultant when we were refining our proposals. He pointed out that problems may arise where partners are unaware of the illegality.

<sup>106</sup> See *Hudgell Yeates & Co v Watson* [1978] QB 451.

<sup>107</sup> Joint Consultation Paper, paras 6.26 and 6.27.

## Reform recommendations

- 8.140 We think it is likely that illegality is a problem which occurs only rarely. There is therefore no need for complex provisions in the draft Bill.
- 8.141 The dissolution of a partnership on the ground of illegality under the existing law reflects the contractual origin of a partnership. It can be argued that the law should not condone an illegal business. There is merit however in having an opportunity to cure an illegality and so to preserve the partnership. RUPA has adopted this approach. Section 801(4) of RUPA provides that a partnership is dissolved and its business must be wound up on the occurrence of specified events including:
- An event that makes it unlawful for all or substantially all of the business of the partnership to be continued, but a cure of the illegality within 90 days after notice to the partnership of the event is effective retroactively to the date of the event for the purposes of this section.<sup>108</sup>
- 8.142 We have considered adopting a similar approach but have decided against it. The partnership might learn of an illegality long after it had occurred and a cure within 90 days of so learning would then have retrospective effect. This creates uncertainty. Nor does the provision in RUPA deal with the circumstance which makes it unlawful for a particular partner to carry on business. We think that it would be simpler and more sensible if illegality did not dissolve a partnership. It is hard to see why a partnership should automatically be wound up when one partner temporarily lacks a practising certificate,<sup>109</sup> or because a partner in a financial management partnership has not complied with relevant financial services legislation. In *Hudgell Yeates & Co*<sup>110</sup> the fact that one partner did not hold a practising certificate did not affect the legality of the practice of the other partners.
- 8.143 The existing rule appears to reflect a contractual analysis of the nature of partnership. One of the problems about the subject of illegality in the law of contract is that it can take many forms and cover a wide range from the gravely criminal to the relatively trivial. Moreover criminal violations may be of a technical nature. The Law Commission consulted on this issue in 1999.<sup>111</sup>
- 8.144 We think that a partnership should not automatically break up because of an illegality. Earlier, we have recommended that the court should have power to order (a) the removal of a partner when an event occurs which makes it unlawful for him to remain a partner and (b) the break up of the partnership where an event occurs which makes it unlawful for the business of the partnership to be carried on.<sup>112</sup> The court therefore will have a discretion to break up a partnership which it can exercise where it views an illegality as sufficiently serious. A third party who

<sup>108</sup> This innovated upon s 31(3) of UPA 1914 which was of similar effect to s 34 of the 1890 Act.

<sup>109</sup> See *Hudgell Yeates & Co v Watson* [1978] QB 451.

<sup>110</sup> *Ibid* at p 464F-H.

<sup>111</sup> *Illegal Transactions: The Effect of Illegality on Contracts and Trusts*, Consultation Paper No 154.

<sup>112</sup> See para 8.126, grounds (a)(5) and (c)(2) above.

contracts with a partnership should continue to have whatever rights the law of contract confers on him where a contract is illegal. But illegality of itself should have no effect on the continuance of the partnership.

- 8.145 We consider that our recommendations to give the court power to remove a partner or break up a partnership and to make interim orders in an application to remove a partner (by which a partner's right to take part in the partnership business and affairs can be suspended) are sufficient in most circumstances. In addition, we think that it is appropriate to allow public authority to take steps to break up an illegal partnership where the public interest so requires. We consider that the Secretary of State should have power in the public interest to apply to court for an order to break up a partnership and where appropriate for an order appointing a liquidator to the partnership.
- 8.146 **We therefore recommend that the Secretary of State should be empowered, if he thinks it expedient in the public interest that a partnership should be broken up, to apply to the court for an order breaking up the partnership and the court may grant that order if it thinks it just and equitable to do so. The court may combine an order breaking up the partnership with an order appointing a liquidator or provisional liquidator.** (Draft Bill, cl 49)

## **OTHER MATTERS**

### **Dispute resolution, self help and instalments**

- 8.147 In the Joint Consultation Paper<sup>113</sup> we invited views on options to introduce a statutory dispute resolution procedure or a statutory self-help procedure by which an outgoing partner could set in motion a fixed timetable for ascertaining the value of his share. We also invited views on the introduction of provisions for payment by instalments which would apply in the absence of agreement to the contrary.<sup>114</sup>
- 8.148 There was little support for the options in either jurisdiction and many consultees thought that the dispute resolution and self-help procedures were not necessary. Some consultees thought that the timetable of the self-help procedure would be too rigid, being too short for some partnerships and too long for others. Consultees were generally opposed to a statutory regime for instalment payments. Most consultees who addressed the issue suggested that an outgoing partner should be immediately entitled to the full value of the share. On the other hand some consultees supported a regime which allowed for interim payments while the value of a partner's share was being ascertained.
- 8.149 We see no need for a dispute resolution procedure in a Partnerships Bill. Partners will be able to opt for alternative dispute resolution if they so wish. The Company Law Review envisages that ADR will develop in shareholder disputes.<sup>115</sup> There

<sup>113</sup> Joint Consultation Paper, paras 7.45 - 7.70.

<sup>114</sup> Joint Consultation Paper, paras 7.71 - 7.81.

<sup>115</sup> In "Modern Company Law: Final Report" (Vol 1 para 2.27) the Company Law Review Steering Group recommended that all forms of ADR should be encouraged in shareholder disputes in private companies. The Steering Group recommended that the Government

should be scope for ADR providers to make similar services available to partnerships. This will not require statutory prescription. We also do not propose to emulate RUPA by introducing a self-help procedure. We have recommended that the court be empowered to provide remedies for the outgoing partner after withdrawal, including the power to require interim payments.<sup>116</sup> We think that this will provide sufficient protection to the outgoing partner and that a self-help procedure or a regime for instalment payments is unnecessary regulation.

should (a) increase awareness of and accessibility to ADR through publicity and the establishment of referral mechanisms and (b) work with arbitration providers to establish an arbitration scheme designed specifically for shareholder disputes. Many partnership disputes are resolved by arbitration; an arbitration scheme for partnership disputes can be developed alongside a scheme for shareholder disputes.

<sup>116</sup> See paras 8.40 – 8.48 above.

# **PART IX**

## **PARTNERSHIP PROPERTY AND THE EXECUTION OF DEEDS**

### **INTRODUCTION**

- 9.1 In this Part we deal with our proposals to allow a partnership to hold property, including land, in its own name and to be the beneficiary of trusts by which property is held on its behalf. These should simplify the rules relating to the holding of property by partnerships. It is a benefit which flows from the introduction of separate legal personality into the English law of partnership.
- 9.2 We also discuss our recommendations on a related topic which is relevant to the conveyance of property, namely the manner in which documents may be signed by or on behalf of a partnership and, in English law, the execution of deeds.

### **PARTNERSHIP PROPERTY**

#### **Existing law**

- 9.3 Sections 20 and 21 of the 1890 Act deal with partnership property. Section 22 was repealed in England and Wales by section 25(2) of and Schedule 4 to the Trusts of Land and Appointment of Trustees Act 1996. Section 22 still applies in Scotland.

#### ***What is partnership property?***

- 9.4 Section 20 of the 1890 Act defines what is partnership property: it is all property and rights and interests in property (a) originally brought into the partnership stock or (b) acquired on account of the partnership or (c) acquired for the purposes and in the course of the partnership business.<sup>1</sup> The section also specifies the uses to which partnership property may be put: such property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement. It also lays down default rules for the devolution of the legal estate or interest in land belonging to the partnership and for the ownership of land which is acquired out of the profits from co-owned land which is not partnership property. Section 21 provides as a default rule that property bought with money belonging to the partnership is deemed to have been bought on account of the partnership and is thus partnership property.
- 9.5 Section 22 applies only in Scotland and provides as a default rule that land or any heritable interest in land is treated as between the partners or their personal representatives as moveable property.

<sup>1</sup> The definition of partnership property covers property which is the subject of an express trust as well as property which is not.

### ***How partnerships hold partnership property***

- 9.6 In English law title to land held by a partnership can be vested in no more than four partners.<sup>2</sup> Where a partnership consists of five or more partners, the legal estate in partnership land must therefore be held by some of the partners on trust for themselves and their fellow partners according to their respective beneficial interests. As a consequence landlords, who wish to obtain a direct right against all partners in large partnerships, often insist that the non-trustee partners are sureties for the trustee partners' obligations or are contractual parties to the lease.<sup>3</sup>
- 9.7 Complications arise when an additional partner joins the partnership or a partner retires. It may be that the partnership is content that the land should continue to be held by those partners who hold as trustees. There is no necessity for a new partner to become one of the trustees, and it will not even be possible if there are already four persons vested with the title. The new partner would nevertheless become entitled beneficially as tenant in common. If a retiring partner is a trustee, that partner can retire as trustee as well. The retiring partner would normally cease to be beneficially entitled on retirement. In some circumstances, it may be desirable, where there have been significant changes in the membership of the firm, for the land to be transferred to new trustees.
- 9.8 If a partnership sets up a company to hold land, it avoids the problems of transfer on a change in membership of the partnership and any landlord's consent to such changes. Conferring legal personality on English partnerships would avoid such complications.
- 9.9 In Scotland a partnership is capable of owning moveable property such as cars, furniture, office equipment and intellectual property rights. Historically, a Scottish partnership has been able to hold title to a lease of heritable property<sup>4</sup> but it cannot own land. When recent legislation is brought into force there will be nothing to stop a partnership with legal personality from owning land in Scotland.<sup>5</sup> There are several statutory provisions which allow a Scottish partnership to own property in its own name while not allowing an English partnership to do so, because the latter has no separate legal personality.<sup>6</sup>

### ***Identifying property as partnership property***

- 9.10 Section 20 treats as partnership property assets which have been brought into the partnership at its commencement. This will usually consist of the contributions of capital made by the partners. Such property need not be held in the name of all of the partners, or in Scotland in the partnership name, but an individual partner

<sup>2</sup> Trustee Act 1925, s 34(2); Law of Property Act 1925, s 34(2): no more than four persons can hold the legal title to land.

<sup>3</sup> *Lindley & Banks*, para 18-63.

<sup>4</sup> *Dennistoun, Macnair and Co v Macfarlane* February 16, 1808 FC, Mor App "Tack" No 15.

<sup>5</sup> See the Abolition of Feudal Tenure etc (Scotland) Act 2000, s 70.

<sup>6</sup> The statutory provisions cover, among others, aircraft, shares in a registered company, patents, UK registered trademarks, and Community trademarks. A Scottish partnership may own a minority interest in a ship but may not be the sole owner. We refer to the statutory provisions in paras 9.35 – 9.51 below.

may hold title to the property. Not all assets which are made available to and used by a partnership for partnership purposes are partnership property.<sup>7</sup> The court looks at all the circumstances to ascertain if the partners have agreed that such assets were to become partnership property. The law applies no presumptions of fact to this question.<sup>8</sup>

- 9.11 Section 20 also deals with property acquired during the continuance of the partnership. It provides that property acquired on account of the partnership or for the purposes and in the course of the partnership business is partnership property. It creates no presumptions that property is acquired on account of the partnership.<sup>9</sup> Section 21 creates a rebuttable presumption of fact by providing that:

Unless the contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm.

- 9.12 Thus, for example, where a partnership took out a life assurance policy on its youngest partner in support of a bank loan to the partnership and paid the premiums on the policy, the court concluded that the policy was partnership property.<sup>10</sup>
- 9.13 Where individual partners use their own funds to purchase property there is no such presumption. Similarly the 1890 Act does not deal expressly with property acquired by an exchange or as a gift. It has been suggested that section 21 would be applied by analogy to property acquired in exchange for partnership property.<sup>11</sup> Where a partner acquires property by gift, it is necessary to have regard to all the circumstances to determine whether the partner or the partnership is the intended donee.

## **Our provisional proposals**

### ***A partnership may own property***

- 9.14 In the Joint Consultation Paper we proposed that a partnership with separate legal personality should be able to own property of any kind in its own name and that property could be held in trust for such a partnership.

<sup>7</sup> See for example *Miles v Clarke* [1953] 1 WLR 537 (a photographer's studio and equipment) and *Harvey v Harvey* [1970] ALR 931 (a farm).

<sup>8</sup> *Miles v Clarke* [1953] 1 WLR 537, 540.

<sup>9</sup> But see the 1890 Act, s 20(3) which creates a rebuttable presumption that where co-owners of land, which is not partnership property, are in partnership in the use of the land and use the profits of the partnership to purchase further land, they hold that further land as co-owners and not as partnership property. See also *Davis v Davis* [1894] 1 Ch 393, in which North J took a similar approach in analogous circumstances.

<sup>10</sup> *Forrester v Robson's Trustees* (1875) 2R 755 (a pre-1890 Act case); *Carter Bros. v Renouf and Another* [1962-3] 36 ALJR 67.

<sup>11</sup> Prime & Scanlan, *The Law of Partnership* (1<sup>st</sup> ed 1995) p 200.

### ***Property which is not held in the name of the partnership***

- 9.15 We also proposed the following rules in relation to property which was not held in the name of the partnership.<sup>12</sup> First, we proposed that property contributed to the stock of the partnership but held in the name of one or more of the partners should be deemed to be held in trust for the partnership. Secondly, we proposed that property which was acquired by one or more of the partners, or by an agent of the partnership, for the partnership should be deemed to be held in trust for the partnership. These two rules, which would adapt the rules of section 20(1) of the 1890 Act to a partnership with legal personality, would be rules of law and not rebuttable presumptions. Our third proposal was to have a rebuttable presumption which would have similar effect to section 21 of the 1890 Act. We proposed that property acquired by a person (other than the partnership itself) with partnership money should, subject to proof of a contrary agreement, be deemed to have been acquired for the partnership and to be held in trust for the partnership.

### ***Protection of purchasers of partnership property***

- 9.16 Where a partnership takes title to land in its own name and holds the land for many years, it is likely that there will be changes in the composition of the partnership. A purchaser of that land will wish to be satisfied that the partnership selling the land is the same legal person as the partnership which is registered as the owner. We suggested that the problem whether the seller is the same person as the person who appears from the title to be the owner arises in the case of any sale but took the view that this was rarely a practical problem.<sup>13</sup> We therefore proposed that there should not be a provision to protect the title of purchasers but invited views on whether there should be rules, on the lines of those in section 36 of the 1890 Act, enabling third parties dealing with a partnership to treat the partnership as continuing until they had notice of a change.<sup>14</sup>

### ***A voluntary register of authority***

- 9.17 We also recognised that in drafting legislation to give effect to our proposals it would be necessary to consider whether the Land Registry in England and Wales and the Registers of Scotland would require extra protection to guard against fraud.<sup>15</sup> We also asked consultees whether there should be a voluntary register of authority to transact in land.<sup>16</sup>

## **Consultation**

### ***A partnership may own property***

- 9.18 A majority of consultees in England and Wales who responded on this issue supported the proposal that partnerships with separate legal personality should be able to own property of any kind in their own name and that property can be held

<sup>12</sup> Joint Consultation Paper, para 11.20.

<sup>13</sup> Joint Consultation Paper, para 4.40.

<sup>14</sup> Joint Consultation Paper, paras 4.44 – 4.45.

<sup>15</sup> Joint Consultation Paper, para 4.39 and especially footnote 32.

<sup>16</sup> Joint Consultation Paper, paras 11.22 - 11.23.

in trust for them. Consultees suggested that this would simplify the holding of land, facilitate the use of partnership property for borrowing and reduce the administrative work involved on every change in membership of a partnership. Some consultees suggested that a partnership should own property only if it were a registered partnership.<sup>17</sup> Unsurprisingly, in Scotland there was a general consensus in favour of the proposal that partnerships with separate personality should be able to own property in their own name as that in large measure is already the position in Scots law.

- 9.19 The Chancery Bar Association stated that their objection to separate personality was partly based on the suggestion that the entity should own property and in particular land. They suggested that it would be much simpler to let land which was partnership property remain vested in trustees.

### ***A voluntary register of authority***

- 9.20 While there was some support for our proposal of a voluntary register of authority to transact in land, the majority of consultees opposed it. Some consultees doubted whether partnerships would use the register. Several, including H M Land Registry, while seeing advantages of separate personality, thought that there would be too much uncertainty for unregistered partnerships to transact in land in their own names.<sup>18</sup> The APP on the other hand saw no need for a voluntary register and suggested that it was sufficient that any partner should be able to sign documents on behalf of the partnership and that deeds should require the signature of two partners. One consultee opposed the idea of a voluntary register as cumbersome and open to abuse. H M Land Registry did not support the proposal for a voluntary register as (a) it did not provide sufficient protection for partners who could be bound by registrations without their knowledge and (b) there would be insufficient protection of third parties if the register was not conclusive of the authority of the registered persons.

### ***Identifying property as partnership property***

- 9.21 Several consultees commented on the efficacy of sections 20 and 21 of the 1890 Act. While most thought that they were effective for partnerships without legal personality, one<sup>19</sup> thought that they did not give adequate assistance in determining whether property was partnership property. She called for a definition which was more susceptible of objective proof and referred to accounting practice. She suggested that there should be a presumption that property paid for with partnership money, credited to a partner's capital account, or regularly used by more than one partner is partnership property in the absence of proof of contrary intent. She suggested that this would be useful in order to take full advantage of the benefits of separate personality.

<sup>17</sup> We are not taking forward the proposal to introduce a registered partnership. See Part XIII below.

<sup>18</sup> Later discussions with H M Land Registry and the Keeper of the Registers of Scotland have altered their views and our views on this issue. See para 9.23ff below.

<sup>19</sup> Elspeth Deards.

### ***Section 20(3) of the 1890 Act***

- 9.22 Our consultant, Roderick Banks, suggested that there was a need to preserve section 20(3) of the 1890 Act as well as the other rules in sections 20 and 21 for partnerships with separate personality.<sup>20</sup> The Faculty of Advocates also favoured the retention of the provisions of sections 20 and 21.

### **Reform recommendations**

- 9.23 We have developed our proposals with the help of interested parties since the end of the consultation. In particular, we have had useful discussions with H M Land Registry and the Registers of Scotland on the practicability of enabling partnerships to own and transact in land. We have also discussed the issue with the APP and with Roderick Banks, our consultant. We have been persuaded by those discussions that our proposals are both feasible and beneficial.
- 9.24 In considering the consequences of allowing unregistered partnerships to own property, including land, in their own name, we have had regard to the interests of the partners, of third parties transacting with the partnership (including creditors) and also of officials responsible for registers of property such as H M Land Registry. While we have addressed the issue of land ownership in particular, other forms of property, including intellectual property, may be equally or more valuable to the partnership and to others. The protection which we recommend is designed to apply to transactions in different types of property and is not confined to land.

### ***Ownership of property generally***

- 9.25 We think that a partnership with separate legal personality should be able to own all types of property except where legislative rules relating to particular forms of property prevent it. Such ownership may involve vesting title to the property in the name of the partnership or holding the property on behalf of the partnership through trustees or nominees. We are not aware of any restrictions on partnerships holding property through trustees or nominees.

### ***Ownership of land***

- 9.26 Our discussions with H M Land Registry and the Registers of Scotland have shown us that it is feasible to allow unregistered partnerships to own and transact in land without creating significant problems. At the outset of our discussions it was perceived that the informal nature of the partnership entity would create problems which would militate against land ownership. In particular we had to address concerns that third parties transacting with a partnership would not be able to rely on the register.
- 9.27 For example, a partnership called Smith & Co registered title to land in its own name and many years later partners in a partnership called Smith & Co sought to convey the land to a third party. The register would show that Smith & Co were the owners of the land but it would not show that the Smith & Co purporting to convey the land was the same partnership as the registered owner. The Smith & Co seeking to convey the land could be a partnership with no historical connection

<sup>20</sup> For the effect of the 1890 Act s 20(3) see footnote 9 above.

with the original Smith & Co or it could be a successor partnership where continuity of partnership had not been preserved and thus a separate entity.<sup>21</sup>

- 9.28 Even if it were the same partnership there would be a need to establish that the partners signing the conveyance had authority to do so. It might be the case that none of Smith & Co's partners had been partners at the time the title to the land was registered. Without a register of partners there would be no public record of the dates when partners joined and left a partnership. Even if the partners were partners when the title to the land was registered, it would still be necessary to establish the authority of the partners signing the conveyance by the partnership.<sup>22</sup>
- 9.29 To address these issues we have considered a number of expedients with H M Land Registry and the Registers of Scotland.
- 9.30 One expedient which we considered was for the land registers to give each partnership which sought to take title to land in its own name a unique registration number which would be recorded on the register. This would reduce the risk of an inadvertent transfer of property by a partnership which had the same name as the registered title holder. Another expedient was to impose on partnerships which took title to land a duty to keep a list of partners authorised to transact in land in the partnership's name or on its behalf. This would enable the land registers to preserve a record of those who had power to bind the title-holding partnership.
- 9.31 After discussions between H M Land Registry and the Registers of Scotland, the two land registers have advised us that they doubt that they will require these expedients. They think that problems may arise only in a small number of cases. They have expressed the view that they have sufficient powers in their own legislative rules to ask for evidence if they are in doubt about the authority of a person to bind a partnership.<sup>23</sup> In England, partners may be able to protect

<sup>21</sup> In developing our recommendations we have attempted to restrict the circumstances in which changes in membership could result in discontinuity of partnership under the default code. We recommend that a partnership will not dissolve so long as it owns any assets and so long as any liabilities exist or may exist: only once all assets have been disposed of and all liabilities discharged or extinguished through the passage of time will the partnership be dissolved. See paras 12.13 – 12.23 below. The most likely occurrence of a discontinuity of partnership is where a partnership breaks up when a partner dies or withdraws and leaves only one surviving partner. The partnership continues but solely for the purpose of winding up (see para 12.20 below). That partner then takes on another partner and continues the business in the same name, unaware that the first partnership has broken up and cannot be reconstituted by taking on a new partner. The new partners will have created a new partnership but may be unaware that they have done so. A similar situation could occur where A and B agree to break up a partnership but during its winding up A takes on C as a partner and continues the partnership business.

<sup>22</sup> RUPA, s 303 addresses the issue by providing for a voluntary register of statements of partnership authority.

<sup>23</sup> In England and Wales, the Land Registration Rules 2003 (SI 2003 No 1417) made pursuant to s 127 of the Land Registration Act 2002 confer upon the Land Registrar the power, if an application is not in order, to "raise such requisitions as he considers necessary" for the application (Rule 16(1)). The registrar may refuse to complete an application if the necessary documents and evidence have not been supplied (Rule 17). Both the Rules and the Act came into force on 13 October 2003. In Scotland the Keeper of the Registers has power under section 4(1) of the Land Registration (Scotland) Act 1979 ("the 1979 Act") to require production of documents and evidence in support of applications for registration. In addition under section 27 of the 1979 Act the Scottish Ministers, after consultation with the

themselves by the use of restrictions or cautions<sup>24</sup> at the Land Registry. The land registers will also benefit from our recommendation, which we discuss below,<sup>25</sup> to protect the *bona fide* third party acquirer of partnership property as that protection will avoid claims for indemnity from such acquirers.

9.32 Officials of the Land Registry and the Registers of Scotland have advised us that there is no need to include in the draft Bill any provision to protect their interests. We agree. As we stated in the Joint Consultation Paper,<sup>26</sup> to some extent the problem whether the seller is the same person as the person who appears from the title to be the owner arises in any sale. The fact that the name is the same is not conclusive. In a sale by a company the use of the company's registered number in the conveyances to and by the company can achieve certainty but that is not available in a sale by an individual. When an individual has title to property, there is a risk that another person with the same name may convey the property and there is the risk of impersonation and fraud. In the case of a sale by a trustee or trustees, there could have been several changes of trustee of the same trust since the original title was acquired. In practice, there is not usually a problem. Only the owner is usually in a position to authorise inspections of the property and to attend, in a way which does not arouse suspicion, to the other practical details surrounding a sale. An attempted fraudulent sale by a non-owner using the owner's name would usually be detectable. The real owner has an interest in preventing such frauds.

9.33 We recognise that circumstances could arise where, without fraud, partners in a successor partnership sought to convey land which they thought was the property of their partnership but which, unknown to them, belonged to another earlier partnership. This could occur if a discontinuity of partnership had occurred.<sup>27</sup> This issue is not confined to land but could arise in relation to other types of property. We discuss it in the context of our recommendation to protect the *bona fide* acquirer of partnership property.<sup>28</sup>

9.34 We see no need for specific provisions in the draft Bill relating to land.<sup>29</sup>

### ***Ownership of other types of property***

9.35 The introduction of separate personality to partnerships governed by English law will allow such partnerships to hold in their own names other forms of property.

Lord President of the Court of Session, have power to make rules *inter alia* to regulate the procedure on application for any registration. The current rules are the Land Registration (Scotland) Rules 1980 (as amended). We therefore do not propose a voluntary register of authority on the lines of RUPA, s 303.

<sup>24</sup> Cautions ceased to exist when the Land Registration Act 2002 was brought into force on 13 October 2003. Cautions against first registration are however preserved.

<sup>25</sup> See para 9.65 below.

<sup>26</sup> Joint Consultation Paper, para 4.40.

<sup>27</sup> See para 9.27 and footnote 21 above.

<sup>28</sup> See paras 9.52 – 9.65 below.

<sup>29</sup> There is nothing to stop the continued use of trustees in the holding of land in those cases where it seems desirable.

- 9.36 For most forms of personal or moveable property there is no complication. Ownership of certain types of property is recorded in registers. There are often statutory provisions which govern the entitlement of persons to own such property. We have reviewed a wide range of such provisions. In some cases, the statute allows a Scottish partnership (which has separate personality) to own the property in its name while not allowing an English partnership to do so. In others the statute speaks of “persons” being entitled to hold the property. In the absence of a provision to the contrary, the reference to persons would include a partnership with separate personality.<sup>30</sup>
- 9.37 We recommend that a partnership with separate personality should be entitled to hold in its own name all types of property unless there is a specific statutory provision which prevents it from doing so. We also recommend that a partnership with separate personality should be able to hold in its own name the following types of property: patents, copyright, registered designs and design rights, UK trade marks, Community trade marks, shares in registered companies, interests in ships, hovercraft and aircraft. We consider each in turn.

#### UK PATENTS

- 9.38 Any person may apply for a patent and “person” includes a body of persons corporate or unincorporate.<sup>31</sup> A Scottish partnership may own a patent. An English partnership may not do so because it lacks personality. Without continuity of partnership it would not be practicable for a partnership to hold patents in its own name as changes of membership would result in the creation of new partnerships. As we recommend a default rule of continuity of partnership, it will be more practicable for partnerships to hold property in their own names. There is no need for any amendment of the Patents Act 1977 to implement our policy that partnerships should be able to hold patents in their own name.

#### EUROPEAN PATENTS

- 9.39 Under the European Patent Convention any natural or legal person, or any body equivalent to a legal person by virtue of the law governing it, may file an application for a European patent.<sup>32</sup> Accordingly, a Scottish partnership, but not an English partnership, may currently own a European patent. We recommend that an English partnership with separate personality should be entitled to hold such a patent directly. No amendment of the Convention is necessary to achieve this.

#### COPYRIGHT

- 9.40 There is no register of owners of copyright. The first owner of copyright is the “author” or in some cases the employer of the “author”.<sup>33</sup> It appears that a

<sup>30</sup> Interpretation Act 1978, s 5 and Sched 1: Unless the contrary intention appears, “person” includes a body of persons corporate or unincorporate.

<sup>31</sup> Patents Act 1977, s 7(1) and Interpretation Act 1978, ss 5, 22(1), Sched 1, Sched 2 para 4(1)(a).

<sup>32</sup> Convention on the Grant of European Patents (1973), Art 58.

<sup>33</sup> Copyright, Designs and Patents Act 1988, s 9(1), s 11 and s 154.

partnership cannot be the author of copyright.<sup>34</sup> Under our recommendations if a partner in the course of the partnership business created a work which attracted copyright, the partner as author would hold the copyright in trust for the partnership.<sup>35</sup> This involves a procedural complication: as the partnership would not be the author, the partnership would require to join the partner as a party to an action if it became involved in litigation in relation to the copyright.<sup>36</sup> However an attempt to make a partnership an “author” would create further complications.<sup>37</sup> Under our recommendations for property ownership, a partnership will be able to acquire copyright from a third party author and thus be a second or subsequent owner of copyright.<sup>38</sup> We do not recommend any legislative change in relation to copyright.

#### UK REGISTERED TRADEMARKS

- 9.41 Any person, natural or legal, who intends in good faith to use a mark for the goods and services specified in the application for registration may apply to register the trade mark.<sup>39</sup> No legislative provision is required to enable a partnership with legal personality to apply to register a trademark in its name. A consequence of our recommendation in relation to separate personality is that partnerships will be able to register trademarks in their own names.<sup>40</sup>

#### COMMUNITY TRADEMARKS

- 9.42 The protection of trademarks throughout the European Union is governed by the Community Trademark Regulation.<sup>41</sup> Article 5 of the Regulation provides that, among others, natural or legal persons who are nationals of Member States can be proprietors of Community Trademarks. We think that a partnership with separate legal personality would be entitled to register a Community Trademark as the Treaty of Rome, in the context of the right of establishment, treats a partnership (with legal personality) formed in accordance with the law of a Member State and

<sup>34</sup> Because it is not an individual or body corporate as required by s 154 of the 1988 Act.

<sup>35</sup> See draft Bill, cl 18(2).

<sup>36</sup> “A person with a purely equitable title (under a trust or a specifically enforceable contract) is permitted to bring a motion for interlocutory relief, but he may not proceed further without joining the legal owner” – Cornish *Intellectual Property* (4<sup>th</sup> ed, 1999), para 2.06. In Scotland the trustee and not the beneficiary would have title to sue whether for interim relief or otherwise. See *Inland Revenue v Clark’s Trustees* 1939 SC 11; *Parker v Lord Advocate* 1960 SC (HL) 29, 41 and Wilson & Duncan, *Trusts, Trustees and Executors* (2<sup>nd</sup> ed 1995), para 1.44.

<sup>37</sup> Copyright, Designs and Patents Act 1988, s 154 requires the author to have a specified connection with the UK which might be difficult to apply to a partnership. In particular, we recommend that a partnership while a legal person should not be a body corporate and thus s 154(1)(c) would not apply.

<sup>38</sup> A partner who is author of a copyright work and who holds it on trust for the partnership could assign it to the partnership and thus give the partnership legal title.

<sup>39</sup> Cornish *Intellectual Property* (4<sup>th</sup> ed, 1999), para 17.03.

<sup>40</sup> It appears that in Scotland a partnership can already be the proprietor of a registered trademark.

<sup>41</sup> E C Council Regulation 40/1994 (OJ L 11, 14.1.94).

having its principal place of business within the Community in the same way as natural persons who are nationals of Member States.<sup>42</sup>

#### REGISTERED DESIGNS AND DESIGN RIGHTS

- 9.43 Registered Designs are governed by the Registered Designs Act 1949. We think that a partnership with separate personality could be the original proprietor of a registered design where it commissions the design or where the design is created by its employee in the course of his employment.<sup>43</sup> Such a partnership could also be a second or subsequent proprietor of the design.<sup>44</sup>
- 9.44 Design rights are created and governed by the Copyright, Designs and Patents Act 1988. A partnership with separate personality could be the first owner of an unregistered design right in a design, for example where it commissions the design or the design is created by its employee in the course of his employment.<sup>45</sup> Such a partnership could also be a second or subsequent owner of the design right.<sup>46</sup>
- 9.45 We see no need to amend the 1949 and 1988 Acts in relation to partnerships with separate personality.

#### SHARES IN UK REGISTERED COMPANIES

- 9.46 Under existing English law partners may be registered as shareholders in the firm name.<sup>47</sup> A Scottish partnership may be a member of a company.<sup>48</sup> By introducing separate personality, our recommendations will enable an English partnership to become a member of a company. No amendment of the Companies Act 1985 is required to effect this change. The partnership would require to give its name and address to the company for inclusion in its register of members.<sup>49</sup> Those details would be registered in Companies House.<sup>50</sup> A consequence of the introduction of separate personality is that the use of a firm name in a register of members and in

<sup>42</sup> Treaty of Rome, Art 48 (ex Art 58) provides: "Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States. "Companies or firms" means companies or firms constituted under civil or commercial law ... and other legal persons governed by public or private law, save for those which are non-profit-making."

<sup>43</sup> Registered Designs Act 1949, s 2(1A) and (1B).

<sup>44</sup> Registered Designs Act 1949, s 2(2).

<sup>45</sup> Copyright, Designs and Patents Act 1988, ss 215(2) and (3), 217(1) and 219(1). Under s 215(4) and s 220 a partnership with separate personality may obtain ownership of a design right by being the first to market the article made to the design if it is exclusively authorised to do so in the United Kingdom and the marketing takes place in a Member State of the EEC or other specified country.

<sup>46</sup> Copyright, Designs and Patents Act 1988, s 222.

<sup>47</sup> *Lindley & Banks*, para 3-07; *Weikersheim's Case* (1873) LR 8 Ch App 831.

<sup>48</sup> Companies House in Scotland has informed us that there are a number of companies which have partnerships as shareholders. Companies House in London have also confirmed that they would accept a return which gave the name and address of a Scottish partnership as a member.

<sup>49</sup> Companies Act 1985, s 352.

<sup>50</sup> Companies Act 1985, s 364A.

a company's annual return would have a different meaning in English law. At present, it is shorthand for the partners of the partnership. On a future registration by a partnership with separate personality it would signify that the partnership as an entity was a member of the company.

#### UK REGISTERED SHIPS

- 9.47 Regulations govern who may be registered as owner of a British ship.<sup>51</sup> The regulations are complex and detailed and require that the ship must have a British connection before it may be registered. Under the current law, a partnership, including a Scottish partnership, may not be the registered owner of a ship. It is thought that a Scottish partnership could be one of the owners of the ship provided it did not have a majority interest.<sup>52</sup> Individual partners may become registered owners of ships and, under our recommendations, may hold the ships in trust for the partnership. Under the Merchant Shipping Regulations 1993 (as amended)<sup>53</sup> a partnership is not qualified to be an owner of a British fishing vessel.<sup>54</sup> We see no reason why a partnership with legal personality should not own a British ship or a British fishing vessel. We have discussed this issue with the DTI who agree.

#### HOVERCRAFT

- 9.48 The Registrar General of Shipping and Seamen keeps a separate registry of hovercraft. In contrast with the rules relating to British ships, a partnership carrying on business in Scotland under the 1890 Act is a person qualified to own a hovercraft.<sup>55</sup> There are a small number of hovercraft in commercial operation. Although the commercial significance of hovercraft is limited, we recommend that, if separate personality is introduced into English partnership law, the Hovercraft (General) Order 1972 be amended to allow English partnerships to own hovercraft.

#### AIRCRAFT

- 9.49 The Civil Aviation Authority maintains the UK register of aircraft. The list of persons authorised to hold an interest in an aircraft includes partnerships carrying on business in Scotland under the 1890 Act.<sup>56</sup> The list of authorised persons also includes:

Undertakings formed in accordance with the law of an EEA State and having their registered office, central administration or principal place of business within the European Economic Area.<sup>57</sup>

<sup>51</sup> Merchant Shipping Act 1995, s 9(2)(a). The current regulations are the Merchant Shipping (Registration of Ships) Regulations 1993 (SI 1993/3138) as amended.

<sup>52</sup> Merchant Shipping Regulations 1993 (SI 1993/3138), regulation 7.

<sup>53</sup> SI 1993/3138.

<sup>54</sup> Regulations 12 and 13.

<sup>55</sup> Hovercraft (General) Order 1972 (SI 1972/674) as amended, Art 5(3).

<sup>56</sup> Air Navigation Order 2000 (SI 2000/1562), Art 4(3)(g).

<sup>57</sup> Air Navigation Order 2000, Art 4(3)(f).

Aircraft operated by partnerships in England and Wales are registered in the name of the partners and it is noted in the register that they are trading as a partnership. On the introduction of separate legal personality into English law, an English partnership will be able to become a registered owner of UK registered aircraft provided that the partnership has the necessary link with the EEA.<sup>58</sup>

### ***Joint Tenancy in English Law***

9.50 Under English common law, a natural person and a corporation cannot hold property, whether real or personal, in joint tenancy.<sup>59</sup> This is because the right of survivorship cannot operate in relation to a company, as a company cannot die.<sup>60</sup> This common law rule led to the enactment of the Bodies Corporate (Joint Tenancy) Act 1899, which gives corporations power to hold property as joint tenants. The rule would, we think, apply equally to a partnership entity created by the draft Bill. We think therefore that we should extend the 1899 Act to partnerships.<sup>61</sup>

9.51 **We therefore recommend:**

- (1) That partnerships (with separate legal personality) can own property of any kind in their own name unless statutory rules exclude them from doing so; (Draft Bill, cls 7(1) and 18(1))**
- (2) That property of any kind may be held in trust for such partnerships; (Draft Bill, cls 7(1) and 18(2))**
- (3) That partnerships should be allowed to own British ships and British fishing vessels;**
- (4) That the Hovercraft (General) Order 1972 be amended to allow English partnerships (with separate legal personality) to own hovercraft;**
- (5) That Art 4(3)(g) of the Air Navigation Order 2000 should be revoked; and**
- (6) That the Bodies Corporate (Joint Tenancy) Act 1899 should be extended to partnerships. (Draft Bill, cl 17(2))**

<sup>58</sup> Nonetheless it would be appropriate to revoke the Air Navigation Order Art 4(3)(g) which refers to firms carrying on business in Scotland. With the introduction of separate personality firms carrying on business in Great Britain should be qualified and are covered by Art 4(3)(f).

<sup>59</sup> See *Law Guarantee & Trust Society Ltd v The Governor and Company of the Bank of England* (1890) 24 QBD 406, 411 per Mathew J.

<sup>60</sup> See *Megarry & Wade*, para 9-003.

<sup>61</sup> While joint tenancy is not a method of holding property in Scots law, a Scottish partnership could hold property by that means in England or Wales. The draft Bill therefore extends the 1899 Act to all partnerships which it governs.

***Protection of bona fide acquirers of partnership property***

- 9.52 Since we received the responses to the Joint Consultation Paper we have reconsidered our policy on the protection of third parties who acquire partnership property or interests in partnership property in good faith and for value.<sup>62</sup>
- 9.53 Discontinuity of partnership occurs where a partnership ceases to exist and another partnership continues the partnership business. The mischief which we seek to address, and which we call “latent discontinuity”, is the purported transfer of property belonging to a partnership (“partnership A”) by partners in another partnership (“partnership B”) where it is not apparent to the transferee that partnership B is a different entity from partnership A.
- 9.54 If our recommendations for continuity of partnership and the winding up of partnerships<sup>63</sup> are implemented, we think that it will be a relatively rare occurrence that partners in one partnership transact with third parties on the erroneous representation that they are a continuing partnership. We can think of two circumstances, however, where it is not unlikely that a problem of latent discontinuity might occur. One is where a majority<sup>64</sup> of partners resolve to break up a partnership and either the majority or a minority continue the business in the same firm name after buying the assets in a winding up. While one might expect the partners in the new partnership to recognise that in such circumstances they had created a new firm and that they should transfer the old firm’s property to the new partnership, there is a risk that they may overlook to do so. The second circumstance is where a partnership breaks up when there is only one surviving member, that person takes on a new partner and he and the new partner continue in business unaware that they have created a new partnership.<sup>65</sup>
- 9.55 To cater for these circumstances and any other circumstance in which discontinuity of partnership would prevent the successor partnership from giving good title to the acquirer of partnership property, which belonged to the former partnership which had broken up, we think that there should be a provision to protect the third party who acquires partnership property or an interest in that property in good faith and for value.
- 9.56 We recognise that the problem of whether the transferor of property, or the creator of a right in property, is the same person as the person who appears from the titles or registers arises in many transactions. There is an argument that we should not make a special rule for partnerships. But we have changed our policy on this matter for two reasons.

<sup>62</sup> See paras 9.16, 9.26 – 9.34 above.

<sup>63</sup> Parts VIII and XII of this report.

<sup>64</sup> We provide (draft Bill, cl 38(3)) that at least one half of the partners can decide to break up a partnership to cater for the circumstances of a tied vote in a small partnership. But in many circumstances there will be a majority vote one way or the other.

<sup>65</sup> The problem would also occur where the partners were aware of the discontinuity and chose to ignore it in the hope that the transferee would not identify the problem and put them to the bother of transferring the title from the old partnership to the new.

- 9.57 First, we think that the protection afforded to the third party will assist partnerships, and in particular small partnerships, to deal with their property more cheaply and speedily. A “think small first” approach means we must cater for the informal and perhaps ill-informed partnership where partners do not have regular access to legal advice. If the partners in, say, a corner shop business are able to give a third party purchaser a good title which is secure from a latent discontinuity of partnership, that should simplify the sale process by reducing the inquiries which the prudent third party has to make.
- 9.58 Secondly, we think that the protection can be framed in a way which protects the third party acquirer against the most likely risk of discontinuity of partnership but which is sufficiently focussed that it does not expose the partners or former partners of the partnership which is the true owner to an unacceptable risk of loss.
- 9.59 Our policy is to provide protection where a partnership (“the former partnership”) has broken up, but a partner of the former partnership or a partner who has entered into partnership with that partner transfers, or creates an interest in, property belonging to the former partnership and apparently on its behalf or in its name.<sup>66</sup> The problem which needs to be addressed is that the person who acts apparently on behalf of the holder of the title to the property (the former partnership) may not have authority<sup>67</sup> to bind the former partnership. The partner in the former partnership may believe that the successor partnership which he has entered into is the same partnership as the former partnership and that he is transacting in the ordinary course of business of that partnership. He may be aware of the discontinuity of partnership but choose to ignore it in the hope that it will not matter. In either event he may have no authority (actual or apparent) to transact. Alternatively, if it is the new partner who effects the transaction he will have no power to bind the titleholder, as he was never a partner in the former partnership. Where those circumstances exist our policy is that the title of the recipient of that property, or interest in property, who receives it in good faith<sup>68</sup> and for value<sup>69</sup> should not be challengeable on the ground that the person or persons making the transfer or creating the interest in property did not have authority (actual or apparent) to bind the former partnership in this transaction.

<sup>66</sup> It may be the case that neither of the parties to the transaction realises that there are two partnerships. The mutual assumption may be that the partner making the transfer is acting on behalf of the partnership which holds title to the property. Therefore when we speak of the transfer being apparently in the name of the former partnership, we are referring to the transferee’s perception that the transferor is the title holder, whether or not a party is aware of the two partnerships.

<sup>67</sup> The authority may be actual (express or implied) or apparent (arising out of estoppel or personal bar).

<sup>68</sup> The requirement of good faith means among other things that the acquirer would take the property subject to any registered security interest as the acquirer would have notice of that interest when acquiring the property.

<sup>69</sup> We confine the protection to the transferee in good faith who has given value for the property or interest in property and do not protect a gratuitous donee. Under the doctrine of the bona fide purchaser without notice the giving of valuable consideration in good faith confers on the purchaser a legal right which prevails over a prior equitable right. See *Snell’s Equity* (30<sup>th</sup> ed 1999), para 4-09ff. In our proposals the former partnership would lose its property to the transferee in good faith and would have to seek a personal remedy against

- 9.60 We do not think that it would be appropriate to give the partner in the former partnership or the person who enters into partnership with him authority to bind the former partnership in the circumstances envisaged as that would deprive a person interested in the assets of the former partnership, such as an outgoing partner, of a remedy against those who alienated the property of the former partnership. We have therefore framed the protection as a protection of the title of the recipient.
- 9.61 The protection would be available in, for example, the following circumstance. A and B have been in partnership operating a corner shop and A retires, leaving B in control of the business.<sup>70</sup> B thereafter takes on C as a partner and B and C, unaware that their partnership is not the former partnership and ostensibly acting in the name of the continuing partnership, later sell the shop to D who purchases in good faith. D would receive a good title and A, if his share in the former partnership had not already been bought out, could claim an account against B on the basis that the shop was an asset which should have been available in the winding up of the former partnership.
- 9.62 The protection would not be available unless (i) the person effecting the transfer did so apparently in the name of or on behalf of the former partnership<sup>71</sup> and (ii) that person was someone who had been a partner in the former partnership (ie B) or someone who had entered into partnership with such a person (ie C). Therefore the risk which a partner would run in allowing title to property to be taken in the name of the partnership would be limited by the restricted scope of the protection given to the third party.
- 9.63 The protection would also assist the land registers<sup>72</sup> by avoiding any question of the land registers having to indemnify the former partnership on registration of the third party's title as there would be no error in the register which would give rise to a claim for indemnity through a refusal to rectify the register.<sup>73</sup>

those who granted the conveyance. To deprive the former partnership of its property we think that the transferee would require to have given value.

<sup>70</sup> A's retirement would cause the break up of the partnership and commence the winding up, but if B paid out A or if A left on the basis that his drawings equalled his entitlement there would be no actual winding up of the business.

<sup>71</sup> The fact that the membership of the partnership may have changed since the date when the old partnership took title and that the (new) partnership's stationery lists the names of the current partners in accordance with the Business Names Act 1985 would not prevent the bona fide third party from relying on the protection as the change in membership would not of itself indicate the creation of a new partnership where there is a default rule of continuity of partnership.

<sup>72</sup> That is, in England and Wales the Land Registry and in Scotland the Land Register.

<sup>73</sup> In England and Wales, the relevant provisions are s 103 of and Sched 8 to the Land Registration Act 2002. Para 1(1)(b) of Sched 8 provides that a person is entitled to be indemnified by the registrar if he suffers loss by reason of a mistake whose correction would involve rectification of the register. In Scotland the relevant provision is s 12 of the Land Registration (Scotland) Act 1979 which requires the Keeper of the Registers to indemnify a person who suffers loss as a result *inter alia* of a refusal or omission of the Keeper to rectify the Land Register.

9.64 While useful particularly in the context of transactions in land the protection would be available in transactions in all types of partnership property.

9.65 **We therefore recommend that where a partnership (“the former partnership”) has broken up, but a partner of the former partnership or a partner who has entered into partnership with that partner in a successor partnership transfers property, or creates an interest in property, belonging to the former partnership and apparently on its behalf or in its name, the title of the recipient of that property, or interest in property, who receives it in good faith and for value shall not be challengeable on the ground that the property was in fact partnership property of the former partnership.** (Draft Bill, cl 42)

### ***The nature of a partner’s interest***

9.66 In existing English law partners are collectively entitled to, and each partner has an undivided share in, all the assets of the partnership. At the same time, no partner is entitled, without the agreement of his co-partners, to insist that a particular asset is vested in him, either during the continuance of the partnership or following its dissolution.<sup>74</sup> Lord Lindley gave the classic definition of the partner’s share in a partnership:

What is meant by the *share* of a partner is his proportion of the partnership assets after they have been all realised and converted into money, and all the debts and liabilities have been paid and discharged.<sup>75</sup>

While, as the editor of *Lindley & Banks* points out, it would be more accurate to speak of a partner’s entitlement to the net proceeds of sale of the assets, the definition reflects the application of the default rules in sections 39 and 44 of the 1890 Act.<sup>76</sup> Where a partnership agreement departs from these provisions of the 1890 Act, the nature of a partner’s share will be determined by that agreement.

9.67 In English law, because of the aggregate approach to partnership, it is necessary to distinguish between the external perspective of a partner’s share, which looks to each partner’s undivided share in every partnership asset, and the internal perspective, which looks to the contractual restrictions which the partnership agreement imposes on the partners’ ownership of the partnership assets. As Hoffmann LJ stated:

As between themselves, partners are not entitled individually to exercise proprietary rights over any of the partnership assets. This is because they have subjected their proprietary interests to the terms of the partnership deed which provides that the assets shall be employed in the partnership business, and on dissolution realised for the purposes of paying debts and distributing any surplus. As regards the outside world, however, the partnership deed is irrelevant. The

<sup>74</sup> *Lindley & Banks*, para 19-04. See more generally, *Lindley & Banks*, ch 19.

<sup>75</sup> *Lindley on Partnership* (5<sup>th</sup> ed 1888), p 339, quoted in *Lindley & Banks*, para 19-05.

<sup>76</sup> *Lindley & Banks*, para 19-06.

partners are collectively entitled to each and every asset of the partnership, in which each of them therefore has an undivided share.<sup>77</sup>

- 9.68 In Scotland, where partnership property<sup>78</sup> may be vested in or held in trust for the partnership as an entity, the partners do not have any direct proprietary interest in any of the partnership assets. The partners own a share of the partnership, which is an incorporeal moveable right or *ius crediti*.<sup>79</sup> As Bell put it:

The share of each partner is a portion of the *universitas*: it forms a debt or demand against the [partnership], so as to be arrestable in the hands of the [partnership].<sup>80</sup>

Thus the distinction between the internal and external perspectives which exists in English law is not part of Scots law. A partner's share under the existing default regime is ultimately his entitlement to claim from the partnership his portion of the net proceeds of sale of partnership assets on a winding up. As long as the partnership continues, however, the partner is entitled, under the existing default regime, to require that the partnership's assets be applied for partnership purposes<sup>81</sup> and to his equal share of the profits of the partnership business.<sup>82</sup>

- 9.69 The introduction into the English law of partnership of separate legal personality will allow us to dispense with the complexity of the two perspectives. The distinction between the rights which exist under the default rules and the rights which arise under a partnership agreement which departs from those rules will however remain. Thus any definition of a partnership share would have to distinguish between the default regime on the one hand and another contractual regime on the other.

- 9.70 In our recommendations in Part VIII on the financial rights of the outgoing partner we refer to the partner's share in the partnership.<sup>83</sup> We think that the outgoing partner's share in the partnership under the default code which we recommend in this report comprises the following elements:

- (1) a right to an equal share of the profits of the partnership; and *either*
- (2) a right to be bought out at the default valuation on withdrawal; *or*
- (3) a right to an equal share of the net proceeds of sale of the assets of the partnership on a winding up.

<sup>77</sup> *IRC v Gray* [1994] STC 360, 377c-e.

<sup>78</sup> Until the Abolition of Feudal Tenure etc (Scotland) Act 2000, s 70 is brought into force a Scottish partnership cannot own land. See para 9.9 above.

<sup>79</sup> Clark, I, 178; Bell, *Comm.* II, 536.

<sup>80</sup> Bell, *Comm.* II, 536.

<sup>81</sup> 1890 Act, s 20(1).

<sup>82</sup> 1890 Act, s 24(1).

<sup>83</sup> See *inter alia* para 8.75 above.

Where partners contract out of the default code the partner's share will be such rights as the partner has in terms of the partnership contract.

9.71 We recognise, however, as *Lindley & Banks* state:

Although it is convenient to refer to a partner's interest in the firm as his "share" that expression is notoriously difficult to define, not least because its meaning differs according to the context in which it is used. ... Thus, whilst the "share" of an outgoing partner may quite properly be viewed solely in financial terms, reference to the "share" of a *continuing* partner must include the totality of the rights which he enjoys under the partnership agreement and under the general law.

9.72 We do not, therefore, propose to attempt a comprehensive definition of a partner's share.

### ***Identifying property as partnership property***

9.73 We do not propose to alter the substance of the rules of the 1890 Act<sup>84</sup> which either determine what is partnership property or which create a rebuttable presumption that property is partnership property. We seek merely to adapt those rules to the other reforms which we recommend.

9.74 Partnerships with separate personality will be able to hold property in their own names. In some circumstances partnerships will continue to allow partners and others to hold property on their behalf. The rules for ascertaining whether property is partnership property (which are currently sections 20 and 21 of the 1890 Act<sup>85</sup>) will remain relevant in such circumstances.

9.75 We do not propose to change the law which creates no presumption that property made available to and used by a partnership in its business is partnership property.<sup>86</sup> Where property is brought into a partnership at its commencement as a capital contribution, that property should be partnership property, even if title remains in the hands of another person. Again we propose no change of substance. Similarly property which is acquired on behalf of a partnership during the continuance of the partnership should be partnership property, whether or not the partnership holds the title to it. Where a partner or third party holds the title to such property the title-holder will hold the property in trust for the partnership.

9.76 Section 21 of the 1890 Act creates a rebuttable presumption that property bought with money belonging to the partnership is partnership property. We wish to preserve this presumption but to extend it to cover property acquired out of partnership property. While the norm may be a purchase using partnership money,

<sup>84</sup> 1890 Act, ss 20 and 21; see paras 9.10 – 9.13 above. Capital contributions at the start of the partnership and assets acquired on account of the partnership are partnership property (s 20(1)); property bought with partnership money is partnership property unless the contrary intention appears (s 21).

<sup>85</sup> See paras 9.10 – 9.13 above.

<sup>86</sup> See para 9.10 above: where assets are made available to the partnership the court looks at all the circumstances to ascertain if the partners have agreed that the assets were to become partnership property.

it is not apparent to us why the presumption should not apply where property is acquired in exchange for partnership property.

9.77 Thus we think that there should be a rebuttable presumption that property acquired out of partnership property has been acquired on behalf of the partnership. This presumption deals both with the situation where there is no documentary title to the property and where the acquirer takes title to the property. Where the acquirer (to whom this presumption applies) holds the property in his name and is a partner, the acquirer will hold the property in trust for the partnership. This is because we propose that there should be a statutory rule that property held in the name of one or more of the partners, which has been acquired on behalf of the partnership or contributed to the partnership as capital, is held by the partner or partners in trust for the partnership.

9.78 We are aware that a case can be made for further presumptions arising from entries in partnership accounting records or the regular use of property by partners in carrying on the business of the partnership.<sup>87</sup> However we are not persuaded that it is desirable to introduce further presumptions as (a) entries in a partnership's accounts will carry great weight in most circumstances, avoiding the need for a presumption and (b) regular use of an asset does not of itself indicate that the asset is partnership property.<sup>88</sup>

9.79 As partners may continue to use land which they co-own but which is not partnership property to carry on a partnership business we think that section 20(3) of the 1890 Act, which creates a default rule as to the ownership of further land purchased with the profits of the partnership business, should be preserved. We have received representations that the provision is still valuable.

9.80 **We therefore recommend:**

- (1) That there should be a rule that property which is held in the name of one or more of the partners and which has been acquired on behalf of the partnership or contributed as capital to the partnership is partnership property and is held on trust for the partnership;** (Draft Bill, cl 18(2))
- (2) That there should be a rebuttable presumption that property which is acquired with money or other assets belonging to the partnership is partnership property;** (Draft Bill, cl 18(1)) **but**
- (3) The existing rule in section 20(3) of the 1890 Act, which creates a presumption that additional land bought out of the profits of a partnership involving the use of co-owned land is not partnership property, should be re-enacted.** (Draft Bill, cl 19)

<sup>87</sup> See the response of Elspeth Deards, para 9.21 above.

<sup>88</sup> See eg *Miles v Clarke* [1953] 1 WLR 537.

### ***The definition of partnership property***

- 9.81 As a partnership will have separate personality and can own property or have property held in trust for it, it is possible to adopt a straightforward definition of “partnership property” to identify the property which makes up the assets of the partnership which are taken into account in valuing a partner’s share in the partnership. This is property to which the partnership is beneficially entitled in English law. Where the partnership holds property in trust for another person or persons, the partnership has by definition no beneficial interest in such property.
- 9.82 The formulation in Scots law, which achieves the same practical result, requires to be different as Scots law does not recognise a split between legal ownership and beneficial ownership. In Scotland partnership property will include (a) property which is owned by the partnership which is not held in trust either for another person or for a purpose other than the partnership business and (b) property which is held by another person in trust for the partnership.
- 9.83 **We therefore recommend:**
- (1) That, in English law, “partnership property” should be defined as property to which the partnership is beneficially entitled, whether or not the property is held in the partnership name; (Draft Bill cl 17(1)(a)) and**
  - (2) That, in Scots law, “partnership property” should be defined negatively as not including property held by the partnership in trust. (Draft Bill, cl 17(1)(b))**

### **THE EXECUTION OF DOCUMENTS AND DEEDS**

#### **Existing law**

- 9.84 In English law there are three difficulties for the execution of deeds by partnerships:
- (1) a partner has no implied authority to bind co-partners by deed;<sup>89</sup>
  - (2) authority to execute a deed on behalf of another person must be conferred by deed;<sup>90</sup> and
  - (3) even if a partner acts with express authority, the form of the deed determines whether the partnership is bound.<sup>91</sup>

<sup>89</sup> *Harrison v Jackson* (1797) 7 TR 207; 101 ER 935; *Steiglitz v Egginton* (1815) Holt 141; 171 ER 193; *Marchant v Morton, Down & Co* [1901] 2 KB 829.

<sup>90</sup> *Schack v Anthony* (1813) 1 M & S 573; 105 ER 214; *Harrison v Jackson* (1797) 7 TR 207; 101 ER 935. The requirement for authority to deliver a deed to be given by deed has been abolished: Law of Property (Miscellaneous Provisions) Act 1989, s 1(1)(c). See generally: The Execution of Deeds and Documents by or on behalf of Bodies Corporate, Consultation Paper No 143, para 8.3; (1998) Law Com No 253, para 7.3.

<sup>91</sup> *Marchant v Morton, Down & Co* [1901] 2 KB 829; *Lindley & Banks*, para 12-178.

9.85 The combination of (1) and (2) in the immediately preceding paragraph means that for a deed to be validly executed by a partnership, it must either be executed by all the partners, or on their behalf by an attorney, authorised by a deed executed by them all.<sup>92</sup> This can be inconvenient for large partnerships. The rule that any deed conveying a legal estate in land to a partnership vests it in no more than four partners is a further complication for large partnerships.<sup>93</sup>

9.86 In Scotland one partner can execute a document on behalf of the partnership.<sup>94</sup>

### **Our provisional proposals**

9.87 In the Joint Consultation Paper we proposed that if partnerships with separate legal personality were to be introduced in English law the rules on the execution of deeds by partnerships should be as follows:

- (1) a document would be executed by the partnership if signed by a partner and expressed to be executed by the partnership;
- (2) there should be a presumption of due execution in favour of an acquirer in good faith and for valuable consideration; and
- (3) there should be a rebuttable presumption that a deed executed in accordance with (1) above was delivered upon execution.<sup>95</sup>

9.88 We also invited views on our suggestion that the provisions governing the execution of documents and deeds in both jurisdictions<sup>96</sup> should make clear that a partner should be able to execute deeds or documents only if he has authority to bind the partnership. Otherwise the provisions might circumvent the rules in sections 5 and 6 of the 1890 Act.

### **Consultation**

9.89 The response from English consultees who addressed the issues was divided. While a majority supported all or at least some of the three proposals set out in paragraph 9.87 above there was strong opposition in particular to our proposal that a document would be executed by the partnership if signed by one partner and expressed to be executed by the partnership.

<sup>92</sup> A deed may also be executed by one partner in the name and in the presence of the co-partners, which is treated as due execution by them: see *Ball v Dunsterville* (1791) 4 TR 313; 100 ER 1038; *Burn v Burn* (1798) 3 Ves Jr 573; 30 ER 1162; *Orr v Chase* (1812) 1 Mer 729; 35 ER 839; *Brutton v Brutton* (1819) 1 Chitty 707.

<sup>93</sup> Trustee Act 1925, s 34(2); Law of Property Act 1925, s 34(2). The problem can be avoided if the partnership incorporates a company to hold land but that may not be a satisfactory solution for small partnerships.

<sup>94</sup> Requirements of Writing (Scotland) Act 1995, Sched 2, para 2(1).

<sup>95</sup> Joint Consultation Paper, para 19.11.

<sup>96</sup> That is, the proposed provision in English law in para 9.87 above and in Scotland the Requirements of Writing (Scotland) Act 1995, (“the 1995 Act”) Sched 2, para 2(1) which provides: “Except where an enactment expressly provides otherwise, where a grantor of a document is a partnership, the document is signed by the partnership if it is signed on its behalf by a partner or by a person authorised to sign the document on its behalf”.

- 9.90 The Law Society opposed this proposal arguing that it would be a recipe for disputes. They requested that the rules for partnership be made analogous to companies, so that the signature of two partners would be required. The APP expressed a preference for execution by two partners so as to give Trustee Act protection to purchasers for value. The Chancery Bar Association and the Country Land and Business Association also supported the signature of two partners.
- 9.91 H M Land Registry expressed concern about the second proposal set out in paragraph 9.87 above. They suggested that the formulation in the Joint Consultation Paper was too restrictive and that a purchaser in good faith should be protected where the person signing expresses himself to be a partner even though he is not. This would, they suggested, bring partnerships into line with the provisions relating to companies.<sup>97</sup>
- 9.92 There was general support for the proposition that the rules on the execution of deeds which we proposed would be subject to rules about the actual or apparent authority of a partner which are currently sections 5 and 6 of the 1890 Act. The Chancery Bar Association however opposed the proposition, arguing that it put further difficulties in the path of a purchaser who tried to accept a deed from a partnership entity.
- 9.93 In Scotland there was general support for our proposal that it should be made clear that a partner in a Scottish partnership should be able to execute documents as the partnership only if he has authority to bind the partnership in the particular transaction. But the Faculty of Advocates doubted whether the reform was necessary.<sup>98</sup> The Committee of Scottish Clearing Bankers supported the proposal on the understanding that a signature was binding unless the other party knows that the partner has no authority in that particular transaction or does not know or believe him to be a partner.<sup>99</sup>

### **Reform recommendations**

- 9.94 We have reviewed our policy in the light of the consultation responses and are persuaded that in English law the signature of at least two partners should be required for execution of a deed. This will be consistent with the position for

<sup>97</sup> In favour of a purchaser a document is deemed to have been duly executed by a company if, *inter alia*, the document purports to be signed by the appropriate person: Companies Act 1985 (as amended), ss 36A(4), 36A(6).

<sup>98</sup> The Faculty thought that the correct interpretation of para 2(1) of Sched 2 to the 1995 Act was that the partner must have authority under ss 5 and 6 of the 1890 Act for the document to be validly executed. They expressed concern that the reference in our proposal to authority to bind in the particular transaction should not undermine the doctrines of general and implied authority. As our proposal is to require that the partner has actual (express or implied) or apparent authority to bind the partnership in the transaction, we do not think that this should be a problem.

<sup>99</sup> This is consistent with the 1890 Act, s 5 which gives a partner apparent authority to bind the partnership when he carries on the partnership business in the usual way. As s 5 states, there is no apparent authority when the person with whom the partner is dealing either knows that he does not have authority or does not know or believe him to be a partner. Our proposal seeks to preserve this rule.

companies and limited liability partnerships in English law.<sup>100</sup> Agents of a partnership who are not partners may not execute deeds as the partnership.<sup>101</sup> We recommend that the method by which a partnership can execute a deed is through the signature of two partners who have the requisite authority to do so. It is not enough that a partner has authority to bind the partnership. All partners have authority to bind the partnership under clause 16 of the draft Bill, if the transaction entered into is “for carrying on in the usual way business of the kind carried on by the partners”. The requisite authority required here is actual authority (whether express or implied) to enter into the transaction *as a deed*. This authority may be expressly provided in the partnership agreement, or the partnership agreement may exclude certain partners from executing deeds.

9.95 In relation to our policy on the presumptions which we proposed in paragraph 9.87 (2) and (3) above, we have not encountered any strong reason for disapplying these presumptions. The presumption in paragraph 9.87(2) is important where it is a requirement that the partners have the requisite authority to sign the deed. It is very difficult for a third party purchaser to know whether the partners that are signing the deed have this authority. Thus, this presumption (or more accurately the deeming) provides an important protection for the third party purchaser. Our intention is to provide protection for a purchaser who is acting in good faith and for valuable consideration against a lack of authority of partners (or persons held out by the partnership to the purchaser as partners) to execute a deed on the partnership’s behalf; but not against a forgery perpetrated by imposters falsely assuming the identity of partners, which would be a nullity.<sup>102</sup> We have also retained the (rebuttable) presumption of delivery of a deed upon execution.<sup>103</sup> We note that retaining these two presumptions would make the draft Bill consistent with the analogous provision of the Companies Act 1985 (section 36A(5) and (6)) and would also be consistent with the Law Commission’s recommendations in its report on Execution of Deeds and Documents by or on behalf of Bodies Corporate.<sup>104</sup>

9.96 Where a partner is not a natural person it is necessary to provide for what amounts to that partner’s signature. In its Deeds report (mentioned above),<sup>105</sup> the Law

<sup>100</sup> In Scotland one director or secretary may sign a document on behalf of a company: The 1995 Act, Sched 2, para 3(1). The Scottish rule for partnerships is thus consistent with the rule for companies.

<sup>101</sup> But a partnership could be bound by a person who acted on behalf of the partnership under a power of attorney. The power of attorney would ultimately have to be conferred by a deed executed by the partnership: Powers of Attorney Act 1971, s 1.

<sup>102</sup> Draft Bill, cl 20(7). The rule that a deed executed by an impersonator has no legal effect is well established and the clause would therefore not apply to such a document. (See, for example, *Re Cooper* (1880) 20 Ch D 611, per Kay J at p 623: “If A personating B executes a deed in the name of B purporting to convey B’s property, no right or interest can possibly pass by such an instrument. It is not a deed.” Kay J’s judgement was approved by the Court of Appeal.)

<sup>103</sup> See Law Commission report on Execution of Deeds and Documents by or on behalf of Bodies Corporate, (1998) Law Com No 253, paras 6.31-6.36.

<sup>104</sup> (1998) Law Com No 253, Part 5. The Government has accepted this report and plans to legislate in 2003 under the Regulatory Reform Act 2001.

<sup>105</sup> (1998) Law Com No 253, see appendix A (draft Bill), Sched 1, para 3(3).

Commission recommended that where a company director or company secretary was itself a company the signature of someone “authorised by the director or secretary to sign on its behalf” was sufficient. We think that a similar approach would be appropriate where a company or a partnership is a partner in a partnership: a document should be treated as signed by the partner if it is signed by an individual who has authority to sign on behalf of the partner.

9.97 In Scotland, we propose to clarify the relationship between the rules for the formal validity of documents in the Requirements of Writing (Scotland) Act 1995 and the rules as to the agency of a partner in clause 16 of the draft Bill and in the general law. We recommend that in Scotland if a document is signed on its behalf by a partner (whether or not that partner has any authority, actual or apparent) the document is valid and the partnership is bound. However the partnership or another interested party can raise proceedings to reduce the document if the partner who signed it had no authority or apparent authority to do so on behalf of the partnership.

9.98 **We therefore recommend:**

- (1) That, in English law, a document is validly executed by the partnership as a deed if and only if (a) it is signed by at least two partners, each of whom has authority to execute the document as a deed on behalf of the partnership and (b) it is expressed to be executed by the partnership and (c) it is delivered as a deed; (Draft Bill, cl 20(1) and (2))**
- (2) The document referred to in (1) above is presumed to be delivered upon its being executed in accordance with (1) above, unless a contrary intention is shown; (Draft Bill, cl 20(3))**
- (3) If a partnership is being wound up by the partners and there is only one partner remaining, the rule in paragraph (1)(a) above should be taken as satisfied if the document is signed by the partner, whether or not he had authority to execute the document; (Draft Bill, cl 20(4))**
- (4) If a limited partnership has only one general partner, the rule in (a) in paragraph (1) above should be taken as satisfied if the general partner signs the document and he has authority to execute the document as a deed on behalf of the partnership; (Draft Bill, cl 20(5))**
- (5) If the partner is not an individual a document should be treated (for the purposes of this provision) as signed by that partner if it is signed by an individual who has authority to sign on behalf of the partner; (Draft Bill, cl 20(6))**
- (6) In favour of a purchaser in good faith and for valuable consideration there is a presumption of due execution; (Draft Bill, cl 20(7) and (8)) and**
- (7) In Scots law, the formal validity of a document signed by a partnership in accordance with the Requirements of Writing**

**(Scotland) Act 1995 is not affected by a partner's lack of authority to sign the document, but the partnership or another interested party should be able to seek the reduction of such a document if the partner had no authority or apparent authority to sign the document on behalf of the partnership. (Draft Bill, cl 21)**

# **PART X**

## **PARTNERS' FINANCIAL AND MANAGEMENT RIGHTS, EXPULSION AND RETIREMENT**

### **INTRODUCTION**

- 10.1 This Part deals with the financial and management rights of partners which are currently covered in section 24 of the 1890 Act. We also address the expulsion, suspension and compulsory retirement of partners.<sup>1</sup>

### **FINANCIAL AND MANAGEMENT RIGHTS**

#### **Existing law**

##### ***Capital contributions***

- 10.2 Partners usually contribute sums to the partnership for the purpose of commencing or carrying on the partnership business. These sums form the capital of the partnership. Where partners contribute money or assets to the partnership as partnership capital, the money or assets will belong to the partnership. In the absence of contrary agreement, the capital of the partnership cannot be increased or reduced without the consent of all the partners.<sup>2</sup> As a result a partner cannot withdraw capital while he is a partner without the consent of co-partners but capital can be written off if it is lost.

##### ***Partnership accounts***

- 10.3 While partners must prepare accounts for tax purposes in accordance with the requirements of the Inland Revenue, there is no regulation of the way in which internal partnership accounts may be prepared for the purpose of allocating profits between the partners. Nor is there any regulation of the way in which partnership assets are valued in a partnership's internal accounts. Partnership accounts are a private matter between the partners.

##### ***Profit shares***

- 10.4 Unless they agree to the contrary, partners are entitled to share equally in the capital and profits of the business and must contribute equally to the losses which a partnership sustains.<sup>3</sup> In *Popat v Shonchhatra*,<sup>4</sup> the Court of Appeal considered the meaning of section 24(1) of the 1890 Act in relation to partners' capital

<sup>1</sup> We include our discussion of expulsion and retirement in this part (rather than in Part VIII) as it concerns the rights and powers which the default code gives the partners as against each other.

<sup>2</sup> See *Heslin v Hay* (1884) 15 LR Ir 431 and *Bouch v Sproule* (1887) 12 App Cas 385, 405, per Lord Bramwell.

<sup>3</sup> 1890 Act, s 24 (1).

<sup>4</sup> [1997] 1 WLR 1367.

contributions. The effect of the Court of Appeal's decision is that, in the absence of agreement to the contrary, partners are entitled to share equally in a partnership's capital even though one partner has contributed £1 and another £1 million. Nonetheless, the court made it clear that the slightest indication of an implied agreement that partners' shares of capital should correspond to their contributions would suffice to displace the default rule of equal shares.<sup>5</sup> Thus significant inequality of capital contributions may be sufficient evidence of itself to displace the presumption of equality.

### ***Indemnity against loss and expenses***

- 10.5 A partner has the right to be indemnified against losses and expenses incurred for the benefit of the partnership. Section 24(2) of the 1890 Act provides that, subject to agreement to the contrary:

The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him –

- (a) in the ordinary and proper conduct of the business of the firm; or
- (b) in or about anything necessarily done for the preservation of the business or property of the firm.

### ***Interest on advances***

- 10.6 In the absence of agreement, a partner is not entitled to interest on the capital contributed to the partnership.<sup>6</sup> But a partner is entitled to simple interest at 5% on any payment or advance made to the partnership in addition to his capital contribution.<sup>7</sup> Again, like the other provisions of section 24, this rule is subject to any agreement, express or implied, between the partners.

### ***Participation in management***

- 10.7 Section 24 (5) of the 1890 Act provides that, subject to agreement to the contrary:

Every partner may take part in the management of the partnership business.

- 10.8 Participation in the conduct of partnership business is the essence of partnership law: partners carry on business together with a view of profit. As partners have unlimited liability for all partnership debts and obligations they would expect to engage in the management of the partnership business, unless they agreed otherwise.<sup>8</sup> As a default rule a partner is not entitled to remuneration for acting in the partnership business.<sup>9</sup>

<sup>5</sup> *Op cit*, Nourse LJ at p 1373.

<sup>6</sup> 1890 Act, s 24(4).

<sup>7</sup> 1890 Act, s 24(3).

<sup>8</sup> Different rules apply in relation to limited partners under the Limited Partnerships Act 1907. See Part XVII below.

<sup>9</sup> 1890 Act, s 24(6).

### ***Decision making: majority or unanimity***

- 10.9 Participation in the management of the partnership business involves partners in differences of opinion. The default rules of the 1890 Act distinguish between “ordinary matters” connected with the partnership business, which may be decided by majority, and other matters.<sup>10</sup> The Act requires, as default rules, the consent of all existing partners before a person can join a partnership<sup>11</sup> and for any change in the nature of the partnership business.<sup>12</sup> Many partnerships define in their partnership agreements the matters which require to be decided either by a special majority or by unanimity.<sup>13</sup> But the 1890 Act does not define what is meant by an ordinary matter connected with the partnership business. In the absence of contractual definition, that is a question of fact. Nor does the 1890 Act provide for special majorities.

### **Our provisional proposals**

#### ***Partnership accounts***

- 10.10 In the Joint Consultation Paper we observed that if a partnership’s internal accounts were prepared according to known accounting standards, an incoming partner would have a more transparent basis on which to make a judgement before becoming a partner. Nonetheless we were not in favour of prescribing mandatory accounting standards for partnerships. Partnership accounts are private documents which partners prepare for their own purposes and no outside party has a legitimate interest in them. To obtain views on the issue, we asked consultees whether a partnership’s internal accounts should be required to comply with accepted accounting standards, unless partners agree otherwise.<sup>14</sup>

#### ***Capital and profit shares***

- 10.11 We also discussed partners’ rights to share equally in the capital and profits of the partnership business and the effect of the Court of Appeal’s decision in *Popat v Shonchhatra*,<sup>15</sup> asking whether consultees considered there was a need to amend section 24(1) of the 1890 Act in the light of that case. We asked whether consultees would favour a provision that, subject to agreement to the contrary, partners should be entitled to the return of their capital contributions in the same proportions as they were contributed.<sup>16</sup>
- 10.12 Recognising that in some partnerships profit shares may vary according to the level of partnership profits or a partner may have some preferential entitlement, we questioned the effect of such variable profit shares on the apportionment between partners of liability to bear losses. We asked whether it should be provided that,

<sup>10</sup> 1890 Act, s 24(8).

<sup>11</sup> 1890 Act, s 24(7).

<sup>12</sup> 1890 Act, s 24(8).

<sup>13</sup> For examples of matters on which partnership agreements commonly require higher majorities, see the Joint Consultation Paper, para 12.34.

<sup>14</sup> Joint Consultation Paper, para 12.12.

<sup>15</sup> [1997] 1 WLR 1367.

<sup>16</sup> Joint Consultation Paper, para 12.18.

subject to agreement to the contrary, losses would be borne in the same proportions as the ultimate residue of assets would be shared under section 44 of the 1890 Act.<sup>17</sup>

### ***Interest on advances***

- 10.13 We also proposed that the rate of interest payable to a partner on a payment or advance beyond the partner's agreed capital contribution should be a commercial rate related to the Bank of England's base rate and not the fixed rate of five per cent.<sup>18</sup>

### ***Management decisions***

- 10.14 In relation to management rights we asked whether it should be provided that, subject to agreement to the contrary, the consent of all the partners would be necessary for (a) a change in the location of the partnership premises, (b) any restriction on the authority of one partner which is not part of a general restriction on the authority of all the partners or (c) any other decisions. We also discussed whether it was appropriate to relax the requirement of unanimity in relation to specified decisions but expressed the view that such matters were best left to the partnerships themselves. We proposed that there should be no new statutory rules as to special majorities for votes on "extraordinary" decisions.<sup>19</sup>

## **Consultation**

### ***Partnership accounts***

- 10.15 Consultees unanimously agreed with our proposition that partnerships should not have a mandatory obligation to comply with specified accounting standards when compiling their internal accounts. Views were divided on whether a partnership's internal accounts should comply with such accounting standards, unless partners agree otherwise. A clear majority were against the idea although there was more support in Scotland for the idea than elsewhere in the UK. Accountancy bodies who responded to the question were unanimously against the idea. It was suggested that such intervention would not be justified as accounting standards were prepared for bodies which required to produce external accounts which showed a true and fair view and not for private partnership accounts. It would not achieve standardisation of partnership accounts as partnerships could opt out of the requirement. The idea was of little worth as partnerships must produce accurate accounts for tax purposes, which could be made available to incoming partners. Partners were in any event under a duty of good faith towards each other and that included keeping full and accurate financial records.<sup>20</sup>

<sup>17</sup> Joint Consultation Paper, para 12.25.

<sup>18</sup> Joint Consultation Paper, para 12.28.

<sup>19</sup> Joint Consultation Paper, para 12.42.

<sup>20</sup> See the 1890 Act, s 28 and s 24(9).

### ***Profit shares and return of capital contributions***

- 10.16 There was general support for the proposal to amend section 24(1) of the 1890 Act in the light of the Court of Appeal's decision in *Popat v Shonchhatra*<sup>21</sup> to the effect that there should be a default rule that partners should be entitled to the return of their capital contributions in the same proportions as they were contributed. The Chancery Bar Association suggested that the proposal reflected the existing law and that the deletion of the words "the capital and" in section 24(1) of the 1890 Act would achieve the desired result.<sup>22</sup>
- 10.17 Several consultees raised the problem of providing a statutory mechanism for the valuation of non-monetary contributions to a partnership such as assets, labour or expertise.<sup>23</sup> The problem of valuing a non-monetary contribution to a partnership arises whether the default rule provides for an equal division of capital or for the return of capital contributions in the same proportions as they were contributed. In either case, a partner who made a non-monetary contribution to the partnership would require to negotiate an agreed valuation of that contribution, if he wished to receive value for that contribution on a winding up of the partnership.<sup>24</sup>
- 10.18 Views were divided on the need to amend section 24 of the 1890 Act to cater for preferential profit shares by providing that losses should be borne in the same proportion as the ultimate residue of assets would be shared under section 44 of the 1890 Act. A majority favoured the proposal but several consultees considered it an unnecessary complication.

### ***Interest on advances***

- 10.19 There was general support for the proposal to replace the fixed rate of interest on advances made by partners to a partnership with a commercial rate of interest.<sup>25</sup> A minority opposed the proposal. One consultee preferred the interest rate to be the rate on judgments to avoid the statement in the statute of a rate which might disappear as a result of a commercial decision. Another advocated the repeal of the

<sup>21</sup> [1997] 1 WLR 1367.

<sup>22</sup> The 1890 Act s 24(1) would then read: "All the partners are entitled to share equally in [ ] the profits of the business...".

<sup>23</sup> The Law Society, the Faculty of Advocates, Roderick Banks, and the Centre for Research into Law Reform identified the problem. Professor Morse and David Guild suggested that the Law Commissions should consider making the decision of the Court of Session in *Bennett v Wallace* 1998 SC 457 a default rule. In that case the Court of Session decided that all assets brought into the partnership should be included in the accounting between the partners both at the start and at the end of the partnership relationship, subject to agreement to the contrary. Consequently, an incoming partner would be entitled only to a share in the increase of the value of an asset such as work in progress. In our view the decision is correct on the facts of that case, where the parties had reserved the valuation of work in progress at the outset of the partnership. But there may be difficulties in applying the reasoning of the court generally, particularly where assets have not been valued at the start of a partnership relationship and the passage of time makes such valuation impracticable. See *Lindley & Banks*, para 10-171.

<sup>24</sup> Partners must agree to the contribution of capital to a partnership. See para 10.2 above. A partner who wishes to have his non-monetary contribution treated as a capital contribution would require to negotiate that at the outset.

<sup>25</sup> 1890 Act, s 24(3).

provision for interest on advances which it considered to be a trap for the unwary because it was little known and seldom invoked.

### ***Management decisions***

- 10.20 Consultees gave little support to any new default rule which required unanimity for particular management decisions such as a change in the location of the partnership premises. Several consultees argued that it was not appropriate to select particular decisions; the circumstances of partnerships varied greatly and detailed rules would not suit all partnerships.<sup>26</sup> While some consultees supported a default rule requiring unanimity for a restriction on the authority of a particular partner, others suggested that it would not be helpful. One consultee suggested that such a restriction would not be an “ordinary matter” and would already require unanimity under the default rules of the 1890 Act. Others considered that such a rule would encourage litigation or the dissolution of a partnership. A partner who was being victimised would have other remedies in equity.<sup>27</sup>
- 10.21 Consultees unanimously agreed with our provisional proposal that there should be no new statutory rules as to special majorities for votes on “extraordinary matters”.

### **Reform recommendations**

#### ***Partnership accounts***

- 10.22 We recommend that a partnership’s internal accounts should not have to comply with accepted accounting standards. We are persuaded by the arguments of consultees that it is inappropriate to regulate the private accounts of partnerships and that it is unnecessary as partners are under a duty of good faith to each other and are required in any event to produce acceptable accounts for tax purposes.<sup>28</sup> Accordingly, we recommend no such requirement either as a mandatory obligation or as a default rule.

#### ***The return of capital contributions, profit shares and responsibility for losses***

##### THE RETURN OF CAPITAL CONTRIBUTIONS

- 10.23 With hindsight, we think that we may have caused consultees unnecessary confusion by referring in the Joint Consultation Paper to the decision of the Court of Appeal in *Popat v Shonchhatra*<sup>29</sup> without stating the specific propositions which

<sup>26</sup> There were tentative suggestions that unanimity could be required for deciding (a) the bank at which the partnership’s accounts were to be held, (b) who were to be the partnership’s accountants and (c) for borrowings in excess of capital. The Association of Chartered Certified Accountants (ACCA) suggested that there should be a prescribed list of “ordinary matters” which were to be decided by majority vote. But a clear majority suggested that the law should not be changed and that detailed provision would lead to hard cases.

<sup>27</sup> He would have the right to seek a winding up of the partnership on the just and equitable ground – 1890 Act s 35(f).

<sup>28</sup> See para 10.15 above.

<sup>29</sup> [1997] 1 WLR 1367.

we derived from the case. Nevertheless, we maintain that it is clear what the appropriate policy should be: there should be no default rule that partners share equally in capital and therefore that they receive equal amounts on the return of capital on final settlement of accounts.<sup>30</sup> Instead partners should be entitled to the return of their capital contributions on final settlement of accounts.<sup>31</sup>

#### PROFIT SHARES

- 10.24 We recommend therefore that the rule, which is currently section 24(1) of the 1890 Act, which provides for equality between partners in relation to capital, profits and losses should be restricted to profits and losses. Such profits and losses would include capital profits and losses, for example on the disposal of partnership assets which are not held as part of the partnership's trading stock.<sup>32</sup> We discuss the rights of partners to a return of capital on final settlement of accounts in Part XII below.<sup>33</sup>

#### RESPONSIBILITY FOR LOSSES

- 10.25 We have considered whether, in order to promote certainty, the draft Bill should provide as a default rule that, where profit shares vary according to the level of partnership profits or there are preferential entitlements, losses should be borne in the same proportion as residual profits are shared. This would equate responsibility for losses with the profit shares available to partners after allowing for prior calls on profits. While some consultees supported such a provision to remove uncertainty, we are not persuaded that it is necessary. While the issue may give rise to some problems in practice, it is difficult to provide a default rule which is suitable and fair in widely varying circumstances. It may be clear in many cases that preferential profit shares are to be ignored and that liability for losses should be equated with partners' entitlements to residual profits. In other cases it may be inferred from the nature of the preferential share that partners envisaged that losses would be borne in proportions which include the benefit which a partner received from a prior call on profits. Thus where a partner is entitled to, say, the first £5000 of profits, parties may intend that he meet the first £5000 of losses. We see no need to complicate the default code.

#### ***Interest on advances***

- 10.26 We recommend that partners should be entitled to a commercial rate of interest on loans which they make to a partnership. We prefer this to the fixed rate of interest

<sup>30</sup> We use the word "capital" in its natural meaning to refer to the aggregate of the capital contributions of the partners and not the capital value of the partnership's assets. See *Lindley & Banks*, paras 17-01 and 17-09. Our policy involves a departure from the underlying principle of community of profits and also losses (both external and internal). The departure is balanced by our recommendation to remove the rule that on final settlement of accounts partners must make good deficiencies of capital. See para 12.128 below.

<sup>31</sup> See para 12.128 below and draft Bill, cl 44 (3).

<sup>32</sup> See *Popat v Schonchhatra* [1997] 1 WLR 1367, 1373 *per* Nourse LJ.

<sup>33</sup> In summary, we recommend that on final settlement of accounts partners should be entitled to the return of their capital contributions in the same proportions as they were contributed where there are sufficient assets to repay capital. See draft Bill, cl 44 (3) and paras 12.119 – 12.128 below.

of 5% which may be appropriate at some stages of the economic cycle but wholly inappropriate at others.<sup>34</sup> This recommendation fits with our general policy to use a commercial rate in other provisions of the draft Bill, such as the provision on the right of a former partner to interest on his share of the partnership until he is paid out.<sup>35</sup>

### **Management decisions**

- 10.27 We see no need to alter the default rules by specifying particular decisions which require unanimous consent or by providing for certain decisions to be taken by special majorities. We agree with consultees that detailed rules would not be appropriate as the circumstances of partnerships differ so greatly. Accordingly, we preserve in the draft Bill the distinction in the 1890 Act between “ordinary matters” which can be decided by majority vote and other matters which require unanimity.<sup>36</sup> The provisions of the 1890 Act requiring unanimity before a new partner may join a partnership and for a change in the nature of the partnership business are preserved in the draft Bill.<sup>37</sup>

### **Agreement on capital contributions**

- 10.28 We think that it would be useful to state as a default rule that a partner is not entitled, nor may he be required, to contribute capital or to vary the amount of his capital contribution to the partnership unless he and all the partners agree.<sup>38</sup>

### **Other default rules in section 24 of the 1890 Act**

- 10.29 We think that the other existing default rules in section 24 of the 1890 Act should be re-enacted.<sup>39</sup> We have taken the opportunity to clarify the circumstances in which a partner is entitled to an indemnity in respect of payments made in the proper conduct of the partnership business. We consider that a partner should be entitled to an indemnity when he, acting in good faith and reasonably, pays a claim against the partnership, which in fact turns out not to be due.<sup>40</sup> The requirements of good faith and reasonable behaviour mean that in most circumstances the

<sup>34</sup> Clause 13(4) of the draft Bill refers to interest on advances and not, as in the 1890 Act, s 24(3) to “any actual payment or advance”. We do not think that a partner should have an automatic right to interest on monies which he pays out for the partnership, for example in meeting a debt of the firm under a guarantee. See *Ex parte Chippendale* (1854) 4 De GM & G 19. A partner will be entitled to an indemnity under cl 12(3) and (5) in relation to liabilities incurred in the proper conduct of the partnership business.

<sup>35</sup> See para 8.75(2) above and draft Bill cl 32(2)(b).

<sup>36</sup> We also recommend unanimity before a partnership liquidator is authorised to exercise certain powers (see para 12.78 below) and where partners exercise an option to expel a partner whose interest has been attached by personal creditors (see para 8.110(6) above).

<sup>37</sup> 1890 Act, s 24(7) and (8). See also RUPA s 401(i) and (j).

<sup>38</sup> This is the existing law. See para 10.2 above. See also *Popat v Shonchhatra* [1997] 1 WLR 1367, 1373 *per* Nourse LJ.

<sup>39</sup> We have replaced the requirement that partnership books are kept at the principal place of business of the partnership and that every partner should have access to them (1890 Act, s 24(9)) with a duty on partners to keep accounting records. See para 11.34 below.

<sup>40</sup> We think that this is the existing law. See *Lindley & Banks*, para 20-13; *Re Webb* (1818) 8 Taunt 443, 129 ER 455 and *McIlreath v Margetson* (1785) 4 Doug KB 278, 99 ER 880.

partner will have to consult his partners before meeting the claim if he wishes to obtain an indemnity.<sup>41</sup>

10.30 **We therefore recommend that:**

- (1) The default rule (currently section 24(1) of the 1890 Act) which provides for equality between partners should be confined to profits and losses and should not refer to capital;** (Draft Bill, cl 11)
- (2) As a default rule, partners should be entitled to a commercial rate of interest on advances which they make to a partnership;** (Draft Bill, cls 13 (1), (4) and (5) and 76(1))
- (3) There should be no statutory rules providing for decision making by special majorities but the distinction between “ordinary matters” which can be decided by majority vote and other matters which require unanimity should remain the default rule and it should be clarified that the question whether a partnership should raise or defend legal proceedings is an ordinary matter;** (Draft Bill, cl 14 (1), (3), (4) and (5)).
- (4) There should be a default rule that the agreement of all the partners is required for a partner to be entitled, or required, to contribute capital to the partnership or vary the amount of his capital contribution;** (Draft Bill, cl 13(1) and (2))
- (5) Other default rules of section 24 of the 1890 Act (the requirement of unanimity for a change in the nature of the partnership business, no entitlement to remuneration, no entitlement to interest on capital, entitlement to take part in the management, unanimous agreement to the introduction of a new partner) should be re-enacted.** (Draft Bill, cls 6(4), 12(1) and (2), 13(1) and (3), 14(1) and (2) and 27)
- (6) A partner’s right to indemnity should be clarified so that he should be entitled to indemnity from the partnership where in good faith and reasonably he pays (or contributes towards) a claim made against the partnership.** (Draft Bill, cl 12(3)(b), (5) and (8))

## **EXPULSION, SUSPENSION AND COMPULSORY RETIREMENT**

### **Existing law**

10.31 While partnership agreements often contain provisions which allow the expulsion, suspension or compulsory retirement of partners, the default regime of the 1890 Act does not. Section 25 of the 1890 Act provides:

<sup>41</sup> In the draft Bill, cl 12(3)(b) we do not refer to good faith but merely to “the reasonable settlement of an alleged personal liability for a partnership obligation”. As partners owe a general duty of good faith (draft Bill, cl 9), we see no need to refer expressly to the requirement of good faith.

No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.

- 10.32 As a result, partnerships which do not have partnership agreements with such a power and who wish to rid themselves of a discordant partner have the options of (a) persuading the discordant partner to agree to be bought out and (b) applying to the court under section 35 of the 1890 Act to have the partnership dissolved.
- 10.33 As there can be a delay in finally determining a partner's expulsion, many partnership agreements provide for the suspension of the partner for a specified period to prevent him entering the partnership premises or taking part in management. A usual suspension clause will preserve the suspended partner's financial rights.<sup>42</sup> Many partnership agreements also have provisions for compulsory retirement, which in effect provide for "no fault" expulsion. These are useful particularly in large partnerships to prevent a partner or small minority from holding a partnership to ransom where there is a disagreement on policy. The default regime of the 1890 Act provides neither for suspension nor for compulsory retirement.

### **Our provisional proposals**

- 10.34 In the Joint Consultation Paper we observed that a power to expel was expropriatory in nature, at least so far as future profits are concerned. A power to expel is also arguably contrary to the essence of partnership as an association of equals and joint owners of a business. On the other hand a statutory power of expulsion might reduce the number of partnership disputes which reach the courts. We expressed the provisional view that it would not be appropriate to give a majority or even a special majority a statutory power to expel a partner. As we proposed to give the court power to expel a partner on certain grounds, we considered that it was not necessary to give a majority a power to expel by implied agreement in the default regime.<sup>43</sup>
- 10.35 We also provisionally proposed that there should be no power of suspension unless the partners expressly agree to one.<sup>44</sup> As the suspended partner would remain a partner during the period of suspension and would retain unlimited liability for partnership debts and obligations, we suggested that such a power was inappropriate in the default regime. We also provisionally proposed that a compulsory retirement power should not be included as a default rule.<sup>45</sup>

### **Consultation**

- 10.36 There was general support for our proposal that if the courts are given the power to expel a partner there should be no other general power of expulsion unless the partnership agreement expressly provides for it.<sup>46</sup> In Part VIII of this report we

<sup>42</sup> See, eg, R C I Anson Banks, *Encyclopaedia of Professional Partnerships* (1987) (Looseleaf: latest update 2003) Precedent 1, cl 21(1).

<sup>43</sup> Joint Consultation Paper, para 13.9.

<sup>44</sup> Joint Consultation Paper, para 13.13.

<sup>45</sup> Joint Consultation Paper, para 13.15.

<sup>46</sup> We do, however, recommend a specific power to expel where a partner allows his partnership share to be charged or, in Scotland, arrested. See para 8.110(6) above.

recommend that the court should have the power to remove a partner and also power to make interim orders (which would allow the court to suspend or limit a partner's authority).<sup>47</sup>

- 10.37 Only two consultees argued for a default power of expulsion in these circumstances. The APP suggested that there should be a power to expel a partner on the grounds of incapacity, conduct prejudicing the carrying on of the partnership business, wilful or persistent breaches of the partnership agreement and bankruptcy. The British Medical Association (BMA) stated that they would only accept continuity of partnership if there was a power of expulsion or a power of compulsory retirement in the default regime.
- 10.38 A substantial majority of consultees opposed a power of expulsion even if the court was not to have power to expel. Similarly, a substantial majority agreed that there should not be a power of suspension unless partners expressly agree to one. Only one consultee<sup>48</sup> argued strongly for a default power of suspension. They considered such a power to be essential in extreme circumstances, as for example when the Financial Services Authority or the Serious Fraud Office investigate a partner. They considered that the prejudice to a partnership in the absence of suspension would be greater than the prejudice to a suspended partner.
- 10.39 Almost all consultees agreed with our provisional proposal that the default regime should not include a power of compulsory retirement.<sup>49</sup>

#### **Reform recommendations**

- 10.40 As we recommend that the court should have power to remove a partner from a partnership,<sup>50</sup> we see no need to create a default rule which gives partners a general power to expel a partner. For the reasons discussed above, we do not think that such a draconian power should be a matter of implied agreement in a partnership. While we recognise the argument, which the APP advance, that many partnerships benefit from express powers to expel and suspend a discordant partner, we remain of the view that partners should expressly agree to such powers.<sup>51</sup> We have recommended that the court should have power to make interim orders on an application to remove a partner, prohibiting a partner from taking part in, or limiting the extent to which he may take part in, the partnership business and affairs.<sup>52</sup> We have also suggested that the general law would give the other partners powers to protect themselves against a partner who was acting in serious breach of duty, pending any application to the court.<sup>53</sup> We think that is sufficient.

<sup>47</sup> See paras 8.126 and 8.131 above.

<sup>48</sup> The Law Society.

<sup>49</sup> The only consultee which disagreed was the BMA; see para 10.37 above.

<sup>50</sup> See para 8.126 above.

<sup>51</sup> Partnership agreements sometimes provide for a power of suspension without requiring proof of wrongdoing by the partner to be suspended. We consider that this should be the subject of express stipulation.

<sup>52</sup> See para 8.131 above.

<sup>53</sup> See para 8.123 above.

# **PART XI**

## **PARTNERS' DUTIES**

### **INTRODUCTION**

- 11.1 In this Part we discuss the duties which partners undertake to each other and, in Scotland, to the partnership. We address both fiduciary duties and the standard of care and skill owed by a partner to the other partners and the partnership. We also deal with the duty of a partner to make information about the partnership business and affairs available to his partners. In formulating policy, we consider three principal questions. Those questions are, first, what duties does a partner undertake, secondly, to what extent should legislation specify the duties and, thirdly, to whom should the duties be owed.
- 11.2 We also discuss the case for the introduction of a duty of disclosure by and to a prospective incoming partner.

### **EXISTING LAW**

#### **The duty of good faith**

- 11.3 Partners stand in a fiduciary relationship with each other. Fiduciary duties are imposed so that a person:
- ... who has had trust or confidence reposed in him by another does not abuse that trust or confidence either for his own benefit or to the detriment of that other relying upon him.<sup>1</sup>
- 11.4 Partners need to trust each other in order to engage in a business for their joint benefit. Before the 1890 Act, the courts recognised the central importance of the fiduciary relationship in partnership:
- If fiduciary relation means anything I cannot conceive a stronger case of fiduciary relation than that which exists between partners. Their mutual confidence is the life blood of the concern. It is because they trust one another that they are partners in the first instance; it is because they continue to trust each other that the business goes on.<sup>2</sup>
- 11.5 Notwithstanding that recognition, the 1890 Act does not contain a general statement of the duty of partners to act in good faith. Rather, the Act contains certain rules which are examples of obligations arising out of the particular fiduciary relationship which partnership involves.<sup>3</sup> In particular, section 28 of the 1890 Act imposes on a partner the duty to render to another partner (or his legal representatives) true accounts and full information affecting the partnership.

<sup>1</sup> Finn, *Fiduciary Obligations* (1977) p 3-4.

<sup>2</sup> *Helmore v Smith* (1885) 35 Ch D 436, 444, *per* Bacon V-C.

<sup>3</sup> See Finn, *Fiduciary Obligations* (1977) p 1, where he warns that the description "fiduciary" is meaningless without a consideration of the particular rules and principles to which that description is applied.

Section 29 requires a partner to account to the partnership for any private benefit which he derives at the expense of the partnership. This duty subsists after the dissolution of the partnership until the winding up is completed.<sup>4</sup> Section 30 requires a partner who carries on a competing business without the consent of his partners to account to the partnership for the profits which he makes from that business.

### **The duty of care and skill**

- 11.6 The 1890 Act contains no statement of the duty of care which a partner owes to the partnership. There is uncertainty in both jurisdictions as to the standard of care which is imposed on a partner.
- 11.7 Historically, in English law a partner's duty to the partnership was to act without "culpable" negligence.<sup>5</sup> In the older authorities the nature and extent of the duty owed by one partner to another was not closely explored, and various expressions are found.<sup>6</sup> There are few reported cases of partners attempting to sue each other in negligence. More recently, Woolf J referred to the duty of a partner to act "without culpable negligence" but he also stated that the partner was "required not to act below the standards of a reasonable businessman in the situation in which he found himself".<sup>7</sup> The latter formulation suggests an objective standard of care. Similarly, in the New Zealand case of *Gallagher v Schulz*<sup>8</sup> the court required a property valuer who entered into partnership with a passive investor to develop the latter's property, to attain an objective reasonable standard of skill and care. Williamson J held that the property valuer should show the skill and care which would be expected from a prudent valuer and experienced property developer.
- 11.8 In Scots law the Institutional writers and some cases suggest that a partner is expected to show in relation to the partnership "that diligence which he would show in his own affairs".<sup>9</sup> However, in *Ross Harper & Murphy v Banks*<sup>10</sup> the Lord Ordinary (Hamilton) rejected this subjective standard. Instead, he maintained that there should be an objective standard of reasonable care between partners and that that standard should be qualified by reference to the way in which the particular partnership carries on its business.<sup>11</sup> The case concerned the liability of a partner

<sup>4</sup> 1890 Act, s 29(2) and *RW Pathirana v A Pathirana* [1967] 1 AC 233, 240; *Thompson's Trustee in Bankruptcy v Heaton* [1974] 1 WLR 605, 613; *Chan v Zacharia* (1984) 154 CLR 178, 197.

<sup>5</sup> *Bury v Allen* (1845) 1 Coll 589, 604; 63 ER 556, 562; and *Thomas v Atherton* (1878) 10 Ch D 185, 199.

<sup>6</sup> There are references in older English cases to a partner's "want of reasonable care" (*Thomas v Atherton* (1878) 10 Ch D 185, 202) and to a partner being "guilty of negligence" (*McIlreath v Margetson* (1785) 4 Doug 278, 279, 99 ER 880).

<sup>7</sup> *Winsor v Schroeder* (1979) 129 NLJ 1266.

<sup>8</sup> (1988) 2 NZBLC 103, Williamson J.

<sup>9</sup> *Mair v Wood* 1948 SC 83, 90; *Blackwood v Robertson* 1984 SLT (Sh Ct) 68. See also Stair *Institutions* I.16.7, Erskine *Institute* III.iii.21 and Justinian *Institutes* III.xxv.9.

<sup>10</sup> 2000 SLT 699.

<sup>11</sup> In that case an allegation that the defender had been negligent in carrying out a conveyancing transaction was answered by the assertion that that was how the partnership had taught him to transact when they trained him as a solicitor. See 2000 SLT 699, 701J.

to indemnify his partners for loss incurred by the partnership in meeting the excess on a professional indemnity policy in relation to damages paid to a third party for professional negligence. Since the publication of the Joint Consultation Paper this case came before the Inner House on a reclaiming motion where the pursuers did not insist in their claim.<sup>12</sup>

- 11.9 Another case, *Lane v Bushby*,<sup>13</sup> a decision of the New South Wales Supreme Court, has been reported since the Joint Consultation Paper was published. That case also concerned the liability of a partner to indemnify his partners for loss incurred in paying damages to a third party for the partner's professional negligence. Dunford J founded on a statutory provision which is substantially the same as section 24(2) of the 1890 Act,<sup>14</sup> requiring a partnership to indemnify a partner in respect of personal liabilities incurred in the ordinary and proper conduct of the business. He held that an implied contractual duty to indemnify his partners in respect of their liability to a third party caused by the partner's negligence would contradict this provision. The provision, referring as it did to ordinary and proper conduct, did not apply where there was fraud, illegality, wilful default or culpable or gross negligence, but it covered ordinary negligence in the course of business. He therefore held that there was no implied term requiring a partner to indemnify his partners for loss caused by his negligence. Referring to *Thomas v Atherton*,<sup>15</sup> he held that it required wilful misconduct or gross or culpable negligence before the partner at fault was liable. While there is scope for differing views as to whether the statutory provision excludes claims in negligence between partners, it is clear that Dunford J considered that the normal standard of reasonable care did not apply in a question between partners but that a greater degree of culpability was required to give rise to liability. He thus had a radically different view of the policy of the law in this field from that of Lord Hamilton in *Ross Harper & Murphy v Banks*.<sup>16</sup>
- 11.10 There thus remains considerable uncertainty as to the circumstances in which partners owe a duty of care to their partners and the partnership and as to the standard of skill and care which the law imposes in the absence of an express contractual statement.

### **Other fiduciary duties**

- 11.11 Because mutual trust is an important aspect of the partnership relationship, partners owe each other fiduciary duties. The obligation to render true accounts and full information is a duty owed by each partner to the other partners.<sup>17</sup> The

<sup>12</sup> We understand that the pursuer partnership withdrew their claim before the hearing was complete after the judges in the Extra Division had expressed dissatisfaction with the idea that partners, in the absence of express stipulation, should owe each other duties of care in relation to loss incurred by the partnership as a result of claims by clients for professional negligence. As a result the Inner House issued no opinions.

<sup>13</sup> [2000] NSWSC 1029.

<sup>14</sup> "The firm must indemnify every partner in respect of payments made and personal liabilities incurred by [the partner] ... in the ordinary and proper conduct of the business of the firm".

<sup>15</sup> (1878) 10 Ch D 185.

<sup>16</sup> 2000 SLT 699.

<sup>17</sup> 1890 Act, s 28.

duty to account for profit and the duty not to compete with the partnership are expressed as duties owed to the partnership.<sup>18</sup> In English law such duties would be owed to the aggregate of partners while in Scotland the duties owed to a partnership would be duties owed to the entity.

#### **No duty to devote full time and attention**

- 11.12 There is no duty in the 1890 Act or at common law for a partner to devote his full-time attention to partnership business or, indeed, a reasonable amount of his time for that purpose.<sup>19</sup> The law leaves it to the partners to agree their respective contributions of time and effort. Partnership agreements often oblige partners to devote their full time and attention to the partnership.

#### **No court power to relieve from liability**

- 11.13 Unlike company directors and trustees,<sup>20</sup> partners who face claims arising from breach of duty cannot apply to the court for relief on the ground that they have acted honestly and reasonably.

### **OUR PROVISIONAL PROPOSALS**

#### **Duty of good faith**

- 11.14 In the Joint Consultation Paper we provisionally proposed that there should continue to be a duty of good faith<sup>21</sup> in partnership relations and that it should be set out in a Partnership Act.<sup>22</sup> In the alternative we asked whether there should be a provision that the obligation of good faith applies in specific circumstances such as the expulsion of a partner or the dissolution of the partnership.
- 11.15 Having regard to the problems which can occur between partners when a partnership breaks up and the partners wish to divide the business connection, we asked whether the court should be empowered to relieve partners from liability for breach of duty where they have acted honestly and reasonably.<sup>23</sup> We also asked

<sup>18</sup> 1890 Act, ss 29 and 30.

<sup>19</sup> See *Lindley & Banks*, para 20-47.

<sup>20</sup> Companies Act 1985, s 727, Trustee Act 1925, s 61 and Trusts (Scotland) Act 1921, s 32 .

<sup>21</sup> Finn, *Fiduciary Obligations* (1977) ch 15 describes the duties of good faith being “certain standards of good conduct” which equity exacts “from persons who are so circumstanced in their relationships with others that they cannot be considered as being ‘at arm’s length’.” He analyses the duties of good faith under eight headings: undue influence, the misuse of property held in a fiduciary capacity, the misuse of information derived in confidence, purchases of property dealt with in a position of a confidential character, conflict of duty and interest, conflict of duty and duty, renewals of leases and purchases of reversions and inflicting actual harm on an “employer’s” business. These headings are useful to show the wide scope of the duties of good faith which can arise in particular circumstances.

<sup>22</sup> Joint Consultation Paper, para 14.17.

<sup>23</sup> The court has analogous powers in relation to trustees and company directors – see Trusts (Scotland) Act 1921, s 32, Trustee Act 1925, s 61 and Companies Act 1985, s 727.

whether such power should be available in all circumstances or only on the dissolution of the partnership.<sup>24</sup>

### **Duty of skill and care**

- 11.16 In view of the uncertainty as to the standard of skill and care required of partners, we proposed that there should be a statutory statement of a partner's duty of care. We provisionally proposed that it should be provided that, in the absence of agreement to the contrary, partners are expected to act with such care and skill as can reasonably be expected of those with the general knowledge, skill and experience that the partners have or purport to have.<sup>25</sup>
- 11.17 We recognised that another option was to adopt the rule that partners must be as diligent in partnership affairs as they would be in their own affairs. We considered that the rationale for the more objective test of a company director's duty of care, which we recommended in our report on directors' duties,<sup>26</sup> does not extend to partnerships. The essence of partnership is the personal relationship between the partners. A partner should take care in selecting a person to be a co-partner and cannot expect more skills of co-partners than they actually possess. On the other hand we suggested that an objective standard of care would be more in keeping with the tendency of case law in both English law and Scots law in recent years.
- 11.18 We therefore asked consultees if they preferred a subjective standard or an objective standard which required a partner to act with such care and skill as would be exercised by a reasonable person having both (i) the knowledge and experience that may reasonably be expected of a person in the same position as the partner; and (ii) the knowledge and experience which the partner has.<sup>27</sup>

### **Duty to devote full-time attention**

- 11.19 We discussed whether there should be a default rule that a partner should devote full time and attention, or any other specified time and attention, to the partnership. While partnership agreements often oblige partners to devote their full time and attention to the partnership, we suggested that this was a matter for express agreement rather than a default rule. Partners may play different roles within a partnership; a particular partner may provide capital, a prominent name or goodwill to a partnership business without being expected to devote as much time to the business as other partners. A default rule requiring a partner to devote reasonable time and attention would not assist as it would lack precision and would invite litigation. We therefore provisionally proposed that there should not

<sup>24</sup> Joint Consultation Paper, para 14.6.

<sup>25</sup> Joint Consultation Paper, para 14.32.

<sup>26</sup> Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties (1999) Law Com No 261; Scot Law Com No 173 and, in particular, Appendix A. The Company Law Review has since adopted a formulation of the director's duty of care which is substantially similar to our recommendation. See *Modern Company Law for a Competitive Economy, Final Report Vol 1*, para 3.10 and Annex C, p 346.

<sup>27</sup> This is the standard which we recommended for company directors in our report Law Com No 261; Scot Law Com No 173. See footnote 26 above.

be a default rule imposing a duty to devote a specified amount of time and attention to the partnership.

### **Court power to relieve from liability**

- 11.20 As our proposals sought to restrict the circumstances in which a partnership was dissolved and as we saw the division of a partnership's business connection on dissolution as the most likely circumstance in which a claim to be relieved of an honest and reasonable breach of fiduciary duty might arise, we did not propose any reform. We merely asked consultees whether the court should be empowered to relieve partners from liability for breach of duty where they have acted honestly and reasonably.

### **Persons to whom duties are owed**

- 11.21 The introduction of separate legal personality raises the issue - to whom are the duties owed? Another question is - who may enforce any duties which partners may owe to the partnership? The latter question is not dependent on separate personality but may arise already in English law by virtue of the "proper plaintiff principle"<sup>28</sup> and the "majority rule principle". Courts in both jurisdictions are reluctant to become involved in disputes concerning the internal management of partnerships.<sup>29</sup> In *Watson v Imperial Financial Services Limited*,<sup>30</sup> the British Columbia Court of Appeal applied the rule in *Foss v Harbottle*<sup>31</sup> in the context of a claim by limited partners against a bank for breach of trust, where the general partners did not wish to pursue the claim. The court held that the claim belonged to the partnership and not the individual partners, notwithstanding that the partnership was not a separate legal entity.<sup>32</sup> The undesirable complexities of *Foss v Harbottle* thus arise under existing partnership law whether the partnership has or has not got separate personality.
- 11.22 We suggested that there were three options. First, partners could owe duties to the partnership and not to their partners. We did not favour this option as it would promote the use of derivative actions in partnership at a time when we are recommending the replacement of such actions in company law.<sup>33</sup> The second option was that partners should owe duties to the partnership but that certain

<sup>28</sup> That principle is that "A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for injury done by B to C". See *Prudential Assurance Company v Newman Industries Limited (No 2)* [1982] Ch 204, 210. It is applied to associations which do not have legal personality as well as to companies which do: *Edwards v Halliwell* [1950] 2 All ER 1064 (CA), 1066 per Jenkins LJ.

<sup>29</sup> See Lord Eldon in *Carlen v Drury* (1812) 1 V & B 154, 158; 35 ER 61, 62.

<sup>30</sup> (1994) 111 DLR (4<sup>th</sup>) 643. See also Lord Lindley quoted in *Lindley & Banks*, 23-15.

<sup>31</sup> (1843) 2 Hare 461, 67 ER 189, ie the proper plaintiff principle.

<sup>32</sup> But the claim could proceed in the name of the partners if they were able to bring themselves within the fraud on the minority exception to *Foss v Harbottle*. See also *Lee v Block Estates* [1984] 3 WWR 118, British Columbia Supreme Court, McEachern CJSC. That case involved an attempt by partners to enforce against other partners an obligation owed to the partnership. The judge referred in his judgment (p 140) to many American authorities which applied the proper plaintiff principle to partnerships.

<sup>33</sup> See Law Commission Report: Shareholder Remedies (1997) Law Com 246.

duties, such as the duty of skill and care and the duties to account for profits and not to compete with the partnership, would be owed both to the partnership and to other partners. The drawback of this option is that a partner may seek to pursue claims for breach of duty in circumstances where a majority of partners acting in good faith is prepared to waive the claim. The third option was that partners should owe each other a general duty of good faith and duties to give accounts and information concerning the partnership but that other duties<sup>34</sup> should be owed to the partnership. While recognising the complexity of option 3 we provisionally proposed that it was the appropriate option.<sup>35</sup> We also proposed that (if option 3 were preferred) a partner should be able to commence an action on behalf of the partnership to enforce duties owed to the partnership, subject to a disclaimer of the action by a majority of the partners acting in good faith on behalf of the partnership.

## **CONSULTATION**

### **Duty of good faith**

- 11.23 Consultees unanimously supported the idea that there should continue to be a duty of good faith in relations between partners. Several suggested that the duty was an essential characteristic of partnership. A majority of consultees supported a statutory statement of the duty of good faith but some expressed concern that that might alter the extent of the duty or hinder the development of the law.

### **Duty of skill and care**

- 11.24 The majority of consultees opposed the proposal for a statutory statement of the duty of skill and care. Several expressed concern that a statutory definition might lead to litigation between partners. The Law Reform Committee of the General Council of the Bar, however, suggested that there was such a duty and that it should be stated in a Partnership Act. In Scotland there was more support for our provisional proposal (that in the absence of agreement to the contrary partners are expected to act with such care and skill as can reasonably be expected of those with the general knowledge, skill and experience that the partners have or purport to have) than for the other options. But the Faculty of Advocates preferred the subjective standard which looks to the knowledge, skill and experience which the partner actually has. In both jurisdictions, of the consultees who supported a statutory statement of the duty of skill and care, the majority supported our provisional proposal.

### **Persons to whom duties are owed**

- 11.25 There was support for a provision defining the persons to whom partners owe the duties which arise out of partnership but views were divided on the terms of that provision. The majority of consultees supported, or suggested variations to, the second option; namely that partners should owe duties to the partnership, but that certain duties, such as the duty of skill and care and duties to account for profits

<sup>34</sup> The duty to account for profits, the duty not to compete in business against the partnership, the duty to act in good faith in the interests of the partnership and the duty of care and skill.

<sup>35</sup> Joint Consultation Paper, para 15.21.

and not to compete with the partnership, would be owed to both the partnership and the partners. There was very little support for the option that partners should owe duties only to the partnership. But Professor Morse preferred this option combined with a rule that a partner should be able to commence an action on behalf of the partnership to enforce duties owed to the partnership, subject to disclaimer of the action by a majority of the partners acting in good faith on behalf of the partnership. Several consultees considered that all duties should be owed to the partnership and the partners. It was suggested that to provide otherwise was contrary to the ethos of partnership. There was only limited support for the third option (that partners should owe each other a general duty of good faith and duties to give accounts and information but that all other duties should be owed to the partnership) as many consultees thought that it was too complex. One consultee argued that the duties should be owed only to other partners.

- 11.26 Several consultees expressed doubt over our proposal (which was linked to option 3) that a partner should be able to commence an action on behalf of the partnership to enforce duties owed to the partnership subject to a disclaimer of the action by the majority of partners acting in good faith on behalf of the partnership. It was suggested that the majority should not have such a power as the litigation was not an “ordinary matter” within section 24(8) of the 1890 Act.<sup>36</sup>

#### **Court power to grant relief**

- 11.27 Consultees were divided on the issue of whether to give the court power to relieve a partner from liability for breach of duty where he had acted honestly and reasonably. The strong weight of opinion in both jurisdictions was against the introduction of a relieving power.

#### **Duty to devote a specified amount of time**

- 11.28 Almost all consultees agreed with our provisional proposal against a default duty to devote a specified amount of time to the partnership.

### **REFORM RECOMMENDATIONS**

#### **Duty of good faith**

- 11.29 As mutual trust underpins partnership and as the 1890 Act already includes several fiduciary duties, there is a case for stating in a Partnerships Act the general duty of good faith as between partners. A broadly worded statement of duty makes the law accessible without altering it or hindering judicial development of the duty.<sup>37</sup> We have considered whether to specify that partners owe a duty to act in good faith in the interests of the partnership. There is case law in support of such a formulation in both Scotland and Ireland.<sup>38</sup> It can be argued that it would be incongruous not to have a statutory statement of such a duty when other, more

<sup>36</sup> See our recommendation in this regard: para 10.30(3) above and draft Bill, cl 14(5).

<sup>37</sup> See our recommendation of a statutory statement of directors’ duties in our report: *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (1999) Law Com No 261, Scot Law Com No 173, Part 4.

<sup>38</sup> *Finlayson v Turnbull* 1997 SLT 613 and *Irish Press plc v Ingersoll* (unreported) High Court, 15 December 1993 (see *Twomey*, para 5.13).

specific, fiduciary duties are stated in the 1890 Act. But on balance we think that it is sufficient to state a general duty of good faith in partnership matters<sup>39</sup> and to re-enact the specific fiduciary duties which are already stated in the 1890 Act.

11.30 Our policy therefore is that there should be a statutory statement that a partner must act in good faith towards the partnership and each of the other partners in relation to any matter affecting the partnership.<sup>40</sup> We consider that in the existing law this is a term of the partnership contract and in English law arises in equity. As this duty is fundamental to partnership we recommend that it should not be capable of being excluded by the partnership agreement. The precise duties encompassed within the general duty of good faith may vary depending on the circumstances of the particular partnership. Partners by their agreement may determine the nature and extent of the particular duties which they undertake to each other and to the partnership. We think however that it would be inconsistent with the partnership relationship for partners to be able to exclude the duty of good faith.<sup>41</sup>

11.31 We also favour the re-enactment of the more specific fiduciary duties (sections 28, 29 and 30 of the 1890 Act) which are consistent with the general duty of good faith but which may be modified by agreement. The power of partners to modify the specific duties is not absolute. In our view, it is subject to the overriding duty of good faith and therefore the modifications must be compatible with that overriding duty. It is open to partners to agree particular terms in their partnership agreement which may modify the application of the duty of good faith in that context. But whatever the partners agree as their mutual rights and duties, they must act in good faith in enforcing those rights and performing those duties. Thus we propose that the mutual rights and duties of partners (and the partnership) should be subject to the duty of good faith.

11.32 **We recommend:**

- (1) **That there should be a statutory statement that a partner must act in good faith towards the partnership and each of the other partners in relation to any matter affecting the partnership;** (Draft Bill, cl 9(1))
- (2) **That that overriding duty of good faith, not being a default rule, should not be capable of being excluded by the partnership agreement and that partners must act in good faith in the context of the particular rights and duties to which they agree in their partnership agreement;** (Draft Bill, cl 9(1) and (3))

<sup>39</sup> This is a broader formulation than a duty to act in good faith in the interests of the partnership as the latter concentrates on the duty owed to the firm while the former covers also the duties owed by the partners in their relations with each other.

<sup>40</sup> For the persons to whom these duties are owed see paras 11.67 – 11.70 below.

<sup>41</sup> The current editor of *Lindley & Banks* (para 16-09) expresses a tentative view that partners can exclude all elements of the duty of good faith because the duty is not part of the statutory definition of partnership, but he points out that it is difficult to imagine circumstances in which partners would do so.

- (3) **That the specific duties in sections 29 and 30 of the 1890 Act (to account for private profits and not to compete with the partnership) be re-stated as default rules in the draft Bill: in each case the partnership may consent to the receipt of the profits or the competition;** (Draft Bill, cl 9(2), (5) and (6))
- (4) **That a partner must keep each of the other partners fully informed of matters affecting the partnership of which the other partners would reasonably expect to be kept informed;**<sup>42</sup> (Draft Bill, cl 9(2) and (4))
- (5) **That any modifications of the rules in (3) and (4) above must be in ways that are compatible with the duty of good faith in (1) above.** (Draft Bill, cl 9(3))

### **Partners' duties in relation to accounting and partnership records**

11.33 We consider that the duty in section 28 of the 1890 Act to render true accounts to any partner or his legal representatives and the rule in section 24(9) of the 1890 Act in relation to access to inspect partnership records should be more clearly expressed. We think that a distinction should be drawn between the records which a partner keeps of the transactions in which he personally is involved and the wider records of the partnership which are necessary to compile a firm's accounts. A partner should be under a duty to ensure that the former records are kept and made available. The partner should also be under a duty to co-operate in the drawing up of partnership accounts and to secure the retention of the firm's records. We see no need to preserve the default rule that the partnership books should be kept at the firm's principal place of business.

11.34 **We therefore recommend, as default rules, that:**

- (1) **A partner should be under a duty to ensure that proper accounting records are kept of transactions affecting the partnership in which he is involved and of which the other partners would reasonably expect such records to be kept;**
- (2) **A partner should be under a duty to ensure that such records are made available, on request, to the partnership and each of the other partners; and**
- (3) **A partner should be under a duty to co-operate with any person who keeps partnership records or draws up partnership accounts on behalf of the partnership.** (Draft Bill, cl 15)

<sup>42</sup> This, together with the recommendations in relation to accounting and partnership records (see paras 11.33 – 34 below) replaces the 1890 Act, s 28.

### **A duty of disclosure to and by an incoming partner**

- 11.35 The general law imposes certain duties on persons who are negotiating their entry into partnership.<sup>43</sup> But the scope and characterisation of those duties is not clear.<sup>44</sup> In particular it is not clear whether a sole trader who wishes to take on a partner or an existing partnership which wishes to recruit an additional partner is under a positive duty to disclose to the prospective partner information which is material to his decision whether to enter into partnership.
- 11.36 We think that it is important to establish the existence of such a duty. The relationship between partners, once the partnership has started, is one of good faith.<sup>45</sup> It is consistent with this concept of partnership that people who wish a person to join them in a partnership should be obliged to inform him about what he is entering into. Proper disclosure is particularly important where a pre-existing partnership is negotiating with a prospective incoming partner. While the incoming partner under the proposed default regime would not incur secondary liability for pre-existing obligations,<sup>46</sup> he could incur indirect liability for such obligations. Such indirect liability would arise if, at the time he joins or thereafter, an existing partner withdraws from the partnership and receives an indemnity from the persons who continued in the partnership.
- 11.37 We do not recommend a legislative statement of the extent of any duty of good faith towards a prospective partner. That can be left to the general law, which is developing. In any event we consider that the duty of disclosure is an incident of the parties' intention to enter into a relationship of the utmost good faith rather than a manifestation of that yet-to-be created relationship.<sup>47</sup> But we think that it would be useful to include a statutory duty of disclosure which a person, or the partners of an existing partnership, should owe to a prospective partner.
- 11.38 There needs to be a limit on the information which must be disclosed. We think that the duty of disclosure should extend to all information which a hypothetical prospective partner would reasonably expect to receive in order to decide whether to enter into partnership. In addition that duty should be capable of waiver: an

<sup>43</sup> See *Lindley & Banks*, para 16-06; Blackett-Ord, *Partnership*, para 10.11.

<sup>44</sup> There are cases where omission to give information in a prospectus is misleading and gives rise to liability: *New Brunswick Railway v Muggeridge* (1860) 1 Dr and Sm 363, *Central Railway Co of Venezuela v Kisch* (1867) LR 2 HL 99. Liability may arise under the law of agency where a prospective partner who is also agent of the proposed partners takes a secret commission: *Fawcett v Whitehouse* (1829) 1 Russ & M 132. In addition the law prevents the misuse of confidential information which is disclosed in the course of negotiations towards a possible partnership: *LAC Minerals Ltd v International Corona Resources Ltd* [1990] FSR 441 (Supreme Court of Canada).

<sup>45</sup> See para 11.3 above.

<sup>46</sup> See para 6.80 above.

<sup>47</sup> In an *obiter dictum* in *Bell v Lever Brothers* [1932] AC 161, 227 Lord Atkin stated: "There are certain contracts expressed by the law to be contracts of the utmost good faith, where material facts must be disclosed; if not, the contract is voidable. Apart from special fiduciary relationships, contracts for partnership and contracts of insurance are the leading instances. In such cases the duty does not arise out of contract; the duty of a person proposing an insurance arises before the contract is made, so of an intending partner."

incoming partner may agree to enter into partnership on incomplete information because he trusts his prospective co-partners.

- 11.39 The incoming partner should have a similar duty of disclosure to his prospective partners extending to all information which a hypothetical prospective partner would reasonably expect to receive in order to decide whether an incoming partner should join the partnership. Again this duty should be capable of waiver.
- 11.40 **We therefore recommend that persons who negotiate to enter into partnership with a prospective partner should be under a duty to disclose to the prospective partner anything known to them (or which they reasonably ought to have known) which a (hypothetical) prudent prospective partner would reasonably expect to be disclosed in order to decide whether to enter into partnership with those persons. This duty may be waived by the prospective partner. In return the prospective partner should be under a duty to disclose to the other prospective partners (or partners in an existing partnership which he plans to join) anything known to him (or which he reasonably ought to have known) which a (hypothetical) prudent partner would reasonably expect to be disclosed in order to decide whether to enter into partnership with the prospective partner. Again, that duty may be waived.** (Draft Bill, cl 10)

#### **Duty of skill and care**

- 11.41 Since receiving the responses to the Joint Consultation Paper we have revised our views on the formulation of a statement of a partner's duty of care and skill. Although a majority of those consultees who supported a statutory statement favoured our provisional proposal (that in the absence of agreement to the contrary partners are expected to act with such care and skill as can reasonably be expected of those with the general knowledge, skill and experience that the partners have or purport to have) we have come to question whether there should be a statutory formulation of the duty of care.
- 11.42 We have become aware of the diversity of views on the appropriateness of partners being liable to each other in negligence for mistakes made in the course of partnership business. In the conference on partnership law organised by the Institute of Advanced Legal Studies in June 2001 many expressed the view that it was not consistent with the ethos of most partnerships that partners should litigate against each other concerning failures to exercise reasonable care in carrying on partnership business.
- 11.43 This has caused us to review the arguments for and against the formulation of the duty of care.

#### ***The options***

- 11.44 There are four options in relation to the duty of care as between partners. At one extreme there is the option of providing that partners owe each other no duties of care because they have come together to pool their skills and share the risks of so doing. At the other extreme there is the option of imposing in all circumstances an objective standard of care by reference to the standard of the competent businessman, without taking account of the fact that the parties are partners (which may justify some tolerance of error on each other's part) and the circumstances of the particular partnership.

- 11.45 We do not see a case for either of the extreme options and therefore consider, first, the arguments for and against a statutory formulation of a restricted duty and, secondly, the arguments for and against the statutory formulation of a duty of reasonable care.

***Arguments in favour of a restricted duty***

- 11.46 Partners accept their partners for better or for worse. Partners in a partnership agreement might choose to impose such a duty of care on each other but it should not be part of the default code. Partnership is a co-operative venture involving the pooling of effort and the sharing of risks inherent in the ordinary course of business.<sup>48</sup> It is not appropriate that partnership should follow company law, which in recent years has imposed an objective standard of care on directors. The recent Australian case of *Lane v Bushby*<sup>49</sup> is consistent with this view.<sup>50</sup>
- 11.47 As case law contains a number of conflicting formulations of the standard of care,<sup>51</sup> it is not prudent to ignore the uncertainty which has been created. Partners should owe each other duties not to cause personal injury or death or physical damage to a partner's private property through lack of reasonable care. But it is not appropriate to the default regime that partners should have implied liability to each other in damages for economic loss to the partnership or physical damage to partnership property caused by mere lack of reasonable care in carrying on business. For liability in damages to be incurred a greater degree of culpability is required. Otherwise the law will be encouraging litigation between partners. In the nineteenth century, the courts imposed liability for "culpable negligence" or "gross negligence".<sup>52</sup> More recently RUPA has provided a restricted formulation of the default rule of a partner's duty of care:

A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or knowing violation of the law.<sup>53</sup>

***Arguments against a statutory restriction of the duty of skill and care***

- 11.48 A statutory definition of the default standard of care is unnecessary. A duty of care does not exist in abstract. The circumstances in which a duty of care arises will determine the content of that duty.<sup>54</sup> In some forms of partnership it may be

<sup>48</sup> See *Hurst v Bryk*, Carnwath J, 11 April 1995 (unreported).

<sup>49</sup> [2000] NSWSC 1029.

<sup>50</sup> See para 11.9 above.

<sup>51</sup> See para 11.6 – 11.10 above.

<sup>52</sup> See *Bury v Allen* (1845) 1 Coll 589; 63 ER 556; *Thomas v Atherton* (1878) 10 Ch D 185.

<sup>53</sup> This standard is consistent with pre-RUPA case law in the United States: see Hillman, Vestal & Weidner, *The Revised Uniform Partnership Act* (2003 ed) pp 193-195. *Prosser and Keeton on Torts* (5<sup>th</sup> ed 1984) p 212 suggests that "gross negligence" has no generally accepted meaning; "but the probability is, when the phrase is used, that it signifies more than ordinary inadvertence or inattention, but less perhaps than conscious indifference to the consequences".

<sup>54</sup> See, for example, *Midland Bank v Hett, Stubbs and Kemp* [1979] Ch 384, 434 per Oliver J.

appropriate to imply a duty by one partner towards the others; in others it may not.

- 11.49 The circumstances of different partnerships are so variable that a legislative rule would create hardship in certain cases. If the standard of care were, as in RUPA, restricted to gross negligence, unacceptable results could follow. For example, the professional partner on whom the passive partner relied in *Gallagher v Schulz*<sup>55</sup> might escape liability for his carelessness. This seems unfair as there are circumstances in which a partner should have a claim in ordinary negligence against another partner.
- 11.50 It would be anomalous to restrict the standard of care owed by a partner to the partnership and the other partners. It is an implied term of a contract of employment that an employee is to use reasonable care in the performance of his work.<sup>56</sup> Thus a salaried partner, who in a particular case is an employee, would on becoming an equity partner owe a less onerous duty of care to the partnership and the other partners. Suppose a salaried partner and an equity partner are jointly careless. The firm suffers significant loss and sues the salaried partner. The salaried partner as an employee would be liable but would not be entitled to any contribution from the equity partner unless he could prove gross negligence. Again this seems unfair.
- 11.51 In any event, it is difficult to give content to concepts such as “gross negligence” or “gross carelessness”. There are varying degrees of negligence and it is difficult to say what is the precise point at which ordinary negligence ends and gross negligence begins.
- 11.52 Finally, it is argued that we are dealing only with a default rule. If a partnership wishes to restrict the standard of care owed by its partners to the firm and the other partners, it can do so by contracting out of the default code.

***Arguments in favour of a statutory statement of an objective standard of reasonable care***

- 11.53 It is anomalous that partners, who are carrying on a business for mutual benefit, do not owe each other duties of care which are measured by an objective standard. Directors and trustees are now expected to attain an objective standard of care.
- 11.54 The standard of reasonable care is flexible and takes account of the circumstances in which the duty of care arises. It would equate the standard of care owed by an employee with that owed as between partners.

***Arguments against a statutory statement of an objective standard of care***

- 11.55 While the objective standard would avoid some of the anomalies which would arise from a restricted standard, it is not consistent with the ethos of many partnerships, and in particular small partnerships, that partners should litigate against each

<sup>55</sup> (1988) 2 NZBLC 103, Williamson J. See para 11.7 above.

<sup>56</sup> *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555. A paid agent may owe a similar duty of care in contract and in tort: see *Chaudhry v Prabhakar* [1989] 1 WLR 29.

other concerning failures to exercise reasonable care in carrying on partnership business. The arguments in paragraph 11.46 above apply. In addition the standard would only be a default rule. Partners wishing to impose a particular standard of care on each other can do so in their partnership agreement.

### ***Our conclusions***

- 11.56 We have concluded that we should not recommend a statutory statement of the default standard of care of a partner.

### ***A restrictive definition of duty***

- 11.57 We did not consult on the introduction of a restrictive definition in the Joint Consultation Paper and there was no consensus among those whom we have since consulted when formulating our recommendations. While there are those who feel strongly that there is a need, in the interest of the stability of partnerships, to restrict the spread of litigation between partners, there are also those who think that the general law relating to duty of care should apply to partners unless they contract to restrict the scope of their duties to each other.
- 11.58 We are aware also of the difficulty of formulating a restricted duty. In the Joint Consultation Paper we criticised the expressions “gross negligence” and “culpable negligence” as being difficult and unclear.<sup>57</sup> The use of the expression “gross negligence” in nineteenth century cases may mislead as it is not clear whether it imported more than what a modern lawyer would call negligence. While the concept of gross negligence has a place in Scots law and in English criminal law, it has been widely criticised in English case law in civil cases.<sup>58</sup> We have concluded that it would not be an appropriate formulation.
- 11.59 We considered using a concept of “gross carelessness” which is a concept which the Law Commission have used in their recommendations on involuntary manslaughter.<sup>59</sup> This would have involved an objective standard of reasonable care but a partner would not incur liability to make reparation to the partnership or his partners for damage to partnership property or economic loss to the partnership (and thereby the partners) unless his conduct of partnership business fell far below

<sup>57</sup> Joint Consultation Paper, para 14.25. Rolfe B (later Lord Cranworth) famously stated in *Wilson v Brett* (1843) 11 M & W 113, 115; 152 ER 737, 739 that he “could see no difference between negligence and gross negligence, that it was the same thing with the addition of a vituperative epithet”. See also *Pentecost v London District Auditor* [1951] 2 KB 759, 764 per Lyskey J; *Houghland v R.R. Low (Luxury Coaches) Ltd* [1962] 1 QB 694, 697-8 per Ormerod LJ. In Scots law, see *Hunter v Hanley* 1955 SC 200, 206 & 207. In any event it is impossible to draw a hard and fast line between “mere” negligence and gross negligence or *culpa lata*, but the judges may recognise gross negligence when they see it – *Raes v Meek* (1889) 16 R (HL) 31, 35 per Lord Herschell. See also *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* [1996] PLR 179 (Jersey Court of Appeal) and *Armitage v Nurse* [1998] Ch 241 (CA). See also the Law Commission’s discussion of the concept of gross negligence in Trustee Exemption Clauses, Consultation Paper No 171, paras 4.67 – 4.78.

<sup>58</sup> See, for example, *Armitage v Nurse* [1998] Ch 241, 254 per Millett LJ.

<sup>59</sup> See *Legislating the Criminal Code: Involuntary Manslaughter* (1996) Law Com No 237, para 5.34.

the objective standard of reasonable care. We encountered considerable difficulty in formulating the standard in a way which would be easy to apply.

- 11.60 We recognise that if we adopted this approach there would be hard cases, for example, where one partner who may be a passive investor relied on the expertise and professional skill of the other.<sup>60</sup> It would also be more difficult for a partnership to claim in the case, suggested by a consultee, where a partnership charges a particular partner with responsibility for renewing a fire insurance policy and suffers loss when he fails to do so and the partnership's premises are destroyed by fire. A consequence of a restrictive definition would be that in order to impose liability on a partner for damage to partnership property or financial loss to the partnership (and thus the partners) through mere negligence, it would be necessary for the partnership or the other partners either (a) to include such a duty as a term of the partnership agreement or (b) to demonstrate that the partner had assumed personal responsibility for the particular task which imported liability for lack of reasonable care.<sup>61</sup> This would involve something more than merely being the managing partner or accepting an instruction or request to carry out the task in the ordinary course of partnership business. We are concerned that a restrictive default rule would thus give rise to hard cases and complexity.
- 11.61 On balance therefore, we think that it is not appropriate to introduce a restrictive definition of the standard of care but to leave it to partners to contract to restrict the standard of care which they may expect from each other.

#### ***An objective standard of care***

- 11.62 We have also concluded that it is not desirable to include in the draft Bill a statutory formula setting out an objective standard of care. As we stated in the Joint Consultation Paper:<sup>62</sup>

The essence of a partnership is the personal relationship between the partners. It can be argued that the expectation of a partner's skill derives from this personal assessment, and not from a perception of what level of skill is considered reasonable for the position of partner. ... A partner cannot expect more skills of co-partners than they actually possess, but can reasonably expect that they will be as careful in partnership affairs as they would be in their own.

- 11.63 These points have added force where the partner has been inadequately trained within the firm and is later criticised for adopting a course of action which he had been taught to adopt.<sup>63</sup>

<sup>60</sup> See for example *Gallagher v Schulz* (1988) 2 NZBLC 103.

<sup>61</sup> See *Williams and Another v Natural Life Health Foods Ltd* [1998] 1 WLR 830. A contractual term excluding such liability might prevent a duty of care arising unless the disclaimer was unreasonable under the Unfair Contract Terms Act 1977: See *Smith v Eric S Bush* [1990] 1 AC 831.

<sup>62</sup> Joint Consultation Paper, para 14.29.

<sup>63</sup> This was part of the defence argument in *Ross Harper & Murphy v Banks* 2000 SLT 699.

- 11.64 In some recent cases the court has acknowledged the existence of a duty of care as between partners and treated the standard of care as the objective standard of reasonable care.<sup>64</sup> But in deciding what is reasonable the court requires to take account of the existence of the partnership relationship and the circumstances of the particular partnership. In many firms, partners have or should have knowledge of a particular partner's ability and experience when he joins the firm. With that knowledge the partners have agreed to pool risks with the particular partner. There must therefore be some tolerance of error. In addition the practices of the partnership are relevant - issues such as the risks which the partners habitually take in the conduct of business and the way in which a partner has been instructed to carry on business within the partnership will have an impact on the reasonableness of his behaviour. Circumstances will vary greatly as between partnerships. It would be very difficult to devise a simple statutory formulation which would articulate these considerations.
- 11.65 We have concluded therefore that it is better to leave it to partners to formulate in their partnership agreements the standard of care which they expect of each other and, in the absence of such a formulation, to the courts to apply the standard of reasonable care in a way which takes account of the circumstances of the particular partnership.
- 11.66 **We therefore recommend that there should not be a statutory default definition of the standard of care owed by a partner to the partnership and the other partners.**

#### **Persons to whom the partners owe duties**

- 11.67 We have also reviewed our policy on the persons to whom partners should owe duties. We are persuaded that the approach which we adopted in the Joint Consultation Paper is unduly complex. It would be simpler if the partner's duty of good faith were stated to be owed both to the partnership and to the partners. We also believe that this is sound in principle. For example, under clause 9 of the draft Bill a partner must account to the partnership for any profits from carrying on a competing business without the consent of all the other partners. Any partner should be entitled to bring an action for an account against a partner who acted in breach of that obligation, although procedurally it would be appropriate for the partnership and all the partners to be made parties to the action both because the accounting should be to the partnership and in order that all should be bound by the result.
- 11.68 We note that the Limited Liability Partnerships Regulations 2001<sup>65</sup> adopt a similar approach in their default provision for LLPs. Regulation 7 provides that the mutual rights and duties of the members, and the mutual rights and duties of the LLP and the members shall be determined, subject to the provisions of the general law and to the terms of any limited liability partnership agreement, by the rules which it then lays down. Those rules include the duty to render accounts to any

<sup>64</sup> See, for example, *Winsor v Schroeder* (1979) 129 NLJ 1266, *Gallagher v Schulz* (1988) 2 NZBLC 103 and *Ross Harper & Murphy v Banks* 2000 SLT 699.

<sup>65</sup> SI 2001 No 1090.

member, the duty to account to the LLP for profits made in competition with it, and the duty to account to the LLP for private profits.<sup>66</sup> We interpret this as providing that the specified duties are owed both to the LLP and the members.

11.69 To achieve this result, we propose that the draft Bill should provide that the duties specified in clause 9 are owed to, and enforceable by, both the partnership and the partners. We do this by providing that the overriding duty of good faith is owed to the partnership and each of the other partners and by particularising certain of the specific duties which arise from that overriding duty.

11.70 **We therefore recommend that partners should owe all duties arising out of the duty of good faith both to the partnership and to the partners.** (Draft Bill, cl 9(1))

#### **No court power to grant relief**

11.71 In view of the lack of support from consultees we see no pressing need to empower the court to relieve partners from liability for breach of duty if they have behaved honestly and reasonably. We therefore do not recommend that the court should be empowered to relieve partners from liability for breach of duty if they have acted honestly and reasonably.

#### **No duty to devote a specified time to the partnership**

11.72 We are persuaded that it would not be appropriate to have a default rule that partners should devote their full time and attention or a specified amount of time to the partnership. Any rule would be inflexible and potentially unhelpful. Where partnerships wish to specify the amount of time and attention partners should give to the partnership business, they are free to do so. We do not recommend that there should be a default rule imposing a duty to devote a specified amount of time to the partnership.

<sup>66</sup> For the rules in the 1890 Act see ss 28 to 30.

# **PART XII**

## **WINDING UP PARTNERSHIPS AND SETTLING PARTNERS' ACCOUNTS**

### **INTRODUCTION**

- 12.1 In this Part we discuss our proposals on the termination of a partnership. We cover the ways in which a partnership may be wound up, including our recommendations for a new method for the solvent winding up of partnerships in both jurisdictions. We discuss the circumstances in which the partnership ceases to exist and the consequences of it ceasing to exist.
- 12.2 We also discuss our recommendations for default rules for settling partners' accounts in a winding up. These rules are also relevant to the entitlement of an outgoing partner on withdrawal from a continuing partnership which we discussed in Part VIII above.<sup>1</sup>

### **THE TERMINATION OF A PARTNERSHIP AND ITS WINDING UP**

#### **Existing law**

- 12.3 A partnership comes to an end on the following grounds:
- (1) reduction in the number of partners to below two;<sup>2</sup>
  - (2) expiry of fixed term, subject to any agreement between the partners;<sup>3</sup>
  - (3) termination of a single adventure or undertaking for which the partnership was entered into, subject to any agreement between the partners;<sup>4</sup>
  - (4) notice by one partner of intention to dissolve the partnership where the partnership was entered into for an undefined time, subject to any agreement between the partners;<sup>5</sup>
  - (5) death or bankruptcy of a partner, subject to any agreement between the partners;<sup>6</sup>
  - (6) at the option of the other partners if any partner suffers his share of the partnership to be charged for his separate debt;<sup>7</sup>

<sup>1</sup> This is because the default valuation of the outgoing partner's share is based on a hypothetical sale of either the assets of the partnership or the partnership business as a going concern and the winding up of the partnership immediately thereafter. See para 8.75 above.

<sup>2</sup> This results from the essence of partnership before the 1890 Act as a relationship or association of persons and also the definition of partnership in 1890 Act, s 1.

<sup>3</sup> 1890 Act, s 32(a).

<sup>4</sup> 1890 Act, s 32(b).

<sup>5</sup> 1890 Act, s 26.

<sup>6</sup> 1890 Act, s 33(1).

- (7) occurrence of an event which makes it illegal for the partnership business to be carried on or for the partners to carry it on in partnership;<sup>8</sup>
  - (8) dissolution by the court on one of the statutory grounds set out in section 35 of the 1890 Act; and
  - (9) dissolution by the unanimous agreement of the partners for the time being.
- 12.4 Until *Hurst v Bryk*<sup>9</sup> it was widely assumed that a rescission of the partnership agreement automatically dissolved the partnership. There is uncertainty as to the effect of the frustration of the partnership agreement.
- 12.5 On dissolution of the partnership, section 38 of the 1890 Act comes into effect. It provides that the authority of the partners to bind the partnership and the other rights and obligations of the partners continue notwithstanding the dissolution but only so far as necessary to wind up the affairs of the partnership and to complete transactions begun but unfinished at the time of the dissolution.

### **Our provisional proposals**

- 12.6 In the Joint Consultation Paper we made proposals to achieve greater stability in partnerships, to remove the right of a partner withdrawing from a partnership to insist on a winding up, and to provide an alternative to dissolution on the occurrence of most of the events listed in paragraph 12.3 above. We have discussed these issues in Part VIII of this report.
- 12.7 We asked consultees whether there should be special provision to deem a partnership to continue for a period after the number of partners has been reduced to one so as to enable the sole remaining partner to find a new partner. Alternatively, we asked whether the last remaining partner should be given the option of buying out the share of the last outgoing partner.<sup>10</sup>
- 12.8 We provisionally proposed that acceptance of repudiatory breach of the partnership agreement should not terminate the contract and dissolve the partnership but that innocent partners must apply to the court for dissolution.<sup>11</sup> We also made proposals in relation to rescission on the ground of fraud or misrepresentation<sup>12</sup> and frustration of the partnership contract.<sup>13</sup> Again we have dealt with these matters in our recommendations on continuity of partnership in Part VIII of this report.<sup>14</sup>

<sup>7</sup> 1890 Act, s 33(2).

<sup>8</sup> 1890 Act, s 34.

<sup>9</sup> [2002] 1 AC 185.

<sup>10</sup> Joint Consultation Paper, para 6.64.

<sup>11</sup> Joint Consultation Paper, para 6.32.

<sup>12</sup> Joint Consultation Paper, para 6.35.

<sup>13</sup> Joint Consultation Paper, para 6.48.

<sup>14</sup> See paras 8.119 – 8.136 above.

- 12.9 We proposed that section 38 of the 1890 Act should be amended to make it clear that former partners of a dissolved partnership can agree to carry on the business of the partnership with a view to the beneficial winding up of the partnership.<sup>15</sup> We also proposed that if partnerships were to have separate personality section 38 of the 1890 Act should deem the dissolved partnership to continue for the purposes of winding up its affairs and completing unfinished transactions.<sup>16</sup>

### **Consultation**

- 12.10 Consultees were not in favour of deeming a partnership to continue to exist for a period after the number of partners has been reduced to one so as to enable the sole remaining partner to find a new partner. Several consultees thought that the suggestion was inconsistent with the essential nature of partnership which involves more than one person carrying on business. There was also only limited support for the suggestion that the last remaining partner might have the option of buying out the share of the last outgoing partner.
- 12.11 By contrast, there was general support for our proposal to make it clear that after dissolution<sup>17</sup> partners could agree to carry on the partnership business with a view to the beneficial winding up of the partnership. Two consultees expressed doubts whether the proposed provision was necessary: if the former partners are unanimous, they can continue the business under the present law. Our consultant also pointed out that it would be difficult for a professional practice to carry on business after dissolution, especially if the business involved long-term commitments. In addition, the relevant professional body might require the partnership to notify its clients of the dissolution which would militate against continuing in business. He recognised, however, that a trading concern might benefit from trading during the winding up.
- 12.12 There was also general support for our proposal that a partnership with separate personality should be deemed to continue after dissolution for the purposes of winding up its affairs and completing unfinished transactions. Some consultees questioned whether the partnership should be deemed to continue, as the provision could simply provide that the partnership continued until the winding up was complete. Several consultees suggested that there should be a formal end to a partnership on completion of a winding up, for example by notice to creditors or by advertisement in the Gazette. H M Land Registry suggested that registered land could remain in the name of a partnership during winding up, but that the partnership should be obliged to transfer the title to the land before completion of the winding up. They suggested that there should be a mechanism for informing the Land Registry when a winding up was completed.

<sup>15</sup> Joint Consultation Paper, para 8.17.

<sup>16</sup> Joint Consultation Paper, para 8.28.

<sup>17</sup> “Dissolution” is the term used in the present law to signify the termination of the partnership and the commencement of the winding up. Under our recommendations it will signify the termination of the partnership (the dissolution of the entity) once all assets have been distributed and all liabilities discharged or extinguished through the passage of time. See para 12.23 below.

### **Reform recommendations**

- 12.13 We think that it is sensible that a partnership should continue as a legal entity during the winding up, so that it can hold the assets of the partnership and discharge its liabilities during that period. We therefore recommend that the termination of the partnership should be a three-step process. The first step is where a decision is taken or an event occurs which commences the winding up of the partnership. We call that first step “the break up” of the partnership. The second step or process is the winding up of the partnership. During the winding up the partnership would continue as an entity. The third step is the termination of the partnership on completion of the winding up when the partnership would cease to exist as an entity. We call this stage “the dissolution” of the partnership.
- 12.14 We note that RUPA used the term “dissolution” to describe the commencement of the winding up process.<sup>18</sup> Commentators have criticised this use of the term as confusing because it referred to the ending of a partnership relationship under UPA.<sup>19</sup> We wish to avoid that confusion. We are aware of the danger of using a term with a meaning under the existing law to describe a different stage in the demise of a partnership. We have preserved the term with a new meaning because we think the term is ideally suitable to describe the final termination of the partnership entity.<sup>20</sup>
- 12.15 We recognise that our proposals in the Joint Consultation Paper involved the termination of the partnership on completion of the winding up without requiring any formal step or notification of that termination. Although several consultees raised the issue, we are not persuaded that there is any pressing need to advertise the completion of the winding up. If the partnership is solvent, the winding up should result in the payment of all of the creditors of the partnership before the residual proceeds of the sale of the partnership assets are distributed to the partners. If the partnership is insolvent, creditors may activate insolvency procedures and thereby supersede the partners’ winding up of the partnership. Whether or not the creditors do so, the partners will retain unlimited liability for the obligations of the partnership and partnership debts can be enforced against the partners.
- 12.16 In order to avoid problems with overlooked assets and with liabilities which emerge or are first discovered after all the assets of a partnership have been distributed, we think that a partnership should continue to exist (a) so long as there are any assets of the partnership which have not been distributed and (b) so long as there are (or may be) any liabilities of the firm which have not been discharged or extinguished through the passage of time. This policy will prevent assets overlooked in a winding up from becoming *bona vacantia* and thus requiring former partners (or creditors) to establish their right to claim the property from the Crown. It will also avoid the complexity of having to transfer responsibility for extant liabilities of the

<sup>18</sup> RUPA, s 801.

<sup>19</sup> See Donald J Weidner, “Pitfalls in Partnership Law Reform: some United States Experience” [2001] Vol 26 Journal of Corporation Law, 1031.

<sup>20</sup> It would be consistent with the use of the term in company law. See eg Insolvency Act 1986, ss 201 – 205.

firm to the partners on dissolution of the partnership. It will also simplify the rules relating to litigation and the rules of limitation and prescription.<sup>21</sup>

- 12.17 In addition, by preserving the partnership in existence we can deal with liabilities which emerge after, and sometimes long after, a firm has ceased to trade. A classic example of a late-emerging liability is a claim against a solicitor for professional negligence by a disappointed would-be beneficiary.<sup>22</sup> If the solicitor has failed to exercise reasonable care in drafting a testamentary disposition, and the testator survives for many years after signing his will, the claim may emerge long after the solicitors' firm had ceased to practise. While in some cases there may be real doubt as to whether a partnership has been dissolved even many years after its known liabilities have been paid and its known assets distributed, we think that this does not matter.<sup>23</sup> In many cases it will be clear with the passage of time that a partnership has ceased to exist.

***Where there is only one remaining partner***

- 12.18 We do not think that it would be appropriate to defer the break up of a partnership in which the number of partners has been reduced to one in order to enable that person to find a new partner and continue the partnership business. We agree with consultees who thought that that would not be consistent with the essence of partnership and we see no need for such a provision. If the sole remaining partner wishes to buy out the interest of the last outgoing partner he can negotiate an agreement with the latter to transfer the partnership's assets to him as a sole trader and avoid having to realise the assets of the partnership.<sup>24</sup> The sole trader can then take on a new partner if he so wishes and thereby create a new partnership.
- 12.19 It would, however, be appropriate to allow a partnership to continue to exist after the number of partners has been reduced to one for the purpose of completing the winding up. It would be unnecessarily inconvenient for the partnership to terminate on the reduction of its numbers to one. It would be much simpler for the partnership to continue for the purpose of completing the winding up. This would avoid problems of the transfer of property from the name of the partnership on the

<sup>21</sup> It has been suggested to us that there could be a problem if a claim against a partnership proved to be unfounded and was dismissed. We do not think so. The pursuit of the claim would be sufficient to keep the partnership in being. In addition, the partnership would incur liabilities for example to its solicitors in defending the claim and when successful in the litigation would have an asset to distribute in the form of a right to costs (expenses) against the unsuccessful claimant.

<sup>22</sup> See eg *White v Jones* [1995] 2 AC 207.

<sup>23</sup> Under existing English law, and Scots law also, the mutual rights and duties of partners survive the dissolution of a partnership and could be relevant many years after a partnership had ceased to exist if a liability were to emerge or an overlooked asset were discovered and proved to be valuable.

<sup>24</sup> Once a partnership breaks up (on whatever ground), the subsequent dissolution of the partnership is inevitable. Thus where the ground of break up is the reduction of the number of partners to one, the partnership must be wound up. We suggest below (para 12.21) that where there are two or more partners after break-up, they can agree to carry on the partnership business to achieve a beneficial winding up. We do not allow a sole remaining partner to carry on the business *as a partner* in the winding up as there is no other partner and it appears artificial to treat the sole partner other than as a sole trader – see para 12.20 below.

event of the withdrawal of the last outgoing partner and it would prevent partnership property from becoming *bona vacantia*. The latter risk could eventuate where the partners overlooked the need to transfer the property before the withdrawal of the last outgoing partner or where that withdrawal was involuntary, for example through death.

12.20 As explained in paragraph 12.25 below, we recommend that where a person ceases to be a partner on the break up of a partnership, he should be treated as remaining a partner during the winding up process.<sup>25</sup> The only exceptions will be where a person ceases to be a partner because of death (or dissolution), insolvency, expulsion or removal by court order. So for the purposes of the winding up there will normally be more than one partner. If, however, there is only one remaining partner,<sup>26</sup> the partnership will nevertheless continue to exist as a legal entity until it has been wound up. We consider that it would be prudent and practical that the sole remaining partner should have power to wind up the partnership and complete any transactions begun but unfinished at the time of the break up. But he would not have power as a partner to continue the business of the partnership by entering into new transactions. He could, of course, continue as a sole trader, but, in order to utilise assets of the partnership for his own business, he would need to come to an arrangement with other interested parties, such as the personal representatives of a deceased former partner or partners. If the interested parties agreed to the surviving partner doing so, but on the basis of receiving a share of the profits, we doubt that this would amount to a new partnership, because it is improbable that they would be regarded as “carrying on a business together”.<sup>27</sup>

12.21 Where two or more partners remain after the break up of the partnership,<sup>28</sup> we think that it would be useful to state that the partners can agree to carry on the partnership business so far as may be necessary for the beneficial winding up of the partnership. This may be the existing law, as some consultees suggested, but an express provision would make the law clearer to the non-expert. The partners would continue to have authority as agents of the partnership under the general law and under clause 16 of the draft Bill.

#### ***Where no partners remain***

12.22 Where all partners have resigned, died or ceased to exist before the winding up is completed, we think that the partnership should continue to exist as an entity as suggested in paragraph 12.16 above. Under the existing law, the rights and obligations of partners survive the dissolution of the partnership so far as is necessary to wind up the affairs of the partnership.<sup>29</sup> Thus the estate of a deceased partner may have to meet obligations arising from the winding up of a defunct

<sup>25</sup> See draft Bill, cl 40.

<sup>26</sup> This would occur where he is the only partner at the time of the break up who has not died or been dissolved, become insolvent, been expelled or been removed by court order.

<sup>27</sup> See draft Bill, cl 1 and Sched 1.

<sup>28</sup> This includes the circumstance where a partner whose resignation has caused the break up of the partnership is treated under cl 40 of the draft Bill as a continuing partner during the winding up. See para 12.25 below.

<sup>29</sup> 1890 Act, s 38.

partnership. The preservation of the partnership entity until all assets have been distributed, and all claims and liabilities discharged or extinguished through the passage of time, achieves a similar result and is the simplest way of sorting out the affairs of a partnership which has broken up.

12.23 **We therefore recommend:**

- (1) **That the winding up of a partnership should be a three-step process: (1) the break up of the partnership which commences the winding up, (2) the winding up and (3) the dissolution of the partnership on completion of the winding up. The partnership would continue as a legal entity until dissolution (Step 3);** (Draft Bill, cls 38, 39(1) and (2) and 45)
- (2) **That a partnership should continue to exist as an entity (for certain limited purposes) when the number of partners is reduced to one;** (Draft Bill, cl 39(1) and (2) and 43)
- (3) **That when a partnership breaks up it may be wound up by one or more of the partners but that where only one partner remains, his authority to bind the firm is limited to acts which are necessary to wind up the firm and complete any transactions begun but unfinished at the time of the break up;** (Draft Bill, cl 43(1) and (4))
- (4) **That after a partnership breaks up (and there are two or more partners remaining) the partners may agree (unanimously) to carry on the partnership business with a view to the beneficial winding up of the partnership and to confer authority on a partner or partners for that purpose; there should be a default rule that other matters connected with the winding up may be decided by majority;** (Draft Bill, cl 43 (2), (3), (5) and (6)) and
- (5) **That the third step (dissolution) should not occur until all of the partnership property and property held by the firm on trust has been distributed and all claims and liabilities of the partnership have been discharged or extinguished through the passage of time.** (Draft Bill, cls 39(2) and 45)

***The entitlement of partners on the break up of a partnership***

12.24 In Part VIII above we pointed out that clause 38 of the draft Bill defines comprehensively the circumstances in which a partnership may break up.<sup>30</sup> One of the circumstances in which a partnership breaks up under the default code is where the partners elect to break it up in response to a partner's notice of resignation.<sup>31</sup> In such circumstances, we consider that the partner who gave notice of resignation which precipitated the break up<sup>32</sup> should not be treated as having

<sup>30</sup> See para 8.30 above.

<sup>31</sup> See para 8.100 above.

<sup>32</sup> And also any partners who gave notice of resignation in response to the first partner's notice.

withdrawn from the partnership on the expiry of his notice and thus he should not get the financial rights of an outgoing partner. Instead he is to be treated as continuing to be a partner during the winding up. He is entitled to take part in the winding up of the partnership and receives his share of the proceeds of the winding up. Similarly, after a partnership has broken up, a partner may not voluntarily withdraw from the partnership but will receive his share of the proceeds of the winding up. In effect, on or after the break up of a partnership, a partner may not voluntarily cease to be a partner.<sup>33</sup>

- 12.25 **We therefore recommend that on or after the break up of a partnership a person may not cease to be a partner voluntarily and that a person whose resignation notice has led to the break up of a partnership is to be treated as continuing to be a partner during the winding up of the partnership.** (Draft Bill, cl 40)

## **A NEW SYSTEM OF WINDING UP SOLVENT PARTNERSHIPS**

### **Existing law**

- 12.26 Partners normally wind up partnerships on dissolution and do not require the appointment of a court officer to effect the winding up. This is in most cases the cheapest and most effective way of winding up a partnership business. Partners retain unlimited liability for the debts of the firm and are entitled to the distribution of any surplus.
- 12.27 On termination of a partnership any partner is entitled to apply to the court to have the partnership wound up.<sup>34</sup> In England and Wales the court may order a dissolution and require one party to bring in an account. The court may appoint a receiver to get in and preserve the partnership's assets and pay the partnership's debts. A receiver does not have power to carry on the business. A manager may do this under the direction of the court. A receiver may be appointed a manager as well and may continue the business as receiver and manager.
- 12.28 In the Joint Consultation Paper we discussed the difficulties and costs involved in the procedure for winding up a partnership by means of an administration order.<sup>35</sup>
- 12.29 In Scotland, the court on ordering the winding up of a dissolved partnership may appoint a judicial factor to wind up its affairs. We discussed in the Joint Consultation Paper the problems which arise as a result of the lack of definition of the powers of the judicial factor.<sup>36</sup>
- 12.30 We concluded that the basic problem in both jurisdictions was the lack of an officer who could take control of the property of the partnership and exercise adequate powers to wind up the partnership in an independent way. We referred to the Harman Report which in 1960 identified the problems in English procedure

<sup>33</sup> But he may cease to be a partner involuntarily, through, for example, death or bankruptcy.

<sup>34</sup> 1890 Act, s 39.

<sup>35</sup> Joint Consultation Paper, paras 8.33 - 8.36.

<sup>36</sup> Joint Consultation Paper, paras 8.37 - 8.40.

and recommended that the official appointed to wind up a partnership should have all the powers of a liquidator in a compulsory winding up of a company or of a trustee in bankruptcy.<sup>37</sup> The Review Body on the Chancery Division of the High Court in 1981 supported this recommendation of the Harman Committee.<sup>38</sup>

### **Our provisional proposals**

- 12.31 In the Joint Consultation Paper we acknowledged that many of the problems associated with winding up partnerships could not be resolved simply by altering the system for winding up. To the extent that partnership disputes are often bitter, the affairs of dissolved partnerships tangled and partnership records incomplete, delay and expense are unavoidable. The law cannot make complicated situations simple. We suggested, however, that the law could ensure that the officers responsible for the winding up have adequate powers.
- 12.32 We provisionally proposed that there should be a new system for winding up solvent partnerships under court supervision in which the court could appoint a liquidator with powers and duties modelled on those of a liquidator in a members' voluntary winding up of a company. We proposed that the partnership liquidator should have express power without the sanction of the court or approval of the partners to do things necessary for the winding up of the partnership's affairs, and that he should require to obtain the prior unanimous approval of the partners to make certain compromises and to carry on the partnership business for its beneficial winding up.<sup>39</sup> We also proposed that a partner or creditor should have the right to apply to the court to determine any question arising in the winding up.<sup>40</sup> This would enable effective court supervision of the winding up when required. We proposed that the partnership liquidator should be under a duty to report to the court if he were of the opinion that the debts of the partnership could not be paid within 12 months of appointment, with a view to initiating the appropriate insolvency procedure.<sup>41</sup>
- 12.33 We pointed out that a liquidator of a company can disclaim onerous property<sup>42</sup> and sought consultees' views on whether a partnership liquidator should have a general power to disclaim onerous property or whether in relation to contracts, such as leases, he should have power to disclaim only those entered into after the relevant legislation came into force.<sup>43</sup>

<sup>37</sup> Report of the Committee on Chancery Chambers and the Chancery Registrar's Office, 1960, Cmnd 967, para 95(2). See Joint Consultation Paper, paras 8.41 – 8.43.

<sup>38</sup> Report of the Review Body on the Chancery Division of the High Court (1981) Cmnd 8205 p 46, para 146(vi).

<sup>39</sup> Joint Consultation Paper, paras 8.44 – 8.52, 8.60.

<sup>40</sup> Joint Consultation Paper, paras 8.53 and 8.60.

<sup>41</sup> Joint Consultation Paper, paras 8.46 and 8.60.

<sup>42</sup> Insolvency Act 1986, ss 178 – 182 apply only to England and Wales. In Scotland the rules in relation to disclaimer of contracts by company liquidators are a matter of the common law. See Joint Consultation Paper, para 8.54.

<sup>43</sup> Joint Consultation Paper, paras 8.54 – 8.58, 8.60.

- 12.34 We also asked consultees if partners should be able to appoint a liquidator to wind up the partnership without recourse to the court and, if so, whether a majority of partners should be able to impose a partnership liquidator on a minority. We also asked whether a partner-appointed liquidator should have the same powers and duties as those of a court-appointed liquidator.<sup>44</sup>

### **Consultation**

- 12.35 A clear majority of consultees in both jurisdictions supported the creation of a new system for winding up solvent partnerships.<sup>45</sup> It was suggested that the problems of the current system were caused principally by the receiver's lack of appropriate powers and the delays and expense incurred in obtaining the authorisation of the court for his acts. Some consultees expressed concerns that the proposed system could be costly and that partners should be able to wind up a partnership without appointing a liquidator.<sup>46</sup> The Chancery Bar Association argued that it was not necessary to replace the receiver and manager by a liquidator; they suggested that the delays and costs which arise when the court becomes involved in a winding up are caused by disputes over the partnership account rather than the role of the receiver and manager.<sup>47</sup>
- 12.36 In Scotland, there was general support for the proposed system.<sup>48</sup> The principal criticism of those consultees who qualified their support was that it would be better to build on the law relating to judicial factors rather than adopt a solution from company law. The Scottish Law Commission considered and rejected that

<sup>44</sup> Joint Consultation Paper, paras 8.64 – 8.66.

<sup>45</sup> The Institute of Chartered Accountants in England and Wales suggested that the proposals were very welcome. NILRAC emphasised the need to replace the present system which they suggested was entirely unsatisfactory and unduly complex. Peter Gibson LJ welcomed the implementation of the recommendation of the Harman Committee (see para 12.30 above) which he considered long overdue.

<sup>46</sup> Our proposal envisaged that it would be open to partners to wind up the partnership themselves and that the new system would be available when disputes between the partners or other circumstances made it impracticable for the partners to do so.

<sup>47</sup> The Newcastle Upon Tyne Law Society also suggested that the proposed system would be as expensive and slow as the present system. Osborne Clark OWA thought that the proposed reforms were unnecessary. Elspeth Deards suggested that it would be sufficient to extend the powers of receivers and managers to manage the business and that the court should remain the final arbiter of the rights of the partners amongst themselves.

<sup>48</sup> The Faculty of Advocates, the Law Society of Scotland, the Royal Faculty of Procurators in Glasgow and the Scottish Chamber of Commerce among others supported the proposal. The Scottish Law Commission's Advisory Group, which includes practitioners with expertise in winding up partnerships, also supported the proposed system.

option.<sup>49</sup> One consultee opposed the proposed system arguing that it should be left to the partners to decide how to wind up a partnership.<sup>50</sup>

- 12.37 There was general support for our proposals on the scheme. But the APP opposed a number of the details. They thought that giving a partner or creditor a right to apply to the court to determine any question arising in the winding up was not desirable as it could create expense and delay. They suggested that instead of empowering a partner to apply to the court for an account, the liquidator should be compelled to submit accounts annually. They also questioned the proposal that a liquidator should be under a duty to report to the court if of the opinion that the debts of the partnership could not be paid within twelve months of appointment with a view to initiating the appropriate insolvency procedure. They stated that it was frequently not possible to pay all creditors and to conclude a winding up within twelve months and suggested that instead of our proposal the liquidator should be obliged (a) to report to the court and the partners on a regular basis and (b) to report to the court upon becoming aware that the partnership is insolvent with a view to initiating the relevant insolvency procedure.
- 12.38 A majority of consultees supported our proposals in relation to the powers which a liquidator should be able to exercise without the sanction of the court or the approval of the partners, and those powers which may be exercised only with the partners' prior unanimous consent. Several consultees expressed reservations about the requirement of the unanimous consent of partners for compromises or arrangements with creditors. Consultees accepted the need for the partners' unanimous approval of the carrying on of the business for its beneficial winding up but some suggested that it would often be impossible to obtain that unanimity. They suggested that the liquidator should be empowered to apply to the court to obtain authority to act when there is only majority support for his proposed acts.
- 12.39 The APP also thought that unanimity would be impracticable. They suggested a different regime: the liquidator should submit a proposal to the partners setting out his proposed strategy and the partners should vote on the proposal. The default rule for the requisite majority for approval should be 75 per cent of the partners. The liquidator should have specific authority to determine the rights and obligations of the partners amongst themselves. An aggrieved partner or creditor should have the right to appeal to the court on the ground of unfairness in a similar manner to that available in company law where a company is under an administration order.<sup>51</sup>
- 12.40 The Law Society of Scotland also suggested a different approach to the powers of the liquidator. They proposed that there should be three categories of powers.

<sup>49</sup> Professor Gretton argued that the use of the judicial factor would be preferable as a liquidator would be a novelty in Scots law and that this would encourage litigation. The Scottish Law Commission considered the option of developing the office of judicial factor when preparing the Joint Consultation Paper. It carried out a research exercise on the use of judicial factors in partnerships and concluded that it was not practicable to reform the law of judicial factors in relationship to partnerships except in the context of a general reform of the law of judicial factors.

<sup>50</sup> Again the consultee may have misunderstood our proposal. See footnote 46 above.

<sup>51</sup> Insolvency Act 1986, s 27.

First, there should be those which a liquidator could exercise through his appointment which did not involve the potential for any additional liability on the partners.<sup>52</sup> Secondly, there should be powers which required sanction but not unanimity as it could be difficult to obtain unanimity.<sup>53</sup> Thirdly, the powers which required unanimous approval of the partners should be confined to those which carried the risk of additional personal liability for the partners.<sup>54</sup>

- 12.41 One consultee<sup>55</sup> pointed out that the winding up of a solvent partnership could involve an insolvent partner. He suggested that the proposed procedure could not be divorced from the rules relating to insolvency and that we should re-examine our proposals with this in mind.
- 12.42 A majority of English consultees supported the introduction of a power to disclaim onerous property or contracts, seeing it as assisting the orderly winding up of a partnership. Several consultees suggested that the power to disclaim should apply only to contracts entered into after the relevant legislation came into force. Some suggested that the power to disclaim should require the unanimous consent of the partners, who would be liable as a result of the termination of a contract; one consultee suggested that the power should be exercised only with leave of the court.
- 12.43 Several Scottish consultees questioned the need for a power to disclaim property where a partnership remained solvent and suggested that the English law of disclaimer was not compatible with Scots property law. The Law Society of Scotland suggested that the liquidator should have power to terminate contracts provided that the other contracting party could claim damages from the partnership.
- 12.44 Consultees were divided on the question whether the partners should have power to appoint a liquidator without recourse to the court. The majority of consultees in England and Wales who responded to the question opposed the idea as unnecessary. The APP, which supported the idea, thought that there might be cost savings and suggested that the default rule should be that partners were unanimous in their decision to appoint a liquidator. They suggested that such a liquidator should have the same powers as a court-appointed liquidator. In Scotland also consultees were divided on the question and one consultee expressed doubts as to whether an informal winding up by a liquidator would be cheaper than a winding up by a court appointee.

<sup>52</sup> They suggested that these should be payments to or compromises with creditors, sale of partnership property, execution of documents, ranking in bankruptcy, drawing cheques, the appointment of an agent and any other act which is necessary for the winding up for which sanction is not specifically required.

<sup>53</sup> They suggested that the following powers should require the sanction of a 75% majority of partners: compromises with a partner or former partner and borrowing on the security of the partnership's assets (up to a specified proportion of the value of the assets).

<sup>54</sup> They proposed that these powers should be (a) the bringing or defending of legal proceedings, (b) any borrowing in excess of a specified limit and (c) carrying on the partnership business.

<sup>55</sup> Professor Morse.

### **Reform recommendations**

- 12.45 We think that there should be a new mechanism for winding up solvent partnerships so that, when there is deadlock between the partners on the break up of a partnership, the partnership can be wound up more speedily and cheaply than at present.
- 12.46 We do not propose to alter the law which allows partners as a norm to wind up the partnership by themselves. As the partners have unlimited liability for the partnership's debts, there is no need for the compulsory involvement of an independent officer, as in the winding up of limited companies.
- 12.47 Partners will also be able to appoint a third party, such as an accountant or lawyer, to wind up the partnership and will be able to confer powers on that person to effect a winding up on their behalf. For example, if the partners in a small partnership are unable to effect the winding up they could appoint the chartered accountant who acts for the partnership to do it for them. Through the law of agency they can confer on their appointee such powers as they possess to wind up the partnership. We see no need to empower partners to appoint a partnership liquidator when they can effect the winding up through the law of agency. Our recommendations in favour of a partnership liquidator are designed to deal with circumstances of deadlock within a partnership, where there is a need for a court-appointed official with sufficient powers to realise the assets of the partnership.
- 12.48 Under our proposals the courts in England and Wales will retain power to appoint a receiver or a receiver and manager in appropriate cases. Similarly in Scotland the courts will retain power to appoint a judicial factor. We expect that our recommended mechanism for a winding up by a partnership liquidator will in practice supplant receivers and managers and judicial factors.
- 12.49 **We therefore recommend that:**
- (1) Partners will continue to be able to wind up the partnership themselves;**
  - (2) Partners will continue to be able to appoint an agent to wind up the partnership on their behalf;**
  - (3) The courts in England and Wales will continue to have power to appoint a receiver or a receiver and manager to a partnership, and in Scotland the courts will continue to have power to appoint a judicial factor; and**
  - (4) In addition there should be a new statutory system for winding up a solvent partnership under court supervision, involving the appointment of a partnership liquidator.**

### ***Who appoints the partnership liquidator?***

- 12.50 We think that only the court should have power to appoint a partnership liquidator. There is no need to empower partners to appoint a partnership liquidator when they can already appoint an agent to wind up the partnership. The partnership liquidator will therefore be a court officer acting under the supervision of the court. The courts which may appoint a partnership liquidator are the High

Court or a county court in England and Wales, and in Scotland the Court of Session or a sheriff court.<sup>56</sup>

12.51 We think that any partner or creditor of the firm should be able to apply to the court for the appointment of a partnership liquidator on or after the break up of a partnership. In addition, other persons with an interest in the winding up should be able to apply. Such persons are: (a) a person who ceased to be a partner on or after the break up of the partnership, (b) the personal representative of a deceased former partner, who but for his decease would have been entitled to take part in the winding up, and (c) the insolvency practitioner in relation to a former partner who but for his insolvency would have been entitled to take part in the winding up.<sup>57</sup> The court will also have power to appoint a partnership liquidator on the application of a former partner where it is satisfied that it is just and equitable to do so.<sup>58</sup>

12.52 We have considered including in the draft Bill provisions specifying the limited circumstances in which a personal representative of a deceased partner or a creditor of the partnership may apply for the appointment of a partnership liquidator. On reflection, we consider this an unnecessary complication. The court will have discretion whether to appoint a partnership liquidator and can refuse to do so when it is not necessary. Thus if the partners, or some of the partners, are themselves winding up the partnership reasonably efficiently and are not failing in their duties or otherwise doing wrong, there will be no reason for the court to appoint a partnership liquidator and we would expect the court to refuse to do so. For example, we would not expect the court to appoint a liquidator on the application of a creditor (the partnership being *ex hypothesi* solvent) unless the creditor were able to demonstrate that the partners were unable to wind up the partnership or were failing in their duty to do so.

12.53 **We therefore recommend that:**

- (1) Only the court should have power to appoint a partnership liquidator to a partnership which has broken up;** (Draft Bill, cl 50(1))
- (2) The following persons should have the right to apply to the court for the appointment of a partnership liquidator:**
  - (a) A partner,**
  - (b) A person who ceased to be a partner on or after the break up of the partnership,**
  - (c) The personal representative of a deceased former partner who but for his decease would have been entitled to take part in the winding up,**

<sup>56</sup> See the definition of “the court” in the draft Bill, cl 76(1).

<sup>57</sup> See draft Bill, cl 50(2) and (5).

<sup>58</sup> See draft Bill, cl 53 and Sched 3, para 2.

(d) **The insolvency practitioner in relation to a former partner who but for his insolvency would have been entitled to take part in the winding up, and**

(e) **A creditor of the partnership.** (Draft Bill, cl 50(2) and (5))

(3) **In addition, the court on ordering the break up of a partnership, on the application of a former partner (or his personal representative or insolvency practitioner) who claims that the partnership affairs are being conducted in a way that is prejudicial to his interests, should be empowered to appoint a partnership liquidator, if it considers the appointment to be necessary or expedient.** (Draft Bill, cl 53(4) and Schedule 3, para 2)

***The court's power to appoint a provisional liquidator***

12.54 As circumstances may arise when it is necessary or expedient to appoint a partnership liquidator urgently to prevent misappropriation of partnership assets or some other wrongdoing, we think that the court should be empowered to appoint a provisional liquidator. The purpose of the appointment of a provisional liquidator would be to preserve partnership property and property which the partnership holds on trust for others pending the determination of the application to appoint a partnership liquidator. The court would have discretion to give the provisional liquidator such of the statutory powers of the partnership liquidator as it thought fit. In the order appointing the provisional liquidator, the court could state the specific statutory powers (whether powers exercisable without sanction or approval or powers exercisable only with such sanction or approval) which it conferred.

12.55 We discuss the provisional liquidator in more detail below, when discussing particular issues relating to the partnership liquidator.

12.56 **We recommend that:**

(1) **The court should have power on an application to appoint a partnership liquidator to appoint a provisional liquidator;** (Draft Bill, cl 51)

(2) **The duty of the provisional liquidator should be to preserve partnership property and property held by the partnership on trust pending the determination of the application to appoint a partnership liquidator; and** (Draft Bill, Schedule 5, para 2)

(3) **The court should have discretion to confer on the provisional liquidator such of the statutory powers of a partnership liquidator (being the powers exercisable with or without sanction or approval) as it considers expedient for the performance of his duty. The provisional liquidator may also exercise such powers with the unanimous approval of the partners.** (Draft Bill, Schedule 5, para 3)

***Who may be appointed liquidator***

12.57 We do not think that it is necessary that the liquidator (or provisional liquidator) should be an insolvency practitioner. The liquidator is to be appointed to carry out

the winding up of a solvent partnership.<sup>59</sup> While we expect that the court would wish to appoint a suitable person such as a chartered accountant who had sufficient experience in relation to partnership business, we see no need to impose statutory qualifications.

***Liquidator to give security***

12.58 We think that it would be appropriate in most cases that the liquidator (or provisional liquidator) should be required to find security before starting to act as liquidator (or provisional liquidator). Where an insolvency practitioner is appointed to wind up an insolvent person he must find security.<sup>60</sup> In relation to persons who are not insolvency practitioners, there is a precedent in the winding up of registered companies before 1985.<sup>61</sup> The practice before the Insolvency Act 1985 was that no security was needed if the winding up was a voluntary winding up but that if the court appointed a liquidator it usually required security.<sup>62</sup>

12.59 The court should be given discretion to determine whether any and what security is to be given by a liquidator (or provisional liquidator) on his appointment. In some cases, it may not be needed: for example, if the partners inform the court that it is not required. In other cases it may be advisable for the court to order security to be given, particularly where different factions of partners are in dispute as to the appropriate means of winding up. Rules of court can provide for the giving, varying and release of security.

12.60 **We therefore recommend that:**

- (1) The liquidator should not be required to have a statutory qualification but the court should be given discretion to appoint a suitable person;**
- (2) The court should be given discretion to determine whether any and what security is to be given by a liquidator (or provisional liquidator) on his appointment; (Draft Bill, cls 50(3) and 51(4) and**
- (3) Rules of court should provide for the appointment of the liquidator (or provisional liquidator) and the giving, varying and release of security.**

<sup>59</sup> We recommend below that the liquidator should apply to the court to initiate insolvency proceedings where he is satisfied that insolvency cannot be avoided. See paras 12.89 – 12.94 below.

<sup>60</sup> See the Insolvency Act 1986, s 390(3) and the Insolvency Practitioners Regulations 1990 (SI 1990 No 439), Regulation 12 (as amended by the Insolvency Practitioners (Amendment) Regulations 1993 (SI 1993 No 221), Regulation 5) and Sched 2.

<sup>61</sup> From 1890 to 1985 a court appointed liquidator was required to give security. See the Companies (Winding Up) Act 1890, s 4(3) and the Companies Act 1948, ss 240(a) and 241(a).

<sup>62</sup> See Palmer, *Palmer's Company Law* (23<sup>rd</sup> ed 1982) para 86.52.

### ***The effect of the appointment of a partnership liquidator***

- 12.61 In order to assist the efficient winding up and to minimise conflict between the partnership liquidator and the partners, it is necessary to provide that all of the powers of the partners cease on the appointment of a partnership liquidator except to the extent that the partnership liquidator agrees to their continuance. Similarly, on appointment of a provisional liquidator the powers of the partners should be suspended except so far as the provisional liquidator sanctions their continuance.
- 12.62 We think that there is no need to vest partnership property in the partnership liquidator on his appointment. By giving powers to the partnership liquidator and by superseding the powers of the partnership, an effective regime for winding up can be established without creating complications, including tax complications, which can arise from the automatic transfer of property. Circumstances may arise however in which the partnership liquidator might find it expedient to take title to all or part of the partnership property in order to pursue legal remedies in relation to that property in his own name.<sup>63</sup> We think that it would be useful to give the partnership liquidator the right to apply to the court for an order vesting partnership property in his official name.<sup>64</sup>
- 12.63 We have also considered whether it would be appropriate to impose a statutory duty on partners to co-operate with the liquidator (or provisional liquidator). Partners owe a duty of good faith to each other and the partnership and that duty continues in the course of the winding up. It may be argued that a failure to co-operate with a liquidator (or provisional liquidator) in a solvent winding up would be a breach of that duty. Nonetheless, as a partnership liquidator (or provisional liquidator) will usually be appointed only when the partners cannot agree on the means by which to wind up the partnership informally, disputes between different partners or different factions of partners can readily be foreseen. In these circumstances we think that a statutory duty to co-operate with the liquidator (and provisional liquidator) will re-enforce the duty of good faith.
- 12.64 As “persons interested in the winding up”<sup>65</sup> may have information which the partnership liquidator (or provisional liquidator) requires to perform his duties, we consider that such persons should owe an overriding duty of good faith to the firm and the partners in relation to the functions of the liquidator (or provisional liquidator).
- 12.65 As the appointment of a partnership liquidator is designed simply to create a more efficient and less costly regime for solvent winding up where partners are unable to agree, we think that the appointment of a partnership liquidator (or provisional liquidator) should not restrict the right of a creditor or claimant against the

<sup>63</sup> In English law this would include property in which the partnership had the beneficial interest, such as property held in trust by another person for the partnership. In Scots law the *ius crediti* of the partnership as beneficiary of a trust would vest, enabling the liquidator to call on a bare trustee to transfer the asset to him: an application for a vesting order could be combined with an application to order the trustee to denude.

<sup>64</sup> There is a precedent in relation to liquidators who are winding up companies in the Insolvency Act 1986, s 145.

<sup>65</sup> A “person interested in the winding up” is defined in the draft Bill, cl 50(5). See paras 12.51 and 12.53(2) above.

partnership from pursuing or enforcing claims against the partnership. In addition a creditor of a partnership should be entitled to seek a court order to wind up the partnership on the ground of insolvency or in Scotland to sequestrate the partnership's estate, notwithstanding the appointment of a partnership liquidator (or provisional liquidator).

12.66 **We therefore recommend that:**

- (1) **All the powers of the partners cease on the appointment of the partnership liquidator, except so far as the liquidator sanctions their continuance;** (Draft Bill, Schedule 4, Part 1, para 1(1))
- (2) **All powers of the partners should be suspended on the appointment of a provisional liquidator, except so far as the provisional liquidator sanctions their continuance;** (Draft Bill, Schedule 5, para 1(1))
- (3) **Partnership property should not vest automatically in the partnership liquidator on his appointment;**
- (4) **A partnership liquidator should nonetheless have a right to apply to the court to vest all or any part of the partnership property in him by his official name;** (Draft Bill, Schedule 4, Part 1, para 6)
- (5) **The partners should be under a duty to co-operate with the partnership liquidator (or provisional liquidator) in the performance of his duties from the time of his appointment;** (Draft Bill, Schedule 4, Part 1, para 1(2) and Schedule 5, para 1(2))
- (6) **Persons interested in the winding up (namely a person who ceased to be a partner on or after the break up, (if deceased) his personal representative or (if insolvent) an insolvency practitioner appointed in relation to him) should owe a duty of good faith towards the partnership and the partners in relation to the functions of the partnership liquidator or provisional liquidator;** (Draft Bill, Schedule 4, para 1(3) and Schedule 5, para 1(3)) **and**
- (7) **The appointment of a partnership liquidator (or provisional liquidator) should not restrict the rights of creditors of, or claimants against, the partnership from pursuing and enforcing their claims against the partnership (or the partners with subsidiary liability) or from applying to wind up the partnership, or in Scotland to sequestrate the partnership's estate.**

***The functions of the partnership liquidator***

12.67 As the partnership liquidator is a new statutory creation we think that it is appropriate that the draft Bill should include a statement of his principal duties to effect an efficient winding up of the partnership.

12.68 **We recommend that the duties of the partnership liquidator should be (a) to get in and realise the partnership's assets; (b) to pay the partnership's debts and discharge its liabilities to persons other than partners (c) to**

**distribute any remaining proceeds of realisation in accordance with the default rules or any substitute provisions in the partnership agreement and (d) to secure that all trust property is transferred to the person entitled to it or a trustee for that person.** (Draft Bill, Schedule 4, Part 1, para 2)

***Contracts entered into by liquidator or provisional liquidator***

12.69 We think that it would be suitable in the interests of clarity to establish as a general rule that a liquidator should not be personally liable on a contract which he enters into in the performance of his functions. If a party contracting with the liquidator wishes the liquidator to incur personal liability on the contract, the contract should so provide. Where the liquidator assumes personal liability under a contract, he should be entitled to an indemnity in respect of that liability out of partnership property.

12.70 **We therefore recommend that**

**(1) A contract entered into by a liquidator (or provisional liquidator) in the performance of his functions should be taken as entered into on behalf of the partnership, unless the contract provides that he should be personally liable on it; and**

**(2) If the liquidator (or provisional liquidator) assumes personal liability under the contract, he should be entitled to an indemnity out of partnership property in respect of that liability.** (Draft Bill, Schedule 4, Part 1, para 5 and Schedule 5, para 4)

***The powers of the partnership liquidator: (a) generally***

12.71 We think that the partnership liquidator should have wide powers to realise the partnership assets and pay its debts. By conferring extensive powers on a partnership liquidator we hope to reduce the expense and delays which occur when a partnership is wound up when the partners are in deadlock.

12.72 In order to wind up a partnership efficiently, the partnership liquidator will normally require extensive powers which he can exercise without requiring the approval of the partners or the sanction of the court. It is often difficult to obtain the agreement of partners to a sensible course of action if the partnership is divided into opposing factions. It may be expensive and time-consuming to obtain the sanction of the court. We think that it is appropriate that the court should be empowered to give a partnership liquidator general powers to wind up the partnership business and that only specified powers should require the approval of the partners or the further sanction of the court.

12.73 The powers which the liquidator may exercise without approval or sanction should include power to bring or defend legal proceedings in the name of the partnership, power to sell partnership property, power to claim in a partner's or debtor's insolvency, power to borrow money on the security of the partnership's assets, power to appoint an agent, and power to execute deeds or documents in the name of the partnership. The liquidator should also be able to do all other things necessary for the winding up. This would cover all acts other than those for which specific approval or sanction should be required.

12.74 **We therefore recommend that:**

- (1) The court should be able to give the partnership liquidator wide powers to carry out the winding up of the partnership without requiring the approval of the partners or the sanction of the court for the exercise of these powers; and**
- (2) The following powers should be exercisable without approval or sanction:**
  - (a) Power to bring or defend any action or other legal proceeding in the name or on behalf of the partnership;**
  - (b) Power to sell any partnership property by public auction or private contract;**
  - (c) Power to do all acts and execute, in the name and on behalf of the partnership, all deeds, receipts and other documents;**
  - (d) Power to prove, rank and claim in the bankruptcy, insolvency or sequestration of any debtor of the partnership or any partner or former partner and to receive dividends from the insolvent's estate;**
  - (e) Power to borrow any money required on the security of the partnership's assets;**
  - (f) Power to appoint an agent to do any business which it would be unreasonable for the liquidator to have to do himself; and**
  - (g) Power to do all such things as may be necessary for winding up the partnership's business and affairs and distributing the proceeds of the realisation of partnership property.**  
(Draft Bill, Schedule 4, Part 1, para 3 and Part 3)

***The powers of the partnership liquidator: (b) powers requiring approval or sanction***

12.75 We think that the partnership liquidator should have power to carry on the partnership business for the beneficial winding up of the partnership only with the approval of all of the partners or the sanction of the court. The partners have unlimited liability for partnership debts and they should not normally be exposed to liability from continued trading without their consent. As circumstances may occur where a partner unreasonably refuses to approve a proposal to carry on business which will demonstrably assist the beneficial winding up, the court should have power to sanction the carrying on of business, notwithstanding the lack of unanimity among the partners.

12.76 Again, because partners have unlimited liability for the debts of the partnership we think that the partnership liquidator should require approval or sanction before he (a) makes a compromise or arrangement with alleged creditors of or claimants against the partnership, and (b) compromises debts and liabilities subsisting or supposed to subsist between the partnership and other persons (including partners or former partners). While the liquidator may pay undisputed debts and obtain

payment of sums which are undisputedly due to the partnership, the power to compromise is one which we think requires approval or sanction. Such approval or sanction gives a degree of protection to the partners and former partners who have secondary liability for the partnership debts. In Scotland, the power to terminate a lease, which we discuss in the succeeding paragraphs, should also require approval or sanction as the partners may be prejudiced by the partnership incurring an obligation to pay compensation or damages arising from the premature termination.

12.77 There may be circumstances in which the partners want the partnership liquidator to distribute certain items of partnership property *in specie* instead of realising the assets and distributing the proceeds of sale. For example a partnership agreement might envisage that particular assets would be returned to a partner on a winding up. As the partnership liquidator's primary duty is to realise the assets and to distribute the proceeds we think that there should be an express power to distribute *in specie*. In other cases a partner may apply in the course of a winding up to receive a particular asset instead of a sum of money equating to its value. To avoid disputes between the partners as to a partner's entitlement to such a distribution, we think that the power should require the unanimous approval of the partners or the sanction of the court unless the partnership agreement has authorised distributions *in specie*.<sup>66</sup>

12.78 **We therefore recommend that:**

- (1) The partnership liquidator be empowered to exercise the following powers only with the unanimous approval of the partners or the sanction of the court:**
  - (a) Power to carry on the partnership business for the beneficial winding up of the partnership;** (Draft Bill, Schedule 4, Part 1, para 3 and Part 2, para 21)
  - (b) Power to make a compromise or arrangement with alleged creditors or claimants against the partnership;** (Draft Bill, Schedule 4, Part 1, para 3 and Part 2, para 19)
  - (c) Power to compromise debts and liabilities subsisting or supposed to subsist between the partnership and other persons, including partners or former partners;** (Draft Bill, Schedule 4, Part 1, para 3 and Part 2, para 20)
- (2) The partnership liquidator should have power to distribute partnership property in its existing form instead of realising the**

<sup>66</sup> For example, the partners might agree in a partnership agreement that an asset would be transferred to a partner on a winding up at a specified value which might be less than market value. The partnership liquidator should have power to give effect to such an agreement and would in normal circumstances have no reason not to do so. But we do not recommend that a partnership liquidator should be obliged to carry out the partners' wishes (whether in the partnership agreement or in the course of the winding up) because there may be circumstances where the threat of an emerging insolvency would make a transfer at an undervalue inappropriate.

**property and distributing the proceeds of realisation (a) if permitted to do so in the partnership agreement, (b) with the unanimous approval of the partners or (c) with the sanction of the court.** (Draft Bill, Schedule 4, Part 1, para 4)

***Disclaimer of onerous property or termination of long leases***

- 12.79 We think that it would be expedient to include in a statutory regime for winding up a power to enable a partnership liquidator to terminate a long term contract which otherwise would prevent him completing the winding up of the partnership's affairs. For example, a partnership may be a tenant under a twenty-one year lease of commercial premises but have broken up when the lease has still fifteen years to run. We think that it would assist the efficient winding up of the partnership if the partnership liquidator were empowered to terminate the lease where he was unable to dispose of it within a reasonable time.
- 12.80 Scotland does not have a statutory regime for disclaimer of onerous property on insolvency. Nevertheless, we recommend that the partnership liquidator should have power, with approval of the partners or sanction of the court, to terminate a lease in such circumstances. The termination would not affect the right of any party (such as the landlord and any other party to the lease or any sub-tenant) to claim compensation or damages from the partnership in respect of the termination. The compensation or damages would be treated as a partnership debt and would not be enforceable against the partnership liquidator personally.
- 12.81 The partnership liquidator would be able to terminate the lease if after at least one year from the date of his appointment he had not disposed of the tenant's interest in the lease and he were satisfied that the partnership's interest in the lease could not be disposed of. He would require to inform the landlord of this view and give him notice terminating the lease. The notice period would vary depending on the nature of the lease. Special rules would be necessary for agricultural leases to allow the efficient hand-over of responsibility for the farm. In relation to agricultural leases in Scotland we recommend that the period of notice be either a period of between one and two years ending with the term of Whitsunday or Martinmas or such period as may be agreed between the partnership liquidator and the landlord. In relation to other leases the period should be six months or where an enactment lays down a shorter period of notice, that shorter period of notice.
- 12.82 In England and Wales, which have an established regime for disclaimer of property in individual and corporate insolvency, we think that the partnership liquidator should have a wide power to disclaim onerous property. As a joint sub-committee of the Insolvency Court Users Committee in co-operation with the Law Commission are reviewing the Insolvent Partnerships Order 1994 and we are not yet aware of the form which their recommendations may take, we think that it would not be appropriate to formulate a regime for disclaimer at this stage. We think that it is sufficient if the draft Bill includes a power to create subordinate legislation to provide for the disclaimer of onerous property.<sup>67</sup>

<sup>67</sup> We generally do not favour the use of subordinate legislation in relation to the draft Partnerships Bill as we wish the basic rules of partnership to be accessible in a statute.

12.83 **We therefore recommend that:**

- (1) **The draft Bill should include a power to make subordinate legislation to empower a partnership liquidator to disclaim onerous property (with the approval of the partners or the sanction of the court);** (Draft Bill, Schedule 4, Part 1, para 7)
- (2) **In Scotland, a partnership liquidator should be empowered (with approval of the partners or sanction of the court) to terminate a lease of land or buildings of which the partnership is the tenant, where he has not disposed of the partnership's interest in the lease within one year after the date of his appointment and he is satisfied that a provision in the lease or a rule of law prevents the disposal of the interest. The liquidator should give the landlord a specified period of notice depending on the type of lease. In an agricultural lease the notice should be either a period of between one and two years ending in the term of Whitsun or Martinmas or such period as is agreed with the landlord. In any other lease the period should be six months or such shorter period of notice as is required by any other enactment. The termination should not affect any claim for compensation or damages in respect of the termination of the lease by any person (including a landlord or sub-tenant). The claim for damages or compensation should be a claim against the partnership and not the liquidator personally.** (Draft Bill, Schedule 4, Part 1, para 8)

***The partnership liquidator's accounts***

- 12.84 It is necessary that the partnership liquidator should account to the partners and any "person interested in the winding up"<sup>68</sup> for his conduct of the winding up. It is important to strike a balance between the aim of allowing the partnership liquidator freedom to carry out the winding up without undue demands from partners and others for regular accounts, and the need for proper accountability to the partners and persons interested in the winding up. Where the winding up continues for more than one year, we think that the partnership liquidator should be required to hold a meeting of the partners and any persons interested in the winding up annually within three months of the end of each year. The partnership liquidator should have the duty of laying before the annual meeting an account of his acts and dealings and the conduct of the winding up. When he has fully wound up the partnership's business he should produce an account showing how he has conducted the winding up and how he has disposed of the partnership property. He should then summon a meeting of the partners and any persons interested in the winding up to consider the account and call for explanation if necessary. We do not propose detailed rules for the conduct of the meetings. Instead, we recommend

However a partnership liquidator will be professionally qualified and should have ready access to subordinate legislation.

<sup>68</sup> See para 12.51 above and draft Bill cl 50(5) for the definition of a "person interested in the winding up".

that there should be a default rule that a resolution against a liquidator's release should be decided by majority vote.<sup>69</sup>

12.85 As a further protection for partners and persons interested in the winding up we think that they should have the right, where they are dissatisfied with the conduct of the partnership's affairs, to apply to the court to order an account to be taken of the partnership's affairs. The court would have discretion whether to make the order so that it could prevent vexatious applications from disrupting the efficient conduct of the winding up.

12.86 **We therefore recommend that:**

- (1) If the winding up by the partnership liquidator continues for more than one year, he should be obliged to summon a meeting of the partners and any person interested in the winding up at the end of the first year after the date of his appointment and of each succeeding year;**
- (2) The partnership liquidator must lay before the meeting a full and true account of his conduct of the winding up during the preceding year;** (Draft Bill, Schedule 4, Part 1, para 10)
- (3) As soon as he has completed the winding up of the partnership's business, the partnership liquidator must prepare a full and true account of the winding up, summon a meeting of the partners and any person interested in the winding up and lay the account before that meeting and explain it;** (Draft Bill, Schedule 4, Part 1, para 11)
- (4) If the partnership liquidator fails to make up accounts or to summon a meeting, he should be guilty of an offence;** (Draft Bill, Schedule 4, Part 1, paras 10(5) and 11(8)) **and**
- (5) Any partner or person interested in the winding up who is not satisfied with the way in which the partnership liquidator is conducting the winding up may apply to the court for an order that an account be taken of the partnership's affairs.** (Draft Bill, Schedule 4, Part 1, para 12)

***Reference of questions to the court***

12.87 During a winding up questions may arise which require to be determined by the court. We think therefore that interested parties should have the right to apply to the court to determine questions arising in the winding up of the partnership and that the court should have power to determine the questions raised and to make other appropriate orders. Issues may arise on which the partnership liquidator needs an authoritative ruling from the court. While applications to the court by partners and others to challenge a decision of the partnership liquidator may disrupt the efficient winding up of the partnership's business, we think that there

<sup>69</sup> See the draft Bill, Sched 4, Part 1, para 11(6).

must be some safety net for an aggrieved partner. The court should not be obliged to make a determination or make any order unless it considers it appropriate to do so and in determining the application can impose such terms and conditions as it thinks fit. We do not see a need for a wider power by which the court may reverse or modify any decision of the partnership liquidator.<sup>70</sup>

12.88 **We therefore recommend that:**

- (1) The partnership liquidator, a partner, a person interested in the winding up,<sup>71</sup> a creditor of the partnership or a person who ceased to be a partner before the break up of the partnership may apply to the court to determine any question arising in the winding up of the partnership; and**
- (2) The court should have discretion whether to determine the application, to impose such terms and conditions as it thinks fit on its determination and to make any other order on the application.**  
(Draft Bill, Schedule 4, Part 1, para 13)

***The partnership liquidator and an insolvent partnership***

12.89 The introduction of the partnership liquidator is designed to make the winding up of solvent partnerships more efficient where the partners are not able themselves to wind up the partnership business. It is not designed to deal with insolvency of the partnership. But in the course of winding up the partnership the partnership liquidator may discover that the partnership, which was believed to be solvent, is in fact insolvent or is likely to become insolvent. It may be possible for the partners to deal with an emerging insolvency by providing the partnership liquidator with their own funds to avert an actual insolvency. Or it may be necessary to institute insolvency procedures. In either event we think that there should be a mechanism by which the partnership liquidator reports to the court on an emerging insolvency and obtains the court's determination of the appropriate course of action. We are satisfied that our proposal that the partnership liquidator should be under a duty to report to the court if he were of the opinion that the partnership's debts could not be paid within 12 months of his appointment<sup>72</sup> is inappropriate. Not only does it impose an unnecessarily rigid time scale on the partnership liquidator but also it in effect creates a new concept of insolvency (the inability to pay debts within a year).

12.90 On reflection, we think that it is prudent to stay with established tests of insolvency, namely the inability to pay debts and absolute (or balance sheet)

<sup>70</sup> cf Insolvency Act 1986, s 263(3) (court control of a supervisor of a voluntary arrangement). We do not think that it is appropriate to give partners and others a right of appeal from the decisions of the liquidator: a dissident partner could use such a right to delay the winding up. The partnership liquidator is intended to have greater independence of the parties and the court than the receiver and manager or, in Scotland, the judicial factor. A right of appeal to the court against a liquidator's decisions could undermine this policy.

<sup>71</sup> See para 12.51 above and draft Bill, cl 50(5) for the definition of a "person interested in the winding up".

<sup>72</sup> Joint Consultation Paper, para 8.46.

insolvency.<sup>73</sup> We consider that where the partnership liquidator is satisfied that the partnership is in fact insolvent or that there is no reasonable prospect of avoiding insolvency, he should be under a duty to apply to the court to initiate insolvency proceedings. He should be given standing (or in Scotland title and interest) to present an application to the court to initiate insolvency proceedings.<sup>74</sup>

12.91 We envisage that a partnership liquidator, on discovering that he did not, or would not, have sufficient sums to meet the firm's liabilities, would approach the partners to seek contributions to meet those liabilities. If the partners did not provide the necessary funds, the partnership liquidator would be satisfied that there was no reasonable prospect of avoiding insolvency in the winding up. At the point when the partnership liquidator was so satisfied, it would be his duty to apply to the court to commence insolvency proceedings.

12.92 In England and Wales the transition from a solvent winding up to insolvency procedure can be effected by giving the partnership liquidator power on behalf of the partnership to apply for the insolvent winding up of the partnership. The precise mechanism by which this can be achieved will depend on the outcome of the reform of the Insolvent Partnerships Order 1994, which is beyond our remit. It will also be necessary to disapply the time limit on the presentation of applications to wind up partnerships when the application is at the instance of the partnership liquidator as it is possible that his application might be made more than three years after the partnership had ceased to carry on business in England and Wales. This can be done in consequential provisions. As the time limits remain in place in the meantime, it is possible that the court might not have jurisdiction to make a winding up order against a partnership. To cover that eventuality, we think that it should be provided that where the partnership is unable to pay its debts and the partnership liquidator has reasonable grounds for believing that the court does not have jurisdiction to wind up, he should apply to the court for directions or such order as the court thinks fit.

12.93 In Scotland the same transition to insolvency procedure can be achieved by giving the partnership liquidator power to present a petition for sequestration of the firm's estate and of the estate of any insolvent partner under sections 5 and 6 of the Bankruptcy (Scotland) Act 1985.

12.94 **We therefore recommend that:**

- (1) If a partnership is unable to pay its debts and there is no reasonable prospect of it becoming able to pay its debts, the partnership liquidator should be under a duty, within one month of the insolvency, to apply to the court for a winding up order (in England and Wales) or (in Scotland) for sequestration of the estate of the partnership;** (Draft Bill, Schedule 4, para 9)

<sup>73</sup> See the Insolvency Act 1986, s 122(1)(f) and 122(1)(e) & (2).

<sup>74</sup> In England and Wales the proceedings would be under the replacement of the Insolvent Partnerships Order 1994; in Scotland the application would be under the Bankruptcy (Scotland) Act 1985.

- (2) **If the partnership liquidator has reasonable grounds for believing that the court does not have jurisdiction to make the orders in (1) above, he should be under a duty to apply to the court for directions;** (Draft Bill, Schedule 4, Part 1, para 9)
- (3) **If the partnership liquidator fails without reasonable excuse to comply with (1) or (2) above, he should be guilty of an offence;** (Draft Bill, Schedule 4, Part 1, para 9)
- (4) **The partnership liquidator should have (in English law) standing to present an application to the court for the partnership to be wound up under the successor order to the Insolvent Partnerships Order 1994 and the existing time limit for presenting an application for winding up a partnership should not apply to a partnership liquidator; and**
- (5) **The partnership liquidator should have title and interest (in Scots law) to apply to the court for sequestration of the partnership's estate and the estate of an insolvent partner under the Bankruptcy (Scotland) Act 1985.** (Draft Bill, Schedule 4, Part 4)

***Appointment of a replacement liquidator or removal of a liquidator***

12.95 Where a partnership liquidator ceases to act and it is necessary to appoint a replacement liquidator, the court should have power to appoint a partnership liquidator. Where a partnership liquidator is guilty of misconduct or there is otherwise sufficient reason to justify his replacement as partnership liquidator, the court should have power to remove him and appoint a replacement.<sup>75</sup>

12.96 **We recommend that (a) if for any reason there is no partnership liquidator acting, the court should have power to appoint a partnership liquidator and (b) the court may, on cause shown, remove a partnership liquidator and appoint another.** (Draft Bill, Schedule 4, Part 1, para 15)

***The release and discharge of a partnership liquidator***

12.97 A partnership liquidator may require to resign his office, for example as a result of ill-health. He will in any event wish to be released and obtain a discharge on completion of the winding up of the partnership. It is necessary, therefore, that the partnership liquidator is entitled to apply for release and discharge. We think that the partnership liquidator should be able to obtain release and discharge from the partnership in the first instance by summoning a meeting of the partners to consider his application. As a fall-back the partnership liquidator should be entitled to apply to the court to obtain release and discharge. He would require to

<sup>75</sup> The removal should be on cause shown: by analogy with company law we suggest that cause might include failure to carry out duties in a diligent and proper manner, misconduct, conflicts of interest and persistently acting against the wishes of a majority of the partners who are acting in good faith – viz Gore-Browne, *Gore-Browne on Companies* (44<sup>th</sup> ed 1996) paras 32.18.2 and 32.18.5 and Palmer, *Palmer's Company Law* (25<sup>th</sup> ed 1992) paras 15.154 – 15.154.2 and 15.644.

give the partnership and the partners notice of such application to the court. If the partnership liquidator dies, his estate should also be entitled to release.

12.98 We have considered whether the discharge should be qualified, as in the winding up of a company, so that a liquidator could, subject to the leave of the court, be subjected to claims arising out of misfeasance or breach of fiduciary or other duty.<sup>76</sup> We have concluded that this would not be appropriate. The partnership liquidator is effecting the solvent winding up of the partnership in place of an informal winding up by the partners. There may often be serious disagreements between the partners and a propensity to litigate. It is important that the partnership liquidator enjoys a considerable degree of independence from the partners and that he is not exposed unnecessarily to the threat of legal claims. We do not propose that the discharge should have any effect in relation to third party claims against the partnership liquidator. The discharge would restrict only claims by the partnership, the partners, former partners and the estates of former partners. If the partnership had a claim against the partnership liquidator the partners could refuse to grant a discharge at the meeting summoned to approve the final accounts or oppose an application to the court for discharge. In order to achieve finality, the effect of the discharge would be to release the partnership liquidator from all liability to the partnership in respect of any act or omission in the exercise of his functions. An aggrieved party who has suffered loss will have a remedy in the unlikely event that a liquidator has been guilty of fraud or has deliberately concealed his wrongdoing. If the liquidator has acted dishonestly in purporting to obtain his release from the partners and interested persons by presenting an account of the conduct of the winding up which he knows to be inaccurate, the release will be ineffective.<sup>77</sup> Similarly if the liquidator obtained his release from the court through fraud or deliberate concealment in his application to the court, an aggrieved party would be able to set aside the court's order.<sup>78</sup> If after his release, the former liquidator discovered that he had not distributed an asset which was partnership property, his discharge would not prevent those entitled to the property from seeking a restitutionary remedy.<sup>79</sup>

12.99 **We therefore recommend that:**

**(1) A partnership liquidator should be able to resign his office by giving notice to the court, each partner, each person interested in**

<sup>76</sup> See the Insolvency Act 1986, s 212. In relation to personal bankruptcy, similar rules exist in English law (Insolvency Act 1986, s 304) while in Scotland the discharge of a trustee in sequestration releases the permanent trustee from all liability except liability arising from fraud (Bankruptcy (Scotland) Act 1985, s 57(5)).

<sup>77</sup> This is because we provide in the draft Bill, Sched 4, para 16(1), that the liquidator is released at the final meeting only if he has complied with para 11 of that Schedule, which requires him to have an honest belief that he has performed his duties as liquidator and to make up an account on that basis.

<sup>78</sup> This could be achieved in an appeal from the court's order, where that was competent, or in a separate action on the ground of the liquidator's dishonesty or fraud. See, for example, *Kuwait Airways Corporation v Iraqi Airways Co (No 2)* [2001] 1 WLR 429.

<sup>79</sup> This is because the release would discharge the liquidator in respect of his acts or omissions in the winding up and in relation to his conduct as liquidator. It would not authorise him to retain another's property after he had ceased to be liquidator.

**the winding up,<sup>80</sup> and (if he was appointed on an application by a creditor) the creditor;** (Draft Bill, Schedule 4, Part 1, para 14)

**(2) A partnership liquidator may apply for release in the first instance by summoning a meeting of the partners and any persons interested in the winding up, which failing by application to the court;** (Draft Bill, Schedule 4, Part 1, para 16) **and**

**(3) The release should have effect to discharge the partnership liquidator of all liability to the partnership, the partners, former partners and the estates of former partners in respect of any act or omission in the exercise of his functions and otherwise in relation to his conduct as liquidator (unless the liquidator has obtained his release by fraud or deliberate concealment of wrongdoing).** (Draft Bill, Schedule 4, Part 1, para 16)

### ***The expenses of winding up***

12.100 The partnership liquidator (or provisional liquidator) should be entitled to use the partnership's assets to fund the proper carrying on of the winding up and to receive his remuneration out of those assets.<sup>81</sup> He should have the first call on the free proceeds of the realisation of the partnership assets. If the partnership remains solvent, the question of priority of debts will not be important. If a partnership becomes insolvent, its creditors will have recourse against the assets of its partners as well as a claim against the partnership estate. It is appropriate therefore to give the partnership liquidator (or provisional liquidator) priority.

12.101 **We therefore recommend that all expenses properly incurred in the winding up, including the remuneration of the partnership liquidator and any provisional liquidator should be payable out of the partnership's assets in priority to all other claims.** (Draft Bill, Schedule 4, Part 1, para 17)

### ***The resignation, removal and release of a provisional liquidator***

12.102 We have discussed above the power of the court to appoint a provisional liquidator,<sup>82</sup> his provision of security or caution,<sup>83</sup> his general duties and powers,<sup>84</sup> and the general rule as to his liability on contracts entered into in performance of

<sup>80</sup> See para 12.51 above and the draft Bill, cl 50(5) for definition of a "person interested in the winding up".

<sup>81</sup> We envisage that the cost of any security which he gives on the order of the court together with the cost of any applications to vary the amount of or discharge the security would normally be treated as expenses properly incurred.

<sup>82</sup> See paras 12.54 – 12.56 above.

<sup>83</sup> See paras 12.58 – 12.60 above.

<sup>84</sup> See paras 12.54 – 12.56 above.

his functions.<sup>85</sup> We have also recommended that partners should be under a duty to co-operate with the provisional liquidator.<sup>86</sup>

12.103 It is necessary also to provide for the termination of the appointment of the provisional liquidator. We think that it is appropriate that he should be able to resign in the same way as a partnership liquidator. He should also cease to hold office on the determination of the application to the court for the appointment of a partnership liquidator. We think that the court should be able to appoint a replacement provisional liquidator if there is no-one acting and where necessary to remove a provisional liquidator and appoint another. In addition the provisional liquidator should be entitled to release if the court grants an application for release.

12.104 **We therefore recommend that:**

- (1) A provisional liquidator should be able to resign his office by giving notice to the court, each partner, each person interested in the winding up, and (if he was appointed on an application by a creditor) the creditor;** (Draft Bill, Schedule 5, para 5)
- (2) A provisional liquidator should cease to hold office on the determination of the application to the court to appoint a partnership liquidator;** (Draft Bill, Schedule 5, para 7)
- (3) If for any reason there is no provisional liquidator acting, the court may appoint a provisional liquidator and the court may, on cause shown, remove a provisional liquidator and appoint another;** (Draft Bill, Schedule 5, para 6)
- (4) A provisional liquidator (or if he has died his personal representative) should be able to apply for release to the court and the court may order his release from the time specified in the order;** (Draft Bill, Schedule 5, para 8(1) and (2))
- (5) On release a provisional liquidator should be discharged from all liability to the partnership, partners, former partners and the estates of former partners in respect of any act or omission in the exercise of his functions and otherwise in relation to his conduct as provisional liquidator (unless the liquidator has obtained his release by fraud or deliberate concealment of wrongdoing).<sup>87</sup>** (Draft Bill, Schedule 5, para 8(3))

### ***Rule-making power***

12.105 We recognise that there are matters relating to the solvent winding up of partnerships which are better dealt with in subordinate legislation than in the draft

<sup>85</sup> See paras 12.69 – 12.70 above.

<sup>86</sup> See para 12.66(5) and (6) above.

<sup>87</sup> See para 12.98 above.

Bill. In particular we consider that the remuneration of the partnership liquidator and the provisional liquidator is a matter which is appropriate for such rules. We consider that there should therefore be a rule-making power for the purpose of giving effect to the solvent winding up of partnerships.<sup>88</sup>

- 12.106 **We recommend that the Secretary of State should be empowered to make rules for the purpose of giving effect to the provisions of the draft Bill in relation to the solvent winding up of partnerships and in particular to provide for the remuneration of the partnership liquidator and the provisional liquidator.** (Draft Bill, Schedule 4, Part 1, para 18 and Schedule 5 para 9)

***The liability and common law duties of a partnership liquidator or provisional liquidator***

- 12.107 We have discussed above the recommendations that as a general rule a partnership liquidator or a provisional liquidator should not incur personal liability on contracts which he enters into in the performance of his functions.<sup>89</sup> We look now at obligations arising in tort or delict.
- 12.108 A partnership liquidator or a provisional liquidator would owe duties of care in tort and, in Scotland, delict in such circumstances as those duties arise in the common law. Thus the liquidator would owe a duty of care to persons whom he could reasonably foresee were likely to suffer personal injury or physical damage to their property as a result of his acts and omissions, in accordance with the general law. Similarly, and again in accordance with the general law, he would owe a duty to take reasonable care to avoid causing economic loss where he had assumed personal responsibility for the economic interests of a person and he knew that that person was relying on his professional expertise.<sup>90</sup> We see no need to make any legislative provision in this regard.

**SETTLING PARTNERS' ACCOUNTS**

**Existing law**

- 12.109 Section 44 of the 1890 Act sets out the default rules which govern the substantive rights of partners on a dissolution of the partnership. Section 44<sup>91</sup> provides that:

<sup>88</sup> We consider that the power to make rules in Scotland in relation to the solvent winding up of partnerships is a reserved matter and is therefore within the jurisdiction of the Secretary of State: see Scotland Act 1998, s 30 and Sched 5, Head C, ss C 1 and C 2.

<sup>89</sup> See paras 12.69 – 12.70 above.

<sup>90</sup> See *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, *Bank of Scotland v Fuller Peiser* 2002 SLT 574.

<sup>91</sup> The 1890 Act, s 44 follows almost word for word Lord Lindley's suggestion of an appropriate default rule for settling accounts in the 5<sup>th</sup> edition of *Lindley on Partnership* (1888) p 402. Interestingly, s 44(a) includes "losses and deficiencies of capital", to which Lord Lindley did not refer, and provides for payment first out of "profits" while Lord Lindley referred to "assets excluding capital".

In settling accounts between partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:

(a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits:

(b) The assets of the firm including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:

1. In paying the debts and liabilities of the firm to persons who are not partners therein:

2. In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital:

3. In paying to each partner rateably what is due from the firm to him in respect of capital:

4. The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible.

12.110 It is useful to give an example of the operation of the section.<sup>92</sup> Suppose that X, Y and Z enter into a partnership sharing profits equally but contributing £9,000, £6,000 and £3,000 respectively to the partnership's capital of £18,000. In addition, Y advances £2,000 by way of loan to the partnership. On dissolution of the partnership, the total assets of the partnership are £10,000. £2,000 is owed to creditors.

12.111 The payment of outside creditors and Y's advance leaves surplus assets of £6,000. There has thus been an overall loss of £12,000 capital (the difference between the surplus assets and the partnership's capital). This must be made up by the partners in the same proportion in which they share profits.

12.112 Profits are divisible equally, so X, Y and Z must each contribute £4,000. In the final settlement of their accounts, X receives £5,000 (£9,000 capital less £4,000 contribution to loss), Y receives £4,000 (£6,000 capital plus £2,000 advance less £4,000 contribution to loss), and Z has to contribute £1,000 (the difference between the £4,000 contribution to loss and the £3,000 capital due to him).

12.113 This is straightforward. The process is more complicated where there is a trading loss and one of the partners is insolvent. In *Garner v Murray*<sup>93</sup> Joyce J held that section 44 did not compel the solvent partners to make up any shortfall of capital resulting from an insolvent partner's inability to contribute his share of lost capital. The deficiency of capital is borne by the solvent partners in proportion to their capital entitlements. This has become known as "the rule in *Garner v Murray*".

<sup>92</sup> We gave this example in the Joint Consultation Paper, paras 8.68 – 8.70.

<sup>93</sup> [1904] 1 Ch 57, 60.

There are two schools of thought as to the correct way of proceeding where the insolvent partner's capital account is already withdrawn before the loss of capital is deducted. Either the deficit on the insolvent partner's capital account is ignored when applying the rule or that deficit is itself treated as a loss which must be shared between all the partners. The latter view is preferred.<sup>94</sup>

- 12.114 Taking the example in paragraphs 12.110 and 12.111, with Z insolvent, the surplus assets of the partnership (£6,000) would be enhanced by the notional contributions of X and Y (£4,000 each) towards the deficiency of capital. This results in total assets available for distribution after the payment of debts and advances of £14,000. This is divided between X and Y in the ratio 3:2, reflecting their capital entitlements. X receives £4,400 (£8,400 less £4,000 contribution) and Y receives £3,600 (£5,600 plus the advance of £2,000 less £4,000 contribution).
- 12.115 The "rule" in *Garner v Murray* does not cover the circumstance where the partnership's assets are insufficient to meet the claims of outside creditors.<sup>95</sup> In such a case, the solvent partners must contribute in their loss sharing ratios<sup>96</sup> until the external liability is discharged.

### **Our provisional proposals**

- 12.116 In the Joint Consultation Paper we did not propose any substantive changes to the rules for distribution of assets on final settlement of accounts. We asked consultees whether section 44 of the 1890 Act operates in a satisfactory way and in particular where the "rule" in *Garner v Murray* applies.

### **Consultation**

- 12.117 The overwhelming response of the consultees who addressed the issue was that the current rules are satisfactory. Our consultant, Roderick Banks, has suggested that there might be merit in a statutory statement of the "rule" in *Garner v Murray*. The Institute of Chartered Accountants in England and Wales, on the other hand, suggested that the "rule" was well understood. However concerns were expressed about the position of the partner who leaves in his current account undrawn profits in order to provide liquidity to the partnership.
- 12.118 Taking the example in paragraphs 12.110 and 12.111 above, suppose that in addition to the advance of £2,000, Y left in his current account undrawn profits of £6,000. The payment of outside creditors (£2,000) and Y's advance (£2,000) would reduce assets of the partnership to £6,000. There would be an overall loss of £12,000 capital which would be paid first out of Y's profits (£6,000) and the balance made good by the partners equally (£2,000 each) in accordance with their equal profit shares, all in terms of s 44(a) of the 1890 Act. This, it was suggested

<sup>94</sup> See *Lindley & Banks*, para 25-52.

<sup>95</sup> See Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand*, *op cit*, at p 263.

<sup>96</sup> By reference to their shares of the profits under the default rule in the 1890 Act, s 44(b)(4).

to us, is a trap for the unwary.<sup>97</sup> It unfairly penalises the partner who is prepared to fund the partnership by not withdrawing his full entitlement to his profit share.

### **Reform recommendations**

12.119 We think that it would be appropriate to reformulate the default rules for the distribution of assets on the final settlement of accounts. First, we have recommended the abolition of the default rule that partners should share equally in the capital of the firm.<sup>98</sup> We think that it is in keeping with the expectations of business people that a partner should receive back the capital which he has invested in the firm if there are funds available to repay it. We also think that the obligation to make up deficiencies in capital is not in keeping with modern business practice. It is based on the principle of community of profits and losses (both external and internal), by which partners share equally any losses including losses of capital.<sup>99</sup> But it is not consistent with the view that a partner's capital is what he risks in the business and does not recover in the event of a deficiency.

12.120 We have also considered the circumstance, which is not infrequent in a failed partnership, where one or more of the partners has taken out of the firm more than his profit share and is thus in deficit in his current account. He will be a debtor of the partnership to that extent and should be required to repay his debt in the context of the settlement of accounts between the partners.

12.121 We think that the following would be appropriate default rules for the settlement of accounts.

12.122 First, partners<sup>100</sup> are to pay to the firm any sums which they are due to the partnership. Secondly, the assets of the firm, including the sums repaid by the partners, shall be applied in the following manner and order:

- (1) in paying the debts of the firm to persons who are not partners;
- (2) in paying to each partner rateably what is due from the firm to him for advances and undrawn profits;
- (3) in paying to each partner rateably what is due from the firm to him in respect of capital; and
- (4) in dividing the ultimate residue, if any, among the partners in the proportion in which profits are divisible.

<sup>97</sup> The trap is avoided if one treats undrawn profits as an advance to the partnership for the purposes of s 44(a). But it is not clear that undrawn profits are properly treated as a loan.

<sup>98</sup> See para 10.30 above.

<sup>99</sup> The recommendation to remove the default entitlement to equal shares of capital itself undermines the principle of community of profits and losses. We think that the removal of this equal entitlement is balanced by the removal of the obligation to contribute to deficiencies of capital.

<sup>100</sup> In this context a partner includes a person who ceased to be a partner on or after the break up of the partnership or the estate of such a person.

- 12.123 Thirdly, in the event that there is a deficiency of assets to meet the claims of third party creditors and the entitlement of partners to payment of advances and undrawn profits, the partners will be liable to contribute to the partnership towards that deficiency in the proportion in which they share losses.
- 12.124 This code would treat partners who had overdrawn their current account as debtors of the firm and partners who had made advances to the firm or had retained part of their profit share in the firm as its creditors.<sup>101</sup> Partners would be required to contribute to any deficiency of assets to meet those claims. By contrast, each partner would risk losing the capital which he had invested in the business unless sufficient funds were realised in the winding up to repay him. On this approach we do not need to be concerned with the rule in *Garner v Murray*.
- 12.125 In the event that a partner was not able to make his contribution to the deficiency of assets, the other partners would have to contribute in the proportion in which those partners share partnership losses.
- 12.126 Under this default regime a partner is obliged to contribute to a deficiency of assets to meet the firm's obligations to third party creditors of the firm and to partners (other than for repayment of capital contributions) only if he is secondarily liable for the obligations in question. Partners may have secondary liability to a third party creditor, for example because they were partners when the firm entered into the contract which gave rise to that liability. In addition, a continuing partnership may have given a former partner an indemnity when he resigned and some of the partners in the partnership may not have secondary liability to third party creditors in relation to whose claims the indemnity was given but may potentially be secondarily liable to the former partner under that indemnity. If a partner is personally liable for an obligation to the third party or would be personally liable under the indemnity to the former partner, he is liable to contribute to the deficiency of assets. By this means the norm in a partnership which has continued on changes in membership will be that the persons who are partners at the break up of the partnership will have liability to contribute to any shortfall to third parties and to their co-partners (except in respect of capital).
- 12.127 We emphasise that these rules are default rules. Where the partners have agreed a different set of rules in relation to partners' contributions in a winding up, those different rules will apply.
- 12.128 **We therefore recommend that the following should be the default rules on settlement of partners' accounts in a winding up:**
- (1) First, partners are to pay any sums which they are due to the partnership.**

<sup>101</sup> This would be consistent with an entity approach to partnership. The partners would also be creditors of the partnership in relation to their capital, but under our recommended scheme, a partner's capital would not be protected by any obligation of the other partners to contribute to deficiencies.

- (2) Secondly, the assets of the partnership, including the sums repaid by partners in (1) above, are to be distributed in the following manner and order:**
- (a) In paying the debts of the partnership to persons who are not partners;**
  - (b) In paying to each partner what is due from the partnership to him (other than in respect of capital);**
  - (c) In paying to each partner rateably what is due from the partnership to him in respect of capital; and**
  - (d) In dividing the ultimate residue, if any, among the partners in the proportion in which profits are divisible.**
- (3) If the partnership has insufficient assets to pay sums due to third party creditors and to repay to partners the sums due to them (other than in respect of capital), the partners individually shall contribute to the partnership towards that deficiency in the proportions in which they were liable to share partnership losses;<sup>102</sup>**
- (4) The partners who are liable to contribute under (3) above are those who are personally liable for the partnership obligations or who would be personally liable for an indemnity granted by the partnership to a former partner in respect of those obligations;**
- (5) If a partner is not liable or, as a result of insolvency, is not able to make his contribution to the deficiency in (3) above, the other partners shall contribute the additional amount needed to meet the deficiency in the proportions in which those partners are liable (as between themselves) to contribute to that deficiency; and**
- (6) In this context a “partner” includes a person who ceased to be a partner on or after the break up. (Draft Bill, cl 44)**

<sup>102</sup> For the default rule of equality of contribution to losses see draft Bill, cl 11(2).

# **PART XIII**

## **MISCELLANEOUS REFORMS, AND PROPOSALS WE HAVE NOT TAKEN FORWARD**

### **INTRODUCTION**

- 13.1 In this Part we discuss the proposals for the reform of partnership law which we have not considered elsewhere in this report, and also the proposals and questions which we made or raised in the Joint Consultation Paper but which, in the light of the response of consultees, we have decided not to convert into recommendations.<sup>1</sup>
- 13.2 The miscellaneous reforms comprise our proposals in relation to various provisions of the 1890 Act, a provision in relation to notices, amendments to the Business Names Act 1985 and a proposal in relation to Scottish criminal procedure. The principal matter which we are not taking forward is the option of introducing a new registered partnership into the law of partnership in both jurisdictions.

### **MISCELLANEOUS REFORM RECOMMENDATIONS**

#### **The repeal of section 3 of the 1890 Act**

- 13.3 Section 3 of the 1890 Act provides:
- In the event of any person to whom money has been advanced by way of loan upon such a contract as is mentioned in the last foregoing section,<sup>2</sup> or of any buyer of a goodwill in consideration of a share of the profits of the business, being adjudged a bankrupt, entering into an arrangement to pay his creditors less than one hundred pence in the pound, or dying in insolvent circumstances, the lender of the loan shall not be entitled to recover anything in respect of his loan, and the seller of the goodwill shall not be entitled to recover anything in respect of the share of profits contracted for, until the claims of the other creditors of the borrower or buyer for valuable consideration in money or money's worth have been satisfied.
- 13.4 In the Joint Consultation Paper<sup>3</sup> we said that the policy behind the section is a relic of old case law in which the recipient of a share of the profits of the business was held liable as a partner for its debts and obligations. We suggested that the postponement of the rights of the lender has an adverse impact today, particularly in start-up and rescue financing, by penalising loans with a variable rate of interest.

<sup>1</sup> We have also discussed such proposals in the individual Parts where they have been intimately connected to the topics in relation to which we are recommending reforms.

<sup>2</sup> The reference is to s 2(3)(d) of the 1890 Act which refers to a contract of loan to a person engaging in business which gives the lender either a right to receive a rate of interest varying with the profits or a right to a share of the profits of the business.

<sup>3</sup> Joint Consultation Paper, paras 5.44 – 5.50.

We provisionally proposed that section 3 should be repealed. Consultees unanimously agreed, although the APP suggested that the repeal should relate only to new transactions.

- 13.5 **We therefore recommend that section 3 of the 1890 Act (which postpones the rights of certain creditors of a partnership) should not be re-enacted in the draft Partnerships Bill.**

#### **Revocation of continuing guarantee by change in membership of partnership**

- 13.6 Section 18 of the 1890 Act provides:

A continuing guaranty or cautionary obligation given either to a firm or to a third person in respect of the transactions of a firm is, in the absence of agreement to the contrary, revoked as to future transactions by any change in the constitution of the firm to which, or of the firm in respect of the transactions of which, the guaranty or obligation was given.<sup>4</sup>

- 13.7 In the Joint Consultation Paper we questioned whether there was a need to retain section 18 in relation to guarantees given to the partnership if many partnerships had continuity of partnership on a change in membership. We suggested that the provision made little sense where the partnership was the creditor in the primary obligation. We also asked whether there was a need for the provision where the guarantee is that the partnership (as the debtor in the primary obligation) will perform its obligation.<sup>5</sup>

- 13.8 Consultees were not exercised by the proposal. While the principle that a guarantor should be released from liability where the creditor alters his risk without obtaining his consent is important, section 18 rarely results in the revocation of a guarantee. The parties to the guarantee can specify in the guarantee whether the obligation depends on the membership of the partnership remaining unchanged. Thus, where a person gives a guarantee to a partnership as a result of a personal connection with one of the partners, he can make it clear whether his obligation is to survive that partner's departure from the partnership. We have recommended continuity of partnership as a default rule. In this context a change in the membership of the partnership may not, in any event, be readily perceived as an alteration of risk. In the light of the consultation response we see no need to re-enact section 18.

- 13.9 **We therefore recommend that section 18 of the 1890 Act is not re-enacted.**

#### **Order charging a partner's share (English law)**

- 13.10 Section 23(2) and (3) of the 1890 Act set out the procedure by which a judgment creditor of a partner may obtain a court order charging the partner's share in the

<sup>4</sup> This provision was a re-enactment of the Mercantile Law Amendment Act 1856, s 7 and the Mercantile Law Amendment (Scotland) Act 1856, s 4, which were repealed by the 1890 Act, s 48.

<sup>5</sup> Joint Consultation Paper, paras 23.2 – 23.6.

partnership with the amount of the judgment debt and interest thereon. The section empowers the court to appoint a receiver over the partner's share and to give directions for accounts and inquiries. It also provides that if the court directs a sale of the partner's share, the other partner or partners may purchase the share.<sup>6</sup>

- 13.11 In the Joint Consultation Paper we suggested that there was no need to alter the rules to take account of the introduction of separate legal personality.<sup>7</sup> Consultees did not dissent.<sup>8</sup>
- 13.12 **We therefore recommend that sections 23(2) and (3) of the 1890 Act should be re-enacted in modern language.** (Draft Bill, cl 46)

### **The rights of an assignee of a share in a partnership**

- 13.13 Section 31 of the 1890 Act sets out the rights of an assignee of a share in a partnership. While the partnership continues, the assignee is not allowed to interfere in the management of the partnership business or to require any accounts of partnership transactions or to inspect the partnership books. His rights are confined to receiving the share of profits to which the assigning partner would otherwise be entitled and he must accept the account of profits which the partners have agreed. On dissolution of the partnership or on the withdrawal of the assigning partner,<sup>9</sup> the assignee is entitled to receive the assigning partner's share of the value of the partnership's net assets and to an account for the purpose of ascertaining that share.
- 13.14 In the Joint Consultation Paper we asked consultees whether the principle in section 31 should be extended to anyone acquiring a partner's share by operation of law while the partner remains a partner.<sup>10</sup> Most consultees thought that the section should be so extended but one consultee was unaware of the issue arising in practice. Several consultees thought that there was no need to extend section 31 as it already covered assignments by operation of law. Two consultees suggested that it should be made clear that the section also applies on a partial assignment of a share.
- 13.15 We think that it should be made clear that the restriction on an assignee's involvement in management applies both in voluntary assignments (whether whole or partial) and also assignments arising by operation of law (as, for example, on the bankruptcy of a partner or the liquidation of a corporate partner).

<sup>6</sup> In para 8.110 above we recommend that a partner may be expelled if he allows his share to be so charged. See the draft Bill, cl 31.

<sup>7</sup> Joint Consultation Paper, paras 18.5 – 18.7.

<sup>8</sup> Professor Webb suggested that it should be made clear that a charging order should be a remedy of last resort.

<sup>9</sup> The withdrawal of the partner is described in the 1890 Act, s 31(2) as the dissolution of the partnership "as respects the assigning partner". This is consistent with the idea of "technical dissolution" by which a partner is dissolved in law on a change in membership but the partners who remain in the business treat the partnership as continuing.

<sup>10</sup> Joint Consultation Paper, paras 23.11 – 23.16.

- 13.16 We do not recommended the re-enactment of section 31 of the 1890 Act in so far as it (a) prevents an assignee during the continuance of the partnership from requiring accounts of the partnership transactions and (b) requires the assignee to accept the account of profits agreed by the partners. We envisage that there may be circumstances where an assignee could legitimately apply to the court for an account, where, for example, it was evident that the other partners were not disclosing the firm's true profits or the assignor's share of those profits. We do not recommend giving the assignee a right to the production of accounts by the partners on demand and think that he should not have a right to inspect the firm's records. But we do not wish to exclude the possibility that the court might in an appropriate case order an account.
- 13.17 **We recommend that assignees of a partner's share (whether by voluntary assignment or by involuntary assignment on death, insolvency or otherwise) should not be allowed to take part in the management of the partnership business or affairs. Such assignees should not be entitled to inspect the partnership's records.** (Draft Bill, cl 36)

#### **Publicity for departure of a partner or break up of a partnership**

- 13.18 Section 37 of the 1890 Act provides:
- On dissolution of a partnership or retirement of a partner any partner may publicly notify the same, and may require the other partner or partners to concur for that purpose in all necessary or proper acts, if any, which cannot be done without his or their concurrence.
- 13.19 This is an important provision as it enables a partner to notify the public and the partnership's customers or clients of the termination of his secondary liability for debts incurred after the date of notification.<sup>11</sup> In the Joint Consultation Paper we proposed no change to the substance of this section.<sup>12</sup> Consultees did not comment on the issue.
- 13.20 **We therefore recommend that section 37 of the 1890 Act (publicity for departure of a partner or break up of partnership) should be re-enacted in modern language.** (Draft Bill, cl 41)

#### **Repayment of premium on premature break up of partnership**

- 13.21 In the Joint Consultation Paper we said that we saw no need to alter the substance of section 40 of the 1890 Act which provides for the repayment of all or part of a premium paid on entering a partnership for a fixed term,<sup>13</sup> when that partnership

<sup>11</sup> See the 1890 Act s 36(1) and (2).

<sup>12</sup> Joint Consultation Paper, para 23.22.

<sup>13</sup> In our recommended reforms and in the draft Bill we draw a distinction between a partnership of defined duration and a fixed term partnership. The former is a partnership in which the partnership agreement provides that the partnership is to end on the expiry of a specified period or on the accomplishment of a venture that the partnership was formed to undertake (cl 76(1)). A fixed term partnership is one where the partnership agreement provides that the partnership is to end on the expiry of a specified period (cl 52(6)).

is prematurely dissolved.<sup>14</sup> Consultees did not comment on the issue but we have since received representations that the provision remains useful and should be re-enacted.

- 13.22 **We therefore recommend that the substance of section 40 of the 1890 Act should be re-enacted: where a partner in a fixed term partnership has paid a premium to another partner in respect of the formation of the partnership and the partnership breaks up before the end of its term, the court should have power to order the repayment of the whole or part of the premium.** (Draft Bill, cl 52)

#### **Amendments to the Business Names Act 1985**

- 13.23 It is appropriate to amend the Business Names Act 1985 (the 1985 Act) in consequence of our recommended reforms. The proposed amendments are principally to apply the 1985 Act to partnerships which are legal persons and to limited partnerships. In particular, we propose (a) to apply the 1985 Act to a limited partnership which carries on business in Great Britain under a name which does not consist of its registered name, without any addition other than one permitted under the 1985 Act, (b) to require a limited partnership to disclose its registered name and the name of each general partner, (c) to provide that if a partnership which is a legal person uses a prohibited name or does not comply with the disclosure requirements of the 1985 Act, each of its partners (or in the case of a limited partnership each of its general partners) may be guilty of an offence, and (d) to apply the 1985 Act to foreign limited partnerships which have a place of business in Great Britain and carry on business in Great Britain.
- 13.24 **We therefore recommend that the Business Names Act 1985 should be amended in consequence of our recommended reforms of partnership law.** (Draft Bill, cl 75 and Schedule 11)

#### **Criminal proceedings against partnerships (Scots law)**

- 13.25 In the Joint Consultation Paper we pointed out the anomaly that, while it is possible for the Crown to bring summary proceedings against partnerships in their own name, it is not possible so to bring solemn proceedings.<sup>15</sup> There may be cases where the Crown would wish to use solemn procedure, for example where a partnership has caused many deaths by selling poisonous food, in order to impose heavier sentences than those available under summary procedure. We therefore provisionally proposed that it should be possible to prosecute partnerships not only by summary procedure but also by solemn procedure.<sup>16</sup> The consultees who responded to this proposal unanimously agreed with it. As this recommendation involves the amendment of legislation on criminal procedure we have not included it in the draft Bill but will inform the Scottish Ministers of the recommendation.

<sup>14</sup> Joint Consultation Paper, para 23.22.

<sup>15</sup> Joint Consultation Paper, para 23.19. The Criminal Procedure (Scotland) Act 1995, s 143 provides for the prosecution on summary procedure of a “partnership, association, body corporate or body of trustees”. Section 70 of that Act, on solemn proceedings, refers only to bodies corporate.

<sup>16</sup> Joint Consultation Paper, para 23.20.

- 13.26 **We therefore recommend that section 70 of the Criminal Procedure (Scotland) Act 1995 should be amended to provide for the prosecution of partnerships as well as bodies corporate.**

#### **PROPOSALS THAT WE HAVE NOT TAKEN FORWARD**

##### **The registered partnership**

- 13.27 In Part XX of the Joint Consultation Paper we set out a possible scheme for conferring separate legal personality on partnerships by registering the partnership in a register of partnerships. We suggested that the registered partnership would provide greater certainty to partners and to outside parties than the present informal partnership. The register would disclose the identity of partners and the dates of their joining and leaving a continuing partnership. It would offer greater certainty as to the status of partners and the duration of a partner's liability for partnership debts. It might also assist in the ownership and transfer of property and in obtaining recognition of the partnership in foreign jurisdictions.
- 13.28 Most consultees opposed the introduction of the scheme either as the exclusive means of the introduction of separate legal personality or as an option where legal personality was available without registration. Arguments advanced against the scheme included the following. It would create unnecessary bureaucracy and administrative burdens. Operating the scheme would be costly. The scheme would be complex. Few partnerships would register as many of the benefits were for third parties and not the partners and there would be penalties for failure to keep the register up to date. If registration were necessary to confer legal personality there would be partnerships with and partnerships without legal personality. That would require complex rules. There was also the danger of public confusion between too many sorts of partnerships as there would be unregistered general partnerships and registered partnerships as well as limited partnerships and LLPs. Such support as there was for the option of the registered partnership was generally lukewarm but one consultee was in favour as a means of allowing a partnership to grant a floating charge.
- 13.29 As we have recommended both the introduction of separate legal personality without registration and a new default rule of continuity of partnership, we think that there would be few advantages to partners from the introduction of the registered partnership which would provide an incentive for them to register. We are also aware of the financial and administrative burden which the scheme could entail and the danger of public confusion by a proliferation of different forms of partnership. We have therefore concluded that we should not recommend the introduction of a registered partnership.

##### **The power to grant floating charges**

- 13.30 In Part XXII of the Joint Consultation Paper we discussed the power of partnerships to grant charges and rights in security over partnership assets. We provisionally proposed that unregistered partnerships with legal personality should be able to grant charges or rights in security in the same way as individuals.<sup>17</sup>

<sup>17</sup> Joint Consultation Paper, para 22.30.

- 13.31 The Law Commission is consulting on proposals that, in English law, partnerships, other non-corporate bodies and individuals should be empowered to grant floating charges.<sup>18</sup> This consultation exercise has revealed wide-ranging support for the proposition that partnerships should be able to grant floating charges. The Law Commission will address this issue in the context of their wider review of charges. In Scotland, the floating charge is a statutory creation and was introduced in 1961.<sup>19</sup> The Scottish Law Commission is consulting on a review of the registration of company charges in Scotland<sup>20</sup> and recognises the need for a review of the law of securities, particularly over corporeal and incorporeal moveable property, in the future.
- 13.32 We do not propose to deal with the issue whether partnerships should be able to grant floating charges except in the context of a wider reform of the law relating to floating charges. Accordingly we have not taken the issue forward in this project.

### **Preserving the rules of equity and common law**

- 13.33 The law of partnership was, until 1890, judge-made law. In England it was the creation of common law and equity; in Scotland the creation of the common law. The 1890 Act was only a partial codification. As Prime and Scanlan<sup>21</sup> state, “the codification was substantial rather than complete”. Section 46 of the 1890 Act provides:

The rules of equity and common law applicable to partnership shall continue in force except so far as they are inconsistent with the express provisions of this Act.

- 13.34 In the Joint Consultation Paper we proposed that the rules of equity and common law should be expressly preserved in the new Partnership Act.<sup>22</sup> There was almost unanimous support among consultees who addressed this issue, although one consultee argued for a more comprehensive codification of the law instead.
- 13.35 Notwithstanding that support, we have revised our view on the appropriateness of such a clause in the light of advice which we have received on current practice in Parliamentary drafting. We recognise that such a statutory statement merely confirms the effect of a new Partnerships Act which, like the 1890 Act, would be an incomplete statement of partnership law. Rules of common law and equity (or in Scotland rules of common law) would continue to be relevant whether or not the statement was included in the draft Bill. The repeal of the 1890 Act would not revive anything which is not in force at the time the repeal takes effect. Thus the pre-1890 Act rules which were inconsistent with the 1890 Act would not revive.<sup>23</sup>

<sup>18</sup> Registration of Security Interests: Company Charges and Property other than Land, Consultation Paper No 164.

<sup>19</sup> The Companies (Floating Charges) (Scotland) Act 1961.

<sup>20</sup> Registration of Rights in Security by Companies, Discussion Paper No 121.

<sup>21</sup> Prime & Scanlan, *The Law of Partnership* (1<sup>st</sup> ed 1995) p 1.

<sup>22</sup> Joint Consultation Paper, paras 23.17 – 23.18.

<sup>23</sup> The Interpretation Act 1978, s 16(1) provides that “where an Act repeals an enactment, the repeal does not, unless the contrary intention appears, - (a) revive anything not in force or existing at the time at which the repeal takes effect...”.

But those rules which were consistent with the 1890 Act and which have developed since 1890 would be preserved except so far as they are inconsistent with the provisions of the new Partnerships Act.

- 13.36 While a provision like section 46 of the 1890 Act has assisted a court in one reported case to determine how far another provision in a Partnership Act has affected the developing common law,<sup>24</sup> we doubt whether it is actually needed.
- 13.37 We therefore recommend that there should not be an express provision in the new Partnerships Act preserving the rules of equity and common law in England and Wales, and in Scotland the rules of the common law, except so far as they are inconsistent with the express provisions of that Act.

### **A model partnership agreement**

- 13.38 In the Joint Consultation Paper<sup>25</sup> we discussed the benefits and limitations of a model agreement. We expressed the provisional view that if the default rules of the 1890 Act were modernised there would be less need for any officially approved model agreement. We doubted if we could overcome the problems of formulating a model agreement that addressed fully the needs of all types of partnership: there is no such thing as a standard form partnership. We pointed out that there was nothing to prevent commercial organisations from producing model agreements if they thought there was a market for them.<sup>26</sup>
- 13.39 Most consultees supported our provisional views, emphasising the impracticality of a detailed model agreement which could readily be adapted to suit different partnerships. While there was no substitute for a carefully drawn up partnership agreement which addressed the needs of the particular venture, it was sufficient for the statute to provide a simple and robust default code. The minority who favoured an official model agreement stressed that it could operate as a starting point for drawing up an agreement to suit the particular partnership. One consultee suggested that it would draw the attention of less experienced individuals to the issues which they needed to consider when entering into partnership.
- 13.40 In view of the consultation response we confirm our provisional view and have not prepared a model partnership agreement.

### **Employment of partner by a partnership**

- 13.41 In the Joint Consultation Paper we pointed out that there was doubt in Scots law (which accords separate personality to a partnership) whether a partnership can enter into a contract of employment with one of its partners.<sup>27</sup> We provisionally

<sup>24</sup> See *Geisel v Geisel* (1990) 72 DLR 245, where Ferg J held that the equivalent of s 10 of the 1890 Act did not exclude a claim by the family of a deceased partner against his partner for negligently causing his death.

<sup>25</sup> Joint Consultation Paper, Part XVI.

<sup>26</sup> See, eg, T Sacker, *Practical Partnership Agreements* (1995) and Roderick Banks, *Encyclopaedia of Professional Partnerships* (1987) (looseleaf: latest update 2003).

<sup>27</sup> See *Allison v Allison's Trustees* (1904) 6 F 496; *Fife County Council v Minister of National Insurance* 1947 SC 629.

proposed that if a partnership was to have separate legal personality it should be able to enter into a contract of employment with one of its partners.<sup>28</sup>

13.42 In both jurisdictions consultees were divided in their response to this proposal. On reflection we are persuaded by the arguments of consultees who stressed that the status, rights and obligations of a partner were wholly different from those of an employee. In addition, a dual role as a partner and an employee could call into question the tax status of the partner and even the existence of the partnership.

13.43 **We therefore recommend that a partnership should not be capable of engaging a partner as an employee.** (Draft Bill, cl 7(4))

#### **Abolition of the twenty-partner limit**

13.44 Except for certain professional firms, partnerships were illegal if they had more than twenty partners.<sup>29</sup> In the Joint Consultation Paper we proposed that the size restriction affecting partnerships should be abolished.<sup>30</sup> Consultees agreed. The Department of Trade and Industry have consulted separately on the issue and the Government has removed the twenty partner limit for all partnerships with effect from 21 December 2002.<sup>31</sup>

<sup>28</sup> Joint Consultation Paper, para 23.21.

<sup>29</sup> See Companies Act 1985, ss 716 and 717 and the 1907 Act, s 4(2) for limited partnerships.

<sup>30</sup> Joint Consultation Paper, paras 5.51 – 5.61.

<sup>31</sup> See Regulatory Reform (Removal of 20 Member Limit in Partnerships etc) Order 2002 (SI 2002/3203).

## **PART XIV**

# **TRANSITIONAL PROVISIONS**

### **INTRODUCTION**

- 14.1 In this Part we deal with the means by which the provisions of a new Partnerships Act may be introduced. There is a risk that some parties' contractual arrangements may be altered by the implementation of our recommendations which would change both the obligatory rules of partnership and the default rules which govern partners' relations with each other. There is also a need to adapt the rules relating to limited partnerships, including the requirements of registration, to the new law. We therefore require to address the issue of transitional arrangements.

### **OUR PROVISIONAL PROPOSALS**

- 14.2 In the Joint Consultation Paper we suggested that the introduction of continuing legal personality by operation of law would be a clear change from the existing position in English law.<sup>1</sup> We set out three options.
- 14.3 The first was to introduce legal personality and a default rule of continuity of partnership to all partnerships from the commencement of legislation implementing the reforms. The second option was to delay the introduction of both legal personality and the default rule of continuity of partnership until a fixed date some time after the commencement of the legislation, to allow partnerships which wished to do so to organise their affairs in the light of the proposed reform. The third option was to apply the new provisions only to partnerships created after the new law came into force.<sup>2</sup>
- 14.4 We examined each of the options. The first option had the drawback that it would involve retrospective legislation which would re-write parties' contracts and possibly affect third parties who let land and buildings to a partnership. Our provisional view was that the new law should not be introduced in this manner.
- 14.5 The second option, which we provisionally favoured, was to provide a transitional period of two or three years for the application of the new law to partnerships. This option avoided the instantaneous alteration of parties' rights and had the advantage of creating a degree of certainty, as after a fixed date the new legislation would apply to all partnerships. This was the approach adopted in RUPA.<sup>3</sup> We recognised that it might not be possible for partners to reach consensus on the re-negotiation of the terms of their partnership agreement and that, as a result, there was a risk that some partnerships might be dissolved during the transitional period. We asked consultees whether a partner in a partnership which exists at the date of commencement of the legislation should have the option during the

<sup>1</sup> In this context we were concerned not only with the issue of separate legal personality which we envisaged would be a mandatory characteristic of all partnerships but with continuity of personality which would be a default rule.

<sup>2</sup> Joint Consultation Paper, paras 4.46 – 4.56.

<sup>3</sup> RUPA, s 1006.

transitional period to elect that the partnership should not have continuity of partnership.<sup>4</sup> A partner could exercise the option and avoid having to dissolve an existing partnership.

- 14.6 The third option, to apply the new law only to partnerships created after the new law came into force, avoided re-writing parties' contracts. But there could be doubt as to when a partnership was formed or reformed after a change of partner. There was thus a risk of uncertainty as to whether a partnership was subject to the new rules. We were not sure if the uncertainty would be sufficiently widespread as to give rise to practical difficulties but invited comments on all of the options.

### **CONSULTATION**

- 14.7 In both jurisdictions there was general support for our provisional view in favour of a transitional period (the second option).<sup>5</sup> There was only limited opposition to the proposal. One consultee opposed the imposition of new rules on existing partnerships. Another consultee favoured a modification of option 3 so that the new default rules would not apply to a partnership until it chose to adopt all or any of the new rules. There was only limited support for option 1, which one consultee suggested would be practicable if there were a delay between enactment and implementation and publicity in the interim.
- 14.8 The APP supported a modified version of option 3 as they were concerned about altering the rights of partners who had deliberately chosen to be governed by the existing default code which allowed a partner to seek a winding up of a partnership on death or withdrawal. They suggested that separate legal personality should be introduced to all partnerships after a transitional period but that the new default rules should apply only to new partnerships formed after the commencement of the legislation. They recognised that their approach created problems and suggested solutions to those problems. The first problem was to identify when an old partnership had become a new one and thus subject to the new default rules. The solution which they suggested was that the old default rules should continue to apply until either (a) the partners decided that the new rules should apply or (b) the business carried on by the partners ceased and a new business commenced (even if carried on by the same partners). The second problem was how to ascertain whether a pre-existing partnership, which had acquired separate legal personality, had continuity of partnership after it had acquired legal personality. The solution which the APP proposed was that on a change of partners a partnership would have continuity of partnership unless the partners decided that there should be a change of personality. Third parties dealing with a partnership could treat the partnership as continuing unless they had notice of a change of personality.

<sup>4</sup> The issue of legal personality is separate from that of continuity of personality. The first will be mandatory; the second will be a default rule. In the Joint Consultation Paper we addressed the particular problems of landlords and tenants in Scottish agricultural holdings and concentrated on the issue of continuity of personality. As a result of the consultation exercise and further advice we have broadened our proposals to include all of the default rules. See paras 14.11 – 14.12 below.

<sup>5</sup> Eleven out of fourteen consultees in England and Wales who responded to the questions supported option 2; the equivalent figures in Scotland were seven out of eleven.

- 14.9 In Scotland, the Faculty of Advocates preferred option 3 as they thought that the difficulties created by the uncertainty which we apprehended would be very limited. If option 3 were not preferred, they supported option 2. Another consultee opposed option 3, arguing that the old default rules required to be replaced as soon as possible. He favoured option 2 but suggested that there required to be some protection for a partner or third party who was materially prejudiced by the introduction of the new rules but who was unable to reach agreement with the other parties as to the alteration of the relevant contractual arrangements. If option 2 were adopted, both the Faculty of Advocates and David Guild supported the idea of giving a partner in an existing partnership the right to elect that the partnership should not have continuity of partnership.<sup>6</sup>
- 14.10 There was general support for a transitional period of two years if option 2 were adopted. The Partnership Advisory Group of the Scottish Law Commission suggested that the court should have power to make an order during the transitional period to extend the two-year period by one year where a partner would suffer severe prejudice as a result of the introduction of continuity of personality as a default rule.
- 14.11 Since the end of the consultation period we have had the benefit of further views in the partnership law conference in London in June 2001 and in the seminar in Manchester in December 2001. We have also discussed the issues with Roderick Banks and with representatives of the APP. Those views and discussions have alerted us to the need to provide a mechanism to protect the interests of partners who have deliberately adopted the existing default code as their partnership agreement so that they can dissolve and wind up a partnership on death or withdrawal from the partnership. It is not just the issue of continuity of partnership but also other rules of the proposed default code which alter the rights of existing partners. In particular, the restriction on the right of an outgoing partner to insist on the winding up of a partnership, which is an important component of our recommendations for continuity of partnership, may be contrary to the wishes of an existing partner and contrary to his existing contractual rights. Where partners have entered into a partnership contract which opts out of the existing default code, the rules of that partnership agreement will prevail over the new default code. There no problem arises. The mischief is where the parties have knowingly adopted the existing default code but have not entered into an agreement contracting out of it.
- 14.12 There was therefore considerable support for the idea of allowing a partner to elect to preserve the existing terms of the default code of the 1890 Act as the contractual terms which govern inter-partner relations within a partnership. This would allow a partner, who had not been able to reach agreement with other partners on the express terms of a new partnership agreement before the end of the transitional period, in effect to veto the alteration of his rights and obligations which the imposition of a new default code would entail. As the election would

<sup>6</sup> While there was no support for this proposal among English consultees, the City of Westminster Law Society and Holborn Law Society and Nick Openshaw suggested that a partner should have the right to require the partnership to opt out of the new default rules. Further discussions and advice after the end of the consultation period disclosed wider support for this proposal. See paras 14.11 – 14.12 below.

merely preserve the status quo of the internal regulation of the partnership, there would be no need to keep the 1890 Act on the statute book. Its terms would be preserved as a matter of contract between the partners to govern their relations with each other.

#### **REFORM RECOMMENDATIONS**

- 14.13 We recognise the advantage of allowing parties to review their contractual arrangements before the introduction of separate legal personality and a new default code which provides for continuity of partnership on changes of partners. While it may be only rarely that partners deliberately adopt particular provisions of the existing default code without entering into a written agreement which sets out the terms of their contract, it is necessary to cater for such circumstances.
- 14.14 In the Joint Consultation Paper we had treated the introduction of continuity of partnership as the main issue which transitional provisions required to address; but consultees have persuaded us that that is only one aspect of the problem. The issue which appears to have caused certain consultees the greatest concern is the possible loss of the existing default right of a partner to insist on the winding up of a partnership on his withdrawal. It is an integral part of our recommendations encouraging continuity of partnership that that right should be curtailed in a reformed default code. We believe that most partners will not be alarmed by our recommendations in relation to the right of the outgoing partner as these reflect what many partners sign up to in their partnership agreements.<sup>7</sup> But we see force in the suggestion that we should not impose the new default code on partnerships or individual partners who do not wish their affairs to be regulated by that code.
- 14.15 To protect the interests of such partnerships and partners we think that there should be a transitional period of two years<sup>8</sup> after the commencement of legislation before the new rules contained in the legislation apply to all partnerships.<sup>9</sup> This period should be sufficient to give partners an opportunity to consider the changes to the rules of partnership law which the legislation will introduce and to amend their partnership agreements. Partnerships formed after the commencement of the legislation and before the end of the transitional period will be subject to the new rules from their formation, except in so far as they contract out of the default rules.
- 14.16 For the purposes of the transitional provisions we recommend that a partnership will not be treated as being formed after the commencement of the legislation merely by a “technical dissolution” during the transitional period. In other words, if the “new” partnership comes into being during the transitional period merely as a result of the withdrawal of a partner from a pre-existing partnership or any other change in membership of that partnership, such as the assumption of a new partner, the new provisions should not apply during the remainder of the transitional period. This can be done by providing that, if on a change of

<sup>7</sup> See Part VIII above.

<sup>8</sup> States which have adopted RUPA have selected transitional periods of various lengths ranging from 21 days in West Virginia to 5 years in Texas. But several states, including Florida, have adopted a two-year period.

<sup>9</sup> The default rules will apply only to the extent that the partners have not agreed otherwise or a partner has elected to preserve the existing default rules.

membership during the transitional period, the “new” partnership (a) has substantially the same membership and (b) succeeds to the whole or substantially the whole business of the “old” partnership, the new provisions should not apply to the “new” partnership until the end of the transitional period. There is a precedent for using the concept of “substantially the same” membership and business in relation to the technical dissolution of a partnership in the Financial Services and Markets Act 2000.<sup>10</sup> We think that the concept, although vague, is satisfactory, particularly where it will be effective only during the transitional period.

14.17 Existing partnerships may elect, by unanimous decision, to be governed by the provisions of the new Act during the transitional period by altering their partnership agreements. For the sake of certainty we think that the election should be in writing and signed by the partners. At the end of the transitional period the provisions of the new Act will apply to all partnerships, except in so far as partnerships contract out of the default rules.<sup>11</sup> This will promote certainty; after the transitional period the 1890 Act will cease to govern partnerships and parties can look to the new legislation both for obligatory rules of partnership law and for the default code.<sup>12</sup>

14.18 We think that it is important to protect the partner who wishes to preserve his rights under the existing default code but who is not able to persuade his partners to agree to terms on which to contract out of the new default code. We are not persuaded that it is necessary to adopt a complex scheme such as that suggested by the APP.<sup>13</sup> It is sufficient if a partner is given a veto against the adoption of the new default rules. We therefore recommend that a partner should have the right during the transition period to elect to preserve the existing rules of the default code of the 1890 Act which govern internal relations within the partnership. If the partnership has an agreement which supplants the existing default code, the terms of that agreement will supplant the new default code. In that circumstance the partner will not need to act to preserve his existing rights. It is only where the partner wishes to preserve rights which he has under the existing default code that he requires to make the election. The effect of the election would be to keep in

<sup>10</sup> Section 32 of the Financial Services and Markets Act 2000 provides that an authorisation is not affected by a change in the membership of a partnership and that if an authorised partnership is dissolved its authorisation continues to have effect in relation to any firm which succeeds to the business of the dissolved firm. Section 32(3) provides that a firm succeeds to the business of another firm only if (a) the members of the resulting firm are substantially the same as those of the former firm and (b) the succession is to the whole or substantially the whole of the business of the former firm.

<sup>11</sup> If the partners in an existing partnership have entered into a partnership agreement which contracts out of the default rules of the 1890 Act, that agreement will continue to have effect. The terms of the partnership agreement will displace the new default rules to the extent that they are inconsistent with those default rules.

<sup>12</sup> The 1890 Act will remain relevant to those partnerships which have adopted the terms of that Act to govern the rights and obligations of partners in relation to each other. But that will simply be a question of contract and the 1890 Act can be repealed in Great Britain (but not Northern Ireland) with effect from the end of the transitional period.

<sup>13</sup> See para 14.8 above.

being the default rules of the 1890 Act as terms of the agreement which governs the internal relations of the partnership in question.<sup>14</sup>

14.19 We are not aware of circumstances which suggest that similar protection should be given to third parties who have transacted with partnerships on the understanding that there is no continuity of partnership. In theory, an owner of land or buildings who granted a lease to a partnership could be prejudiced if the partnership obtained continuity of partnership and thus continuing separate legal personality during the currency of the lease. The possible mischief is as follows. Under existing English law (and possibly Scots law) a change of partners would dissolve the partnership and, depending on the terms of the lease, could bring the lease to an end. Continuity of personality would (in Scots law) preserve the partnership as tenant and thus keep the lease in existence. But we doubt whether this is a significant practical problem as a landlord who wished to terminate the lease on a change of partners would be likely to include a provision to that effect in the lease. We also see no need to make special provision for farming partnerships in Scottish agricultural holdings, which we discussed in the Joint Consultation Paper.<sup>15</sup> If (as we recommend) the right to elect to preserve the default code is given to a partner (whether a general partner or a limited partner) in a limited partnership as well as to a partner in a general partnership, this should provide sufficient protection to landlords who enter into agricultural partnerships with farmers.

14.20 The draft Bill contains clauses<sup>16</sup> enabling the Secretary of State to make transitional provisions, consequential amendments and savings by statutory instrument. We outline below the structure of the transitional provisions which we consider to be appropriate and the provisions of the draft Bill which empower the Secretary of State to make the relevant regulations.

#### **14.21 We therefore recommend that:**

- (1) There should be a transitional period of two years starting with the commencement date of the new Partnerships Act; (Draft Bill, cl 79(4))**
- (2) During the transitional period a partnership formed before the commencement date (“an old partnership”) will, subject to (3) below, continue to be governed by the mandatory and default rules of the 1890 Act; (Draft Bill, cl 79(1))**
- (3) If during the transitional period an old partnership decides, by unanimous decision which is signed and in writing, that the provisions of the new Partnerships Act should apply to it before the**

<sup>14</sup> We think that such a veto is consistent with principle. It reflects the fact that all the partners originally agreed (tacitly or expressly) that their internal relations should be governed by the 1890 Act default code. In the absence of a like agreement that the new default rules should apply (evidenced by the partner’s veto) the original agreement must continue.

<sup>15</sup> Joint Consultation Paper, paras 4.49 and 4.54.

<sup>16</sup> Clauses 78 and 79.

**end of the transitional period, the new provisions will apply from the date of, or provided for in, that decision;** (Draft Bill, cl 79(3)(b))

- (4) At the end of the transitional period the provisions of the new Partnerships Act will apply to all partnerships whenever formed;** (Draft Bill, cl 79(3)(a))
- (5) A partner in an old partnership may, during the transitional period unilaterally elect that the partnership shall after the end of the transitional period continue to be governed by the default rules of the 1890 Act. The election must be in writing and be signed by the electing partner;** (Draft Bill, cl 79(3)(d))
- (6) Partnerships formed after the commencement date, whether or not during the transitional period, will, from their commencement, be subject to the provisions (including, where applicable, the new default rules) of the new Partnerships Act;** (Draft Bill, cl 79(1) and (2))
- (7) A “new” partnership, which is created during the transitional period merely by a change in membership of an old partnership, will not be treated as formed after the commencement date (for the purposes of (6) above) provided (a) its membership is substantially the same as the old partnership and (b) it succeeds to the whole or substantially the whole of the business of the old partnership. This rule applies also to subsequent “new” partnerships so created during the transitional period;** (Draft Bill, cl 79(3)(c))
- (8) Neither the default scheme under the 1890 Act nor the default scheme under the new Partnerships Act will apply to a partnership whose agreement provides for different terms.**

#### **Partnership property: transitional provisions**

14.22 There may be circumstances, particularly in England, in which an existing partnership has arranged that partnership property is held in trust for named partners. Such property, which is partnership property under the 1890 Act, would not be partnership property under the draft Bill because it is held in trust for persons other than the partnership entity.<sup>17</sup> We think that it is necessary therefore to have a transitional provision to allow such property to be treated as partnership property.

14.23 As there is an adequate mechanism in the draft Bill for holding property as partnership property in the future, we need a provision only for property which is presently partnership property but which would not be partnership property under the draft Bill. We think that the appropriate mechanism is to provide that property of an old partnership which is partnership property on the date when the new Partnerships Act first applies to that partnership will remain partnership property

<sup>17</sup> See the draft Bill, cl 17.

under the new Partnerships Act. We think that the power of the Secretary of State in the draft Bill to make transitional provisions is wide enough to include such a provision.

- 14.24 **We therefore recommend that there should be a transitional provision that the partnership property of an old partnership on the date when the provisions of the Partnerships Act first apply to that partnership will be treated as partnership property under the new Partnerships Act for so long as it would have been treated as partnership property under the 1890 Act.** (Draft Bill, cl 79(2))

**Limited partnerships and special limited partnerships: transitional provisions**

- 14.25 We propose that limited partnerships (which we discuss in parts XV to XVIII of this report) should have the benefit of a similar transitional regime to that which we propose for general partnerships in paragraph 14.21 above. Thus, for example, pre-existing limited partnerships may continue to be governed by the 1907 Act in the two-year transition period but may opt to be governed by the new law before the expiry of that period. All new limited partnerships, including pre-existing general partnerships which decide to become limited partnerships, will require to register under the new law after the commencement date of the Partnerships Act.
- 14.26 In addition, we require to allow pre-existing limited partnerships to use the “LP” suffix during the transitional period.<sup>18</sup>
- 14.27 As we propose to change the information relating to limited partnerships which must be contained in the register of companies, we require to empower the Registrar of Companies to take the necessary steps to amend the register in relation to pre-existing limited partnerships and to issue registration certificates to pre-existing limited partnerships which opt to be governed by the new law. We also propose that the registrar should be empowered to note on the register that a pre-existing limited partnership has opted to be governed by the new law.
- 14.28 We will also require transitional provisions for special limited partnerships.<sup>19</sup> In particular, there has to be a mechanism by which existing limited partnerships which wish to register as special limited partnerships may do so during the transitional period and provisions to enable the registrar to register them as such and issue new registration certificates.
- 14.29 Again, the draft Bill contains clauses enabling the Secretary of State to make the necessary transitional provisions by statutory instrument.<sup>20</sup>

<sup>18</sup> Otherwise the pre-existing limited partnerships, which are not governed by the new law during the transitional period and which used a suffix “limited partnership” or “LP”, might be guilty of an offence under cl 64 of the draft Bill. See para 15.78 below.

<sup>19</sup> Draft Bill, cl 73 and Sched 10.

<sup>20</sup> Draft Bill, cl 79(3)(e).

# **PART XV**

## **ESTABLISHING AND OPERATING A LIMITED PARTNERSHIP**

### **(1): REGISTRATION AND DE-REGISTRATION**

#### **INTRODUCTION TO PARTS XV TO XIX**

- 15.1 In this and the next four Parts we discuss our proposals for the reform of limited partnerships. As we have stated, our concern is not to create a default code for limited partnerships; such partnerships are used for specialised purposes and will normally be governed by formal agreements. Rather our aims are (a) to integrate the rules relating to limited partnerships into the law relating to general partnerships, (b) to remove doubts about the way in which a limited partnership may operate and (c) to produce a coherent body of law relating to limited partnerships.
- 15.2 In the Joint Consultation Paper on Limited Partnerships<sup>1</sup> we asked consultees if we had correctly identified the main priorities for reform. Consultees generally agreed with our priorities but several raised issues with which we deal in our recommendations for the reform of partnership law generally<sup>2</sup> or which are beyond the scope of our reference.<sup>3</sup>
- 15.3 There was general support for retaining the name “limited partnership” which was well established and understood.<sup>4</sup>
- 15.4 As we are concerned only with the statutory rules which are specific to the regulation of limited partnerships, we present the issues in this and the next four Parts in a different way from our proposals in relation to general partnerships.<sup>5</sup> In particular, without setting out the terms of the 1907 Act in each instance, we look at our propositions for reform, summarising the response of consultees and making our recommendations. We also discuss provisions in the draft Bill on which we have not consulted but which we think are not controversial.
- 15.5 In this Part we look at the regime for registration of a limited partnership and recommend reforms including a mechanism to allow defunct partnerships to be

<sup>1</sup> Consultation Paper No 161; Discussion Paper No 118, para 1.12. Hereinafter “Joint Consultation Paper (LP)”.

<sup>2</sup> Eg whether all partners in a partnership must receive a share of the profits, whether a partnership can hold property in its own name and whether there should be continuity of partnership.

<sup>3</sup> Eg whether registering a limited partnership constitutes operating a collective investment scheme for the purposes of the Financial Services and Markets Act 2000 and the status in the United Kingdom of limited partners in partnerships constituted in other jurisdictions.

<sup>4</sup> Joint Consultation Paper (LP), para 1.14.

<sup>5</sup> Much of the law relating to general partnerships is not contained in the 1890 Act but in rules of common law. By contrast most of the rules specific to limited partnerships are contained in the 1907 Act.

deleted from the register. As registration is a means of publishing changes in a limited partnership, we discuss whether these changes should have effect only when they are registered or can have effect at an earlier date. We also discuss how to publish the limited liability of the limited partners in such a partnership and the relationship between regulation under partnership legislation and the Business Names Act 1985.

- 15.6 In the next Part we discuss the central role of the general partner in managing the limited partnership and his responsibility for registration obligations. We also discuss whether there is a need for a special definition of “business” in relation to limited partnerships and the adaptation of rules which apply to general partnerships.
- 15.7 In Part XVII we deal with the liability of the limited partner and in Part XVIII the rights and obligations amongst themselves of the partners in a limited partnership. In Part XIX we address the case for retaining a limited partnership without legal personality. The reason for this suggestion is the increased use of English limited partnerships in recent years as vehicles for private venture capital investment overseas and the need to avoid uncertainty in the tax treatment of such limited partnerships by foreign tax authorities. To achieve this end we recommend the introduction of an option to register a special limited partnership.

#### **THE REGISTRATION OF A LIMITED PARTNERSHIP: AN OVERVIEW**

- 15.8 Under the existing law, registration with the Registrar of Companies is the essential step in the creation of a limited partnership. Limited partnerships must be registered as such, otherwise every limited partner is deemed to be a general partner.<sup>6</sup> Registration also gives third parties the means to find out if the partnership is a limited partnership and, if so, which of the partners have limited liability.
- 15.9 We are not proposing to abolish registration. However, in the Joint Consultation Paper (LP) we identified some uncertainties surrounding the registration of a limited partnership.<sup>7</sup> In particular, it is unclear exactly when the partnership obtains limited liability status.<sup>8</sup> Is it once the application is filed, or only when the registration certificate is issued? This is important because if the partnership begins to carry on business before it has limited liability status all partners will have unlimited liability. There are also some uncertainties about the registration of a limited partnership that has not yet begun to carry on business and therefore does not constitute a partnership.
- 15.10 We therefore provisionally proposed that a limited partnership should exist from the date of registration of the statement signed by partners, as stated in its certificate of registration.

<sup>6</sup> 1907 Act, s 5.

<sup>7</sup> Joint Consultation Paper (LP), paras 3.23 – 3.25.

<sup>8</sup> 1907 Act, ss 8 and 13.

- 15.11 There was general support among consultees for the proposal although two consultees<sup>9</sup> in a joint response argued for an earlier date. They suggested that a limited partnership should gain limited liability status at the date of its formation as a partnership, provided that the application form for registration was delivered for registration within a specified period of, say, ten days. This would enable the limited partners to have limited liability in relation to the transactions of the limited partnership from the moment of formation.
- 15.12 We do not favour this suggestion. Limited liability is a privilege which should not be available until those who may transact with a partnership have the means to ascertain the existence of such limited liability. We also foresee that it could create uncertainty for the limited partners. If the application is not delivered within ten days, or is returned because it is illegible, the limited partners would find that they were general partners in the partnership until the form was submitted correctly. This is not acceptable: limited partners should have a reasonable degree of certainty as to when they obtain limited liability and when the partnership may safely begin to trade.
- 15.13 Under our proposals, registration will operate in the following way. A partnership will become a limited partnership on the date of registration of the statement signed by the partners, as stated in the certificate of registration. This provides certainty as to the creation of the limited partnership and the date of that creation. This certainty will benefit both third parties and limited partners.

#### **The pre-existing partnership**

- 15.14 If a partnership exists before registration, the registration will confer limited liability status, and the pre-existing partnership will become a limited partnership. For example, a general partnership, Smith & Jones, may want to change its status and become a limited partnership. In such a case the partnership entity will continue (now as Smith & Jones LP),<sup>10</sup> but upon registration the limited partners will gain limited liability. At the same time the partners, both general and limited, will become subject to the requirements of the draft Partnerships Bill relating to limited partnerships.

#### **The new partnership**

- 15.15 We also provide for the circumstance where a general partnership does not exist before registration. In many cases parties will envisage from the beginning that their undertaking will be a limited partnership. In such cases it is not in their interest to begin to carry on business before registration, as none of the partners will have the benefit of limited liability. As the persons will not have carried on business before registration there is no partnership yet in existence.<sup>11</sup>
- 15.16 A limited partnership is a partnership with special characteristics. The entity which is registered as a limited partnership is a partnership. There needs to be a partnership for there to be a limited partnership. We propose therefore that where

<sup>9</sup> The APP and British Venture Capital Association (BVCA).

<sup>10</sup> See recommendation on disclosure of limited liability status: para 15.71 below.

<sup>11</sup> See the draft Bill, cl 1(2).

persons apply for the registration of a limited partnership before they have started to carry on business, the partnership will be formed on the date of registration.

15.17 Thus the partnership comes into existence on the earlier of:

- (1) two or more persons starting to carry on business with a view to profit;<sup>12</sup> or
- (2) registration of a limited partnership.

15.18 Once the limited partnership is registered, the registration scheme is important when limited partners join or resign from the limited partnership. Under our proposals a person does not become a limited partner until he is registered as such. Similarly he does not cease to be a limited partner until his withdrawal is registered. The register does not simply record something which has occurred independently. It is constitutive: registration confers limited liability upon a partner.

15.19 In this way it will be clear when a person becomes a limited partner and when he ceases to be a limited partner.<sup>13</sup> This is not the case under the 1907 Act. A search of the register will reveal whether a person is or remains a limited partner. This is important both to third parties and also to limited partners, as we propose that general partners should be responsible for registration requirements.

15.20 In summary, registration is the step which transforms a partnership into a limited partnership. It is also fundamental to the creation of limited partners. As under the current system, the register will also provide information to third parties. However under our proposals third parties will not need to consult the register to discover whether a partnership is a limited partnership. We propose that limited partnerships will be required to use the suffix "LP" or a similar suffix as part of their name.<sup>14</sup>

### **Formation of a limited partnership**

15.21 **In the light of our proposals on registration discussed above, we recommend that:**

- (1) A limited partnership should exist from the date of registration of the limited partnership as stated in the certificate of registration; (Draft Bill, cls 54(1) and 67)**
- (2) The registrar should be obliged to register the partnership or proposed partnership as a limited partnership, if satisfied that the**

<sup>12</sup> A general partnership is established and it may then apply for registration as a limited partnership.

<sup>13</sup> The limited partner may of course lose limited liability by participation in management. See para 17.23 below.

<sup>14</sup> See para 15.71 below. Once the third party is thus informed as to the status of the partnership, he can consult the register if he requires more information such as the names of the limited partners.

**statutory requirements are complied with, and to supply it with a registration certificate.** (Draft Bill, cl 67(1))

### **The content of the certificate of registration**

15.22 The registrar is to issue a certificate of registration on registration of the statement signed by the partners. We think that the certificate need not contain all the details in the statement. It can be confined to (a) the name of the limited partnership, (b) the fact of its registration as a limited partnership and (c) the date of registration. The certificate therefore will provide certainty to the partners and others as to the existence of the limited partnership and the date of its formation as such a partnership. The other details in the statement will be contained in the register and will be available for inspection.<sup>15</sup>

15.23 **We therefore recommend that the certificate of registration of a limited partnership should contain the following information: (a) the name of the limited partnership, (b) the fact of its registration as a limited partnership and (c) the date of registration.** (Draft Bill, cl 67(2))

### **Status of certificate of registration**

15.24 In the Joint Consultation Paper (LP) we proposed that (a) the certificate of registration should be conclusive evidence that the limited partnership was duly formed on the date stated and (b) the certificate of registration (whether original or as amended) should be conclusive as to other particulars, unless the contrary is proved.<sup>16</sup> These proposals won almost unanimous support from consultees. Since the consultation period we have decided to recommend that the certificate of registration should record only the name of the partnership, the fact of registration and the date of registration.<sup>17</sup> We consider therefore that the certificate should be conclusive evidence both of these particulars and that all registration formalities have been complied with.<sup>18</sup> We note that section 13(7) of the Companies Act 1985 is a precedent.<sup>19</sup> We consider that it is appropriate also to provide that a copy of or extract from an original document sent to the registrar, if signed by the registrar, should be admissible in evidence in all legal proceedings.

15.25 **We therefore recommend that:**

**(1) The certificate of registration should be conclusive evidence (a) that all registration formalities have been complied with, (b) that**

<sup>15</sup> See paras 15.60 – 15.61 below.

<sup>16</sup> Joint Consultation Paper (LP), para 3.26(2) and (3).

<sup>17</sup> See para 15.23 above.

<sup>18</sup> It would be anomalous to provide that the particulars recorded in the certificate were conclusive and at the same time to allow evidence to rebut a presumption of compliance with all registration formalities. We provide separately for the correction of errors which may occur in transcribing onto the register information which has been provided to the registrar. See para 15.55 below.

<sup>19</sup> The Companies Act 1985, s 13(7) provides that a certificate of incorporation is conclusive evidence that registration requirements have been complied with and does not leave open the possibility of contrary proof.

**the partnership was registered as a limited partnership on the date stated in the certificate and (c) that the partnership name is as specified in the certificate;** (Draft Bill, cl 71(1))

**(2) The certificate of a change in the name of a partnership should be conclusive evidence (a) that the partnership was registered as having a new name on the date specified in the certificate and (b) that its partnership name is as specified in the certificate;** (Draft Bill, cl 71(2))

**(3) A copy or extract from an original document sent to the registrar should if signed by the registrar be admissible in evidence in all legal proceedings as of equal validity with the original document.** (Draft Bill, cl 71(3))

#### **INFORMATION TO APPEAR ON THE REGISTER**

15.26 Section 8 of the 1907 Act requires the following particulars of a limited partnership to be registered:

- (1) the firm name;
- (2) the general nature of the business;
- (3) the principal place of business;
- (4) the full name of each of the partners;
- (5) the term, if any, for which the partnership is entered into, and the date of its commencement;
- (6) a statement that the partnership is limited, and a description of every limited partner as such; and
- (7) the sum contributed by each limited partner, and whether paid in cash or how otherwise.

15.27 In response to our questions in the Joint Consultation Paper (LP) most consultees supported the retention of a description of the general nature of the business, although some questioned its utility. There was also strong support for retaining the registration of the names of limited partners. It was suggested that the privilege of limited liability should be balanced by the obligation of public disclosure. Two joint consultees<sup>20</sup> opposed the registration of the names of limited partners as certain other jurisdictions, such as Jersey, did not require such disclosure and suggested that some investors object to investing in UK limited partnerships because of the disclosure requirements. Another consultee<sup>21</sup> suggested that it involved an administrative burden which gave little benefit while another<sup>22</sup> thought

<sup>20</sup> The APP and British Venture Capital Association (BVCA).

<sup>21</sup> 3i plc.

<sup>22</sup> Igloo Regeneration.

that the removal of the twenty partner limit was a reason for removing this requirement.

- 15.28 The Inland Revenue considered that it would be helpful for the administration of taxes if the addresses of partners could be listed but recognised that the registrar should be given powers to restrict the publication of this information.<sup>23</sup>
- 15.29 Before setting out our recommendations on the contents of the register we discuss the existing requirement to register a principal place of business.

### **The principal place of business**

- 15.30 Section 8 of the 1907 Act provides:

The registration of a limited partnership shall be effected by sending by post or delivering to the registrar at the register office in that part of the United Kingdom in which the principal place of business of the limited partnership is situated or proposed to be situated a statement signed by the partners... .

- 15.31 In the Joint Consultation Paper (LP) we identified a number of uncertainties surrounding the registration of a principal place of business and we expressed misgivings as to the policy behind this requirement.<sup>24</sup> We were aware of doubts among the users of limited partnerships as to the consequences of a change in the principal place of business after initial registration, whether the change was within the United Kingdom or the limited partnership moved its principal place of business offshore. We observed that the general view appears to be that there is no requirement that the limited partnership must maintain its principal place of business or, indeed, conduct any business in the United Kingdom.
- 15.32 We provisionally proposed to abolish the requirement for registration of a principal place of business and to replace it by a requirement to have a United Kingdom registered office. We also proposed that registration of a limited partnership should be at the register office in the part of the United Kingdom in which the registered office is or is to be sited.<sup>25</sup>
- 15.33 Consultees strongly supported the proposals. Only two consultees expressed doubt. One argued that it was not appropriate to associate the limited partnership with a limited company: registration of a limited partnership created limited liability; it did not create the partnership. The Inland Revenue was concerned that abolishing the requirement to have a principal place of business in the United Kingdom might assist a limited partnership that operated for criminal purposes or that engaged in tax avoidance or evasion. Another consultee suggested that, like companies and LLPs, the registered office of a limited partnership should be specified as being situated in England and Wales, in Wales or in Scotland.

<sup>23</sup> See the analogous suggestions in relation to company directors in “Directors’ Home Addresses – A Consultative Document” URN 01/1140 (2001).

<sup>24</sup> Joint Consultation Paper (LP), paras 3.18 – 3.21.

<sup>25</sup> Joint Consultation Paper (LP), para 3.22.

15.34 As we see no strong policy justification for requiring a limited partnership to have a principal place of business in a particular part of the United Kingdom at the time it first registers, and as it appears that some limited partnerships registered under the 1907 Act do not maintain a principal place of business or conduct any business in the United Kingdom, we think that the requirement initially to have a principal place of business in the United Kingdom should be abolished.<sup>26</sup> In its place we think that it is sufficient that a limited partnership should have a registered office in England or Wales or in Scotland and that the register should state the address of that office.

### **The contents of the register**

15.35 In the Joint Consultation Paper (LP) we suggested that there was a case for reducing the amount of information contained in the register.<sup>27</sup> We consider that we can safely reduce the particulars of a limited partnership which require to be registered. We propose that neither the description of the general nature of the partnership's business nor the duration of the partnership should be registered. In relation to the former, we see little advantage in registration particularly where no issue of *vires* arises. In relation to the latter, we see no significant benefit in requiring the registration of the duration of a partnership; the obligation could be burdensome if over time the partners alter the agreed duration of their partnership.

15.36 The register should contain the name under which the partnership is registered as a limited partnership.<sup>28</sup> It should contain the names and addresses of all general partners. It is the general partners who have unlimited liability for the debts and obligations of the limited partnership and it is therefore important that third parties have access to their names and addresses. We also propose that the name of each limited partner should be registered. Registration confers limited liability on limited partners. In addition a third party may benefit from access to the names of limited partners should one or more involve themselves in management and thus lose limited liability. Registration of his name also enables a limited partner to check that the general partner has duly registered him as such and thereby limited his liability. We also propose that the register should contain the amount of any capital contribution which a limited partner makes to the partnership. This information, combined with the obligation to register any increase or withdrawal of capital, will enable a third party to ascertain the extent of a limited partner's liability should he withdraw his capital while he is registered as a limited partner.<sup>29</sup>

15.37 It is necessary also to register the address of the registered office of the limited partnership. We consider that it is useful also for the register to state the jurisdiction in which the registered office is located. Finally, when a partnership exists before registration, the register should disclose the date of the formation of

<sup>26</sup> We note that the practice of not maintaining a principal place of business in the United Kingdom means that the existing law does not require limited partnerships to maintain a substantive presence in the United Kingdom. We see the Inland Revenue's concerns mentioned in para 15.33 above in that context.

<sup>27</sup> Joint Consultation Paper (LP), para 3.15.

<sup>28</sup> This is necessary for the conclusive status of the certificate and to allow people to search the register electronically in future.

<sup>29</sup> See paras 17.31 and 17.33 below.

the partnership. This should enable third parties to identify the period during which the partners of a pre-existing firm had unlimited liability for the entity's debts and obligations, when the partners carried on business before registering the firm as a limited partnership.

15.38 **We therefore recommend that:**

- (1) The requirement for the registration of a principal place of business, initially in the United Kingdom, should be abolished and be replaced by the requirement to have a registered office in England or Wales, or in Scotland;** (Draft Bill, cl 62)
- (2) The register should contain the following information concerning the limited partnership:**
  - (a) The name under which the partnership is registered;**
  - (b) The name and address of the proposed general partner (or, if there is more than one, all of them);**
  - (c) The name of each limited partner and the amount of any capital contribution made by him to the partnership;**
  - (d) Whether the registered office of the partnership is in England or Wales, or in Scotland;**
  - (e) The address of the registered office;**
  - (f) If the partnership existed before registration, the date of formation of the partnership.** (Draft Bill, cl 66)

**Registration of changes in limited partnerships**

15.39 As time passes, the details contained in the application for registration will become out-dated. There is a need for a mechanism to keep the register up to date. We think that this should be done in the following way.

***Change of partnership name***

15.40 As the register contains the name of the partnership and confers limited liability on the limited partners, we think that a change of the name of a limited partnership should not be effective until the change is registered.<sup>30</sup> To do so, the limited partnership must deliver a notice to the registrar specifying its existing name and its proposed name. If satisfied that the statutory requirements in relation to the

<sup>30</sup> Limited liability is conferred on partners by registration of the partnership as a limited partnership with a particular name and by registration of the names of the limited partners. See paras 15.21 and 15.38 above. We have recommended that the certificate of registration be conclusive evidence of the partnership name. See para 15.25 above. As a result, any unregistered change of name would be ineffective. In addition it is not desirable that a limited partnership should trade under a name which is different from its registered name as that would impede third parties from using the register to ascertain information about the limited partnership and thereby weaken the effectiveness of the register.

name are met,<sup>31</sup> the registrar will alter the register to record the change of name and supply the partnership with a certificate of the change of name. The certificate will record the change of name and the date on which the change was registered and will be conclusive evidence of those facts.

- 15.41 **We recommend that a change of partnership name will not have effect until the change is registered. To effect such a change a notice must be delivered to the registrar who, if satisfied that the statutory requirements in relation to the name are met, must alter the register and supply the partnership with a certificate of the change of name. The certificate will be conclusive evidence of the partnership name and the registration of the new name on the date specified in the certificate.** (Draft Bill, cls 68 and 71(2) and Schedule 7, para 1)

### ***New limited partners***

- 15.42 As registration is a precondition for the establishment of a limited partnership, we think it appropriate that a person should not enjoy the status of a limited partner until he is registered as such. To this end, there should be delivered to the registrar a notice that a person is a proposed limited partner. The notice should specify the name of the limited partnership, the name of the proposed limited partner and the amount of the capital contribution (if any) being made by him. On receipt of the notice, the registrar should register the person as a limited partner.
- 15.43 **We recommend that a person should become a limited partner only on his registration as such. Notice that a person is a proposed limited partner, specifying his name and any capital contribution to the partnership, should be delivered to the registrar. If the proposed limited partner is a general partner in the partnership (and is applying to become a limited partner) the notice must state that fact. On receiving the notice the registrar must register the person as a limited partner (and, where the applicant was a general partner, record the fact that the partner has ceased to be a general partner in the partnership).** (Draft Bill, cls 54(1) and 68 and Schedule 7, para 3)

### ***A person becoming a general partner***

- 15.44 As a general partner has unlimited liability for the debts of the partnership there is not the same imperative for registration before he can become a partner. We think therefore that a person should become a general partner on the date on which he and the limited partnership have agreed. The default rule is that a person may become a partner only with the agreement of all the general partners,<sup>32</sup> but a limited partnership may have its particular rules which govern the admission of partners. Notification of his joining the partnership should be made to the registrar within twenty-eight days of his joining.

<sup>31</sup> See paras 15.64 – 15.66 below.

<sup>32</sup> Draft Bill, cl 60(1).

- 15.45 **We recommend that a person should become a general partner on the date agreed between him and the limited partnership and that notification of his joining the limited partnership as a general partner should be made to the registrar within twenty-eight days after he joins.** (Draft Bill, cl 68 and Schedule 7, para 5)

***A person ceasing to be a general partner or a limited partner***

- 15.46 A person may cease to be a general partner or a limited partner in many circumstances. Death of an individual or dissolution of a non-natural person will terminate a person's status as partner. On such an occurrence, we think the fact that a person has ceased to be a partner should be registered within twenty-eight days. We see no need to regulate when a person ceases to be a general partner. This can be left to the general law of partnership and the terms of the partnership agreement.
- 15.47 As we have recommended above, a person may only become a limited partner on registration. Similarly, we consider that the general rule should be that a person may cease to be a limited partner only when his withdrawal from the limited partnership is registered. We think that the register should govern the status of the limited partner, except on the death or dissolution of that partner or on dissolution of the partnership.<sup>33</sup>
- 15.48 We consulted on the proposition that section 10 of the 1907 Act should be repealed. Section 10, among other things, requires the advertisement in the Gazette of a statement when a general partner becomes a limited partner and when the share of a limited partner is assigned.<sup>34</sup> We also proposed that the draft Bill should provide a complete mechanism by which changes in the status of partners and the composition of the limited partnership can be made without the requirement for notice in the Gazette or elsewhere. There was almost unanimous support for these propositions. We have therefore adopted a policy that there should be no notice requirements in relation to changes in the limited partnership beyond the registration of those matters which the draft Bill requires to be registered.
- 15.49 **We recommend that:**

- (1) A person should cease to be a general partner in accordance with the rules of law in relation to general partnerships or the terms of the partnership agreement but he may incur liability to third parties by holding out until his change of status is published in the register;** (Draft Bill, cls 26 and 68 and Schedule 7, para 5(5))
- (2) Subject to paragraph (3) below, a person should not cease to be a limited partner until his change of status is published in the register;** (Draft Bill, cls 54(2) and 68 and Schedule 7, para 4(7))

<sup>33</sup> If the limited partner involves himself in management he loses limited liability for the period of that involvement. A person will also cease to be a limited partner on the dissolution of a limited partnership.

- (3) **A person should cease to be a limited partner on death or (if a non-natural person) dissolution and the fact that he has ceased to be a general partner or limited partner (as the case may be) should be registered within twenty-eight days after the death or dissolution.** (Draft Bill, cls 54(3) and 68 and Schedule 7, paras 4(1) and 5)

***Other changes in the limited partnership***

- 15.50 A change in name of an existing general partner or limited partner, a change of the address of a general partner, the death or (if not an individual) dissolution of a limited partner, and an increase or withdrawal of a limited partner's capital contribution<sup>35</sup> are all changes which will make the register outdated unless there is an obligation to deliver to the registrar a notice specifying the nature of the change. We think that it would be convenient to have a uniform period of twenty-eight days for delivery of the relevant notice.
- 15.51 **We therefore recommend that a limited partnership should, during its continuance, be under a duty to deliver to the registrar a notice of any of the following changes within 28 days of the event:**
- (1) **A change of name of an existing general or limited partner;**
  - (2) **A change of address of an existing general partner; and**
  - (3) **An increase or withdrawal of the capital contribution of a limited partner.** (Draft Bill, cl 68 and Schedule 7, para 5)
- 15.52 We have recommended that a limited partnership should have a registered office.<sup>36</sup> If a limited partnership wishes to change the address of its registered office, it is important that the address is publicised as it is the address to which important communications<sup>37</sup> may be sent. Indeed, unless the change of address is registered the new office would not be the registered office.
- 15.53 **We therefore recommend that a limited partnership may change the address of its registered office only by delivering notice of the change to the registrar who must alter the register. The change in address should have effect only from the date when it is registered.** (Draft Bill, cl 68 and Schedule 7, para 2)

<sup>34</sup> Joint Consultation Paper (LP), para 3.30.

<sup>35</sup> We consider that the registration of increases and decreases in a limited partner's capital contribution will assist a third party to identify when a limited partner, who has drawn out or received back all or part of his capital contribution, has thereby incurred personal liability for partnership obligations to the extent of the amount withdrawn or received back. See draft Bill, cl 56(2) and (3).

<sup>36</sup> See para 15.38 above.

<sup>37</sup> Such as the registrar's preliminary inquiry letters when considering de-registration. See para 15.83 below.

## REGISTRATION OF CORRECTIONS

- 15.54 In any registration system, errors may occur in transcribing onto the register the information which has been provided to the registrar. The register can be corrected if the registrar is empowered to alter the erroneous entry and, where the erroneous information has been included in a certificate, to issue a revised certificate to the partnership.
- 15.55 **We therefore recommend that, on the application of a general partner or another person who has authority to make the application on behalf of the partnership, the registrar should be empowered to register a correction to the register and that, if he does so, he should be required to supply the partnership with a revised certificate.** (Draft Bill, cl 68 and Schedule 7, para 6)

## ADMINISTRATION OF THE REGISTRATION SYSTEM

### Delivery of documents

- 15.56 In order to allow the registration system to operate using e-mail and the internet, we require to make provision for “delivery” to the registrar in electronic form.<sup>38</sup> We also think that it would be advantageous to allow for contracting out of the functions of the registrar in accordance with the Deregulation and Contracting Out Act 1994 by laying down mandatory rules as to what amounts to delivery.
- 15.57 **We therefore recommend that the registrar should be empowered to approve the form and means by which a document may be delivered to him and that where the registrar directs that documents are to be delivered to an authorised person at a specified address, delivery of a document to another address should not be treated as delivery.** (Draft Bill, cl 68 and Schedule 9, para 1)

### Registration of information

- 15.58 The registrar should have discretion as to how he keeps the registered information provided that it is possible to inspect the information and to produce a legible copy. This will enable the registrar to maintain an electronic register. We also think that it would be appropriate that the registrar be required to keep the originals of documents sent to him for ten years.<sup>39</sup>
- 15.59 **We therefore recommend that the registrar should be empowered to keep the registered information in any form he thinks fit, provided that it is possible to inspect the information and to produce a copy of it in legible form. The registrar should be required to keep original documents, which are sent to him, for ten years.** (Draft Bill, cl 68 and Schedule 9, para 2)

<sup>38</sup> See the draft Bill, cl 72(2) which empowers the registrar to approve the manner in which a document may be authenticated.

<sup>39</sup> This is the time during which the Registrar of Companies is required to keep the originals of company documents: see Companies Act 1985, s 707A, which was inserted by the Companies Act 1989, s 126.

### **Inspection of register**

- 15.60 It is necessary to provide for inspection of the register. Section 16 of the 1907 Act provided for the inspection of statements filed by the registrar and the payment of an inspection fee.
- 15.61 **We therefore recommend that any person should be entitled to inspect information kept by the registrar and to require a copy of information kept in the register or a certified copy of, or extract from, the original of any document. A person should also be able to require a certificate of the registration of a limited partnership or a certificate of the registration of a change in the name of a limited partnership.** (Draft Bill, cl 68 and Schedule 9, para 3)

### **Power to make regulations**

- 15.62 Section 17 of the 1907 Act empowers the Board of Trade to make rules. We think that the provision should be re-enacted in modern language. This will enable the administration of the register to be adapted to meet changing circumstances and fees to be fixed at a level which will enable the registrar to provide an efficient service to persons using or dealing with limited partnerships. We understand that there is demand for the register to be available on-line but that the current level of fees cannot support that facility. If the Secretary of State is empowered to fix the level of fees, it should be possible to fund an on-line register.
- 15.63 **We recommend that the Secretary of State should have power to make regulations to:**
- (1) Impose fees in respect of (i) registration of a limited partnership or of information relating to such a partnership, (ii) the inspection of the register or any documents or information relating to a limited partnership or (iii) the provision of a certificate or an extract or copy of any document;**
  - (2) Provide for the performance by the assistant registrar or other officers of acts which the registrar is required to perform in relation to limited partnerships; and**
  - (3) Make provision for the translation of documents delivered to the registrar which relate to limited partnerships whose registered office is in Wales.** (Draft Bill, cl 68 and Schedule 9, para 4)

## **THE NAME OF A PARTNERSHIP AND DISCLOSURE OF LIMITED LIABILITY STATUS**

### **Name of limited partnership**

- 15.64 Under existing law limited partnerships are not governed by the rules of the Companies Act 1985 restricting the use of certain names.<sup>40</sup> We asked consultees

<sup>40</sup> Companies Act 1985, s 26 prohibits the registration of certain categories of name, including a name which is the same as one already appearing in the list of company names (s

whether there should be any restriction on the names which may be registered for limited partnerships, and if so what restrictions. Most consultees supported the introduction of restrictions similar to those affecting companies. While there did not appear to have been serious problems, several consultees suggested that the use by limited partnerships of names which were the same as those of registered companies could cause confusion.

15.65 On balance, while recognising that there is not a major practical problem, we think that it would be appropriate to have a similar regime for the names of limited partnerships as that which applies to other registered commercial bodies, namely companies and LLPs.

15.66 **We therefore recommend that a limited partnership should not be registered by a name:**

**(1) Which is the same as a name appearing in the registrar’s index of company and corporate names, unless the person whose name appears in the index consents;**

**(2) The use of which as the name of the partnership would in the opinion of the Secretary of State constitute an offence; or**

**(3) Which in the opinion of the Secretary of State is offensive.** (Draft Bill, cl 63(3) - (5))

#### **Disclosure of limited liability status**

15.67 In the Joint Consultation Paper (LP) we observed that it was a significant omission in the 1907 Act that the name of a limited partnership need not disclose its status.<sup>41</sup> We suggested that if a third party is put on notice that he is dealing with a limited partnership he will then have an opportunity to consult the register.

15.68 Almost all consultees agreed with our provisional proposal that the name of a limited partnership must end with “limited partnership” or a suitable abbreviation such as “lp”. One consultee, which has extensive practical experience of limited partnerships, suggested that the suffix should be “limited partnership” because most limited partnerships already used that in their names. Another suggested that many firms already use the suffix “LP”. Two consultees proposed that registration details (limited status, registered number and registered office) should be given on the partnership’s stationery.

15.69 Almost all consultees also supported our provisional proposal that all documents issued by a limited partnership must use the name with the proposed suffix.

15.70 In view of the general support for the proposals, we think that the name of a limited partnership should end with a suitable suffix which identifies its status as such. We consider that there should be stated on the documents of a limited

26(1)(c). There are no equivalent restrictions on similar names for businesses under the Business Names Act 1985.

<sup>41</sup> Joint Consultation Paper (LP), paras 3.33 – 3.34.

partnership both the name of the limited partnership and the address of its registered office. We do not think that it is necessary for the documents of a limited partnership to contain further details other than the requirements of the Business Names Act 1985.

15.71 **We therefore recommend that:**

- (1) The name of a limited partnership must end with either “limited partnership” or the abbreviation “lp” or “LP” ; (Draft Bill, cl 63(1))**
- (2) If the registered office of the limited partnership is in Wales the alternative suffix may be “partneriaeth cyfyngedig” or the abbreviation “pc” or “PC”; (Draft Bill, cl 63(2))**
- (3) The name of the limited partnership (which includes the suffix) and the address of its registered office must be stated on any partnership document. (Draft Bill, cl 65(1) and (2))**

**Limited partnerships and the Business Names Act 1985**

15.72 We also raised the issue of the requirements of the Business Names Act 1985 (the 1985 Act) in the context of our proposals, mentioned above, to require disclosure of status in the name of a limited partnership. We asked whether the 1985 Act should be amended so as to remove or limit the requirement to give details of limited partners.<sup>42</sup> In the alternative, in case there were concerns over holding out,<sup>43</sup> we asked whether there should be statutory clarification that the inclusion of the name of a limited partner in the firm-name or in the particulars disclosed under the Business Names Act 1985 does not by itself hold out a limited partner as a general partner.

15.73 There was general support among consultees for the amendment of the 1985 Act although some supported the alternative of a statutory clarification in relation to holding out. We think that the amendment of the Business Names Act 1985 is preferable. It will bring Britain into line with competing jurisdictions.

15.74 We consider that a limited partnership should not be subject to the 1985 Act if the partners carry on business under its registered name. The Act should apply only where the partners carry on business under another name. Where the 1985 Act does apply, we see no need for the names of limited partners to be stated on partnership documentation as their names can be obtained from the register.

15.75 We have recommended<sup>44</sup> that the 1985 Act should have effect where the partners in a limited partnership use a name other than its registered name in carrying on business so that (a) the suffix to the name of the limited partnership is a permitted

<sup>42</sup> Joint Consultation Paper (LP), para 3.39.

<sup>43</sup> We doubted whether such a concern was well founded, but recognised that a limited partner would require to be cautious and to avoid allowing his name to appear in the firm name or on its business letters without some clear indication that he was a limited partner. See *Lindley & Banks*, 29-10 – 29-13.

<sup>44</sup> See paras 13.23 – 13.24 above.

addition under section 1; (b) the name of a limited partner need not be stated on any business letter, written order, invoice, receipt or demand but merely the registered name of the limited partnership and the name of each general partner; (c) a list of partners is maintained at the registered office of the limited partnership; and (d) the limited partners incur no liability for non-disclosure in terms of the Act.

### **Improper use of “limited partnership” as a name**

- 15.76 We think that it would be appropriate to penalise the improper use of the term “limited partnership” or its equivalent Welsh name or any contraction of the term as a business name or title. As we recommend that it should be compulsory to disclose limited liability status, it is important that persons are discouraged from misleading the public by making inaccurate representations as to status.
- 15.77 As we propose to regulate the use of the term “limited partnership” it is necessary to provide for the legitimate use of the term in Britain by partnerships which are constituted overseas and which have the essential characteristics of a limited partnership. We consider that a partnership which is registered outside Great Britain and in which some of the partners by registration have limited liability for partnership obligations should be entitled to describe itself as a “limited partnership” in Britain. We refer to such bodies as “oversea limited partnerships”.
- 15.78 **We therefore recommend that only (a) a limited partnership, (b) a partner in a limited partnership, (c) a partnership registered outside Great Britain and in which one or more of the partners by registration has limited liability for partnership obligations (“oversea limited partnership”) and (d) a partner in an oversea limited partnership should be allowed to use the expression “limited partnership”, its Welsh equivalent or contractions or imitations of those expressions at the end of their business names. Any other person using those expressions in the last words of their business name or title should be guilty of an offence.** (Draft Bill, cl 64)

### **DE-REGISTRATION OF A LIMITED PARTNERSHIP**

- 15.79 At present Companies House has no power to de-register a limited partnership. In the Joint Consultation Paper (LP) we suggested that this creates two difficulties. First, over time the register becomes progressively out of date. Secondly, a company cannot use the same name as a limited partnership while such a name remains on the Companies Act index. We suggested that it would be sensible to have a provision similar to that applying to companies to enable defunct partnerships to be struck off.<sup>45</sup>
- 15.80 Consultees unanimously supported our proposal. Some consultees suggested that we should make clear what would be the effect of de-registration if a partnership remained in being when de-registered, namely the conversion of the limited partnership into a general partnership, thus removing the limited liability of the

<sup>45</sup> Joint Consultation Paper (LP), para 3.31.

limited partners. Two consultees<sup>46</sup> also suggested that there should be a mechanism by which a limited partnership could convert itself into a general partnership.

15.81 We therefore confirm our provisional proposal for a de-registration system. We have modelled the system on the Companies Act 1985 to include safeguards against inappropriate de-registration. There is, of course, a fundamental difference between registration and de-registration. A partnership may be brought into being by registration if the partnership did not exist before registration.<sup>47</sup> By contrast, de-registration does not break up a partnership or dissolve it. De-registration removes the limitation on the liability of the limited partners, making them general partners in a continuing partnership. We have therefore sought to introduce safeguards to protect a limited partner against an inappropriate de-registration.

15.82 We also think that there should be a mechanism for re-registration where the partnership was capable of existing as a limited partnership when it was de-registered and where a back-dated re-registration would be just and equitable. We propose that re-registration may be achieved by a combination of (a) an application to register the partnership as a limited partnership in the normal way and (b) a court order putting the limited partnership and other persons in the position in which they would have been if there had been no de-registration.

15.83 **We recommend that:**

**(1) The registrar should have power to de-register a limited partnership:**

**(a) If the registrar receives an application for de-registration after all the partners of the limited partnership (or former partners of a dissolved limited partnership) have agreed;** (Draft Bill, cl 68 and Schedule 8, para 1) **or**

**(b) If after inquiry the registrar has reasonable grounds for believing that one of the grounds for doing so exists;** (Draft Bill, cl 68 and Schedule 8, para 2)

**(2) The grounds for de-registering a limited partnership referred to in paragraph (1)(b) above are (a) that it has been dissolved, (b) that it does not have one or more general partners and one or more limited partners, (c) that it does not have a registered office and (d) that where a limited partnership, which was not previously a general partnership, has been formed by registration, the partners have not begun to carry on business together during a period of at least two years immediately after registration;** (Draft Bill, cl 68 and Schedule 8, para 2(2) and (4))

<sup>46</sup> The APP and BVCA (a joint submission), and the Law Society of Scotland.

<sup>47</sup> If a pre-existing partnership is registered as a limited partnership, the partnership becomes a limited partnership and limited liability is conferred on the limited partners who are registered as such. See the draft Bill, cls 1(5), 54(1), 56(1) and 67.

- (3) Before the registrar de-registers a limited partnership under paragraph (1)(b) above, the registrar must have made preliminary inquiries by sending two letters to the registered office of the limited partnership, the second letter following six weeks after the first letter. In the letters the registrar should state his belief that a ground for de-registering exists and invite a reply showing why the partnership should not be de-registered. Where there are reasonable grounds for believing that the partnership does not have a registered office the letters of inquiry may be sent to the general partner or partners and to any limited partner whose address is known to the registrar; (Draft Bill, cl 68 and Schedule 8, para 3)**
- (4) In addition, before de-registering under either of paragraph (1)(a) or (b) above, the registrar must publish a de-registration warning in the Gazette at least three months before he de-registers a limited partnership; (Draft Bill, cl 68 and Schedule 8, paras 1(1)(b), 2(1)(c) and 4)**
- (5) If the registrar de-registers a limited partnership, he must publish notice of the fact in the Gazette and de-registration takes effect on the date specified in the notice; (Draft Bill, cl 68 and Schedule 8, para 5)**
- (6) If the de-registered partnership re-registers itself as a limited partnership, the court should be able on the application of the partnership or any partner, within 3 years of de-registration, to make an order to backdate the limited liability of the limited partners to the date of de-registration and otherwise to put the limited partnership and other persons in the position they would have been in if the limited partnership had not been de-registered; (Draft Bill, cl 68 and Schedule 8 para 6(1), (5) and (6))**
- (7) The court may make the order in paragraph (6) above if it is satisfied (a) either that the application for de-registration had not been properly authorised or that none of the grounds for de-registering the partnership existed when it was de-registered and (b) that it is just and equitable to do so. (Draft Bill, cl 68 and Schedule 8, para 6(2), (3) and (4))**

# **PART XVI**

## **ESTABLISHING AND OPERATING A LIMITED PARTNERSHIP (2): THE GENERAL PARTNER AND OTHER MATTERS**

### **INTRODUCTION**

- 16.1 In this Part we consider the central role played by the general partner in a limited partnership. Under the existing law, the general partner is the person with whom third parties deal and in most circumstances he alone has unlimited liability for the debts and obligations of the partnership. He alone is allowed to manage the business of the partnership and bind the firm.<sup>1</sup>
- 16.2 We also consider whether there is a case for widening the definition of “business” in the 1890 Act in its application to limited partnerships and address miscellaneous issues relating to the limited partnership.

### **THE GENERAL PARTNER**

- 16.3 In the Joint Consultation Paper (LP) we raised a number of issues about the identity and role of the general partner. Before considering these issues we have to define what a general partner is. The 1907 Act defines a general partner as “any partner who is not a limited partner as defined by this Act”.<sup>2</sup> We think a similar definition is appropriate.
- 16.4 **We therefore recommend that a general partner should be defined as a person who is a partner in a limited partnership but is not a limited partner.** (Draft Bill, cl 54(4))

### **Who may be a general partner?**

- 16.5 Section 4(4) of the 1907 Act provides that a body corporate may be a limited partner. The Act is silent as to whether a body corporate may be a general partner but Companies House routinely registers limited partnerships which have companies as general partners. A large majority of consultees supported our proposition expressly to provide that a body corporate may be a limited or general partner.<sup>3</sup> Those who opposed the proposition thought that it was not necessary. Almost all consultees considered that there was no need to restrict the right of limited companies to be general partners in a limited partnership.
- 16.6 We propose to remove any residual uncertainty by not re-enacting section 4(4) of the 1907 Act. In the draft Bill we define a partnership as “an association formed

<sup>1</sup> 1907 Act, s 6(1).

<sup>2</sup> 1907 Act, s 3.

<sup>3</sup> Joint Consultation Paper (LP), para 3.3.

when two or more persons start to carry on business together under a partnership agreement”.<sup>4</sup> A limited company is a legal person and can therefore be a partner both in a general partnership and in a limited partnership.<sup>5</sup>

### **Dual functioning of a general partner as a limited partner**

- 16.7 We noted in the Joint Consultation Paper (LP) that statutes in Jersey and Guernsey allow a person to function both as a general partner and as a limited partner.<sup>6</sup> We observed that it was hard to see how a person can be both a general partner and a limited partner unless in different capacities and that we were not aware of any pressure for change in this respect. Most consultees strongly opposed the idea of changing the definition of “general partner” to allow the same person to be both a general partner and a limited partner. It was widely felt that this would create confusion and unwanted complications. We agree. We do not take the matter any further.

### **Responsibility for registration formalities**

- 16.8 Section 5 of the 1907 Act treats any limited partnership which is not registered in accordance with the Act as a general partnership, thus excluding the limited liability of the limited partners. The same result appears to follow if the registered particulars are inaccurate<sup>7</sup> or if the limited partnership does not notify the registrar of the changes listed in section 9.<sup>8</sup> We suggested that it was unduly harsh to deprive limited partners of the limitation of their liability for what may be no more than an administrative mistake or a comparatively trivial change. This was so, particularly as the general partner has control over registration procedures.
- 16.9 We therefore proposed that general partners should be fully responsible for the registration formalities and should have exclusive authority to sign the original registered particulars and any amendments.<sup>9</sup> We also proposed that default in registration formalities should not remove the limited liability of limited partners but that the general partner or general partners should be liable for daily fines similar to those which apply to companies.<sup>10</sup>
- 16.10 Consultees unanimously supported the proposal that general partners should be fully responsible for the registration formalities and that they alone had authority to sign the original registered particulars and any amendments. There was also unanimous support for the proposition that default in registration formalities should not remove the limited liability of limited partners. Almost all consultees

<sup>4</sup> Draft Bill, cl 1(2).

<sup>5</sup> See para 4.15 above.

<sup>6</sup> Joint Consultation Paper (LP), paras 3.4 – 3.7.

<sup>7</sup> See *MacCarthaigh v Daly* [1985] IR 73, where protection was temporarily lost, because the contributions, which were referred to in the registration particulars as having been made, were not paid until some months later.

<sup>8</sup> See *Lindley & Banks*, para 29-28.

<sup>9</sup> This involves altering the rule in the 1907 Act, s 8, which requires all the partners to sign the initial registration statement.

<sup>10</sup> Joint Consultation Paper (LP), para 3.48.

supported our proposal of daily default fines on the general partners at the levels which apply to companies. One consultee suggested that a distinction should be drawn between deliberate defaults and accidental errors and that the default fine should be exacted only in respect of the period in which the general partner was aware of, and failed to correct, the default.

- 16.11 The unanimous support of consultees confirms our view that it is not appropriate to preserve the harsh consequences of minor defaults in registration formalities for limited partners.<sup>11</sup> It would be possible to empower would-be limited partners to register themselves as limited partners and to require that limited partners should give notice of ceasing to be limited partners. Nevertheless, we think that it is simpler to impose registration obligations exclusively on the general partner or general partners in most circumstances. Only where there is no general partner will a limited partner be empowered to register a notice that he is ceasing to be a limited partner.<sup>12</sup>
- 16.12 At the same time, not all limited partnerships are in fact managed by the general partner. Many limited partnerships are collective investment schemes under the Financial Services and Markets Act 2000 (FSMA) and therefore must be operated by an “authorised person”.<sup>13</sup> The general partner is rarely an authorised person under FSMA. The general partner therefore usually appoints a manager, who is an authorised person, to operate the limited partnership. We consider that where the general partner has appointed a manager who is an authorised person to operate the business of the limited partnership, the obligation to sign documents and comply with registration requirements should fall on the authorised person. This is because establishing, operating or winding up a collective investment scheme is a regulated activity and a general partner would be criminally liable if he undertook such activity without authorisation. The authorised person and not the general partner must sign the documents and be responsible for registration formalities.<sup>14</sup> The only document which the authorised person may not sign is the original application for registration which must be signed by the proposed general partner or general partners.<sup>15</sup>

<sup>11</sup> A radical default in registration, such as a failure to register the limited partnership or to register a person as a limited partner, could however deprive a person intending to be a limited partner of limited liability.

<sup>12</sup> This is necessary to deal with the circumstance where a general partner has died (or, if a corporate body, has been dissolved) and a limited partner wants to become a general partner, for example to avoid the risk of de-registration. In this circumstance the limited partner wishing to become a general partner may sign his own notice (draft Bill, Sched 7, para 4(5)). Where there is no general partner and a limited partner wishes to leave the partnership, the limited partner will have to arrange the appointment of another general partner (draft Bill, cl 60(1)) or arrange the break up of the partnership either by a vote of the limited partners (draft Bill, cl 61(1)) or by applying to the court (draft Bill, cl 47(1)).

<sup>13</sup> A person may carry on a regulated activity in the United Kingdom only if he is an authorised person or an exempt person (FSMA, s 19). A person obtains authorisation from the Financial Services Authority under Part IV of FSMA. Section 38 of the FSMA empowers the Treasury to make exemption orders.

<sup>14</sup> See the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001 No 544) (as amended), Art 51.

<sup>15</sup> Draft Bill, cl 66(2). Normally there will be no partnership in existence before the limited partnership is registered and thus no person to authorise the manager to act on the

16.13 We think that the existing level of default fines is unduly low<sup>16</sup> and that assimilation with the levels applied to companies is appropriate. We do not think that it would be practicable to distinguish between deliberate defaults and accidental errors and therefore support the imposition of set daily fines.

16.14 **We therefore recommend that:**

- (1) General partners should be fully responsible for the registration formalities and (subject to (4) below) should have authority to sign the original registered particulars and any amendments, and where applicable authorised managers should have the same responsibility and authority except for signing the original application for registration;**
- (2) Where there is default of registration formalities, the general partner or general partners, or where applicable the authorised manager, should be liable for daily fines similar to those which apply to companies;**
- (3) Default in registration formalities should not of itself remove the limited liability of the limited partners; and**
- (4) A limited partner should sign a notice of a person ceasing to be a limited partner only if (a) he is the person ceasing to be a limited partner and is to become a general partner and (b) the partnership does not have one or more general partners, and limited partners should sign an application to de-register a limited partnership only if there are no general partners. (Draft Bill, cls 66(2) and 68; Schedule 7, paras 1(3), 2(3), 3(4), 4(4), 4(5), 5(5), 5(7), 6(1); Schedule 8, paras 1(4) and (5))**

#### **OTHER RESPONSIBILITIES OF THE GENERAL PARTNER**

16.15 As general partners alone have the right to manage the business, it makes sense that they should have the sole decision-making power in relation to ordinary business matters and that responsibility for performing statutory requirements should fall on them.

16.16 Thus we think that there should be a default rule that differences as to ordinary matters relating to the partnership business may be decided by the general partner or a majority of general partners. Other matters require the unanimous decision of the general partners.<sup>17</sup> There should also be a default rule that the consent of the

partnership's behalf. To protect the general partner from liability under the FSMA for "establishing" a collective investment scheme by signing the application for registration, we will recommend an amendment to the FSMA as a consequential provision under cl 78 of the draft Bill.

<sup>16</sup> The 1907 Act, s 9(2) sets the daily default fine in respect of failure to register changes at a maximum of £1 per day.

<sup>17</sup> These are default rules; a partnership agreement could allow a limited partner to participate in decisions. But making decisions about ordinary matters would be likely to amount to

general partner, or all of the general partners, is necessary before a person may become a partner.

16.17 The general partner or general partners should bear responsibility for ensuring that the partnership name is stated on partnership documents. Also it should be the general partner or general partners who should have power to wind up the firm.

16.18 Again, where the limited partnership is a collective investment scheme under FSMA the authorised manager will have responsibility for ensuring that the partnership name is stated on partnership documents and winding up the firm.

16.19 **We therefore recommend that:**

- (1) There should be a default rule that any difference arising as to ordinary matters connected with the partnership business may be decided by the general partner, or if there is more than one general partner, by a majority of them. (Draft Bill, cl 59(4))**
- (2) There should be a default rule that differences about other matters relating to the partnership must be decided by the general partner, or if there is more than one general partner, all of them; (Draft Bill, cl 59(5))**
- (3) There should be a default rule that a decision whether a limited partner should be given authority to act on behalf of the partnership is not an ordinary matter; (Draft Bill, cl 59(6))**
- (4) There should be a default rule that a person may become a partner in a limited partnership only with the consent of the general partner, or if there is more than one general partner, all of them, or, if there are no general partners, all the limited partners; (Draft Bill, cl 60(1) and (3))**
- (5) A general partner who without reasonable excuse fails to ensure that the name of the limited partnership and the address of its registered office are stated on any partnership document should be guilty of an offence and liable to a fine; (Draft Bill, cl 65(3))**
- (6) There should be a default rule that, unless the court orders otherwise or there are no general partners, the general partner, or if there is more than one general partner, all of them are responsible for winding up the partnership. (Draft Bill, cl 61(2))**

involvement in management which would contravene cl 55 of the draft Bill and expose the limited partner to unlimited liability.

### **LIMITED PARTNER EXCLUDED FROM MANAGEMENT**

- 16.20 Under the 1907 Act a limited partner may not take part in management.<sup>18</sup> The limited partnership is a useful vehicle for investors who do not wish to take an active role in the management of their funds. They may use it to create an investment fund under the control of a general partner who alone has unlimited liability for the partnership's obligations. The limited partner is only liable to the extent of his capital contributions (if any), provided he does not take part in the management of the partnership business. We discuss in the next Part whether we should give further guidance on what constitutes "management".<sup>19</sup> The basic rule however appears sound.
- 16.21 **We therefore recommend that a limited partner should not take part in the management of the partnership business.** (Draft Bill, cl 55(1))

### **LIMITED PARTNER NOT AN AGENT**

- 16.22 At present a limited partner has no implied power to bind the firm. We see no need to alter this rule. We propose that a limited partner when acting in his capacity as limited partner should have no implied (or usual) authority to bind the partnership. It is, of course, possible for the general partners to give a limited partner express authority to act on behalf of the partnership.<sup>20</sup> But a limited partner would require to act with care as involvement in the management of the partnership would remove the limitation on his liability.<sup>21</sup> In addition a limited partner may incur liability under the general law by holding himself out as a general partner if a third party relies on that representation to his detriment.
- 16.23 **We therefore recommend that a limited partner should have no implied authority to bind the partnership.** (Draft Bill, cl 59(2))

### **A SPECIAL DEFINITION OF CARRYING ON "BUSINESS"?**

- 16.24 In the Joint Consultation Paper (LP) we discussed the definition of "business" in section 45 of the 1890 Act.<sup>22</sup> In our proposals for the reform of general partnerships we had suggested that there was no need to redefine the term "business", as the term is sufficiently wide to cover all commercial undertakings and seems apt to include investment as a commercial venture.<sup>23</sup> Because some consultees suggested that there is doubt among those who use limited partnerships as investment vehicles as to whether carrying on investment activities falls within the ambit of carrying on business for the purposes of the 1907 Act, we raised the issue again in our consultation on limited partnerships. We asked consultees

<sup>18</sup> 1907 Act, s 6(1).

<sup>19</sup> See paras 17.3 – 17.17 below.

<sup>20</sup> We have recommended in para 16.19 above that the decision to give a limited partner such authority should be an extraordinary matter requiring unanimity among the general partners.

<sup>21</sup> See para 17.23 below.

<sup>22</sup> Joint Consultation Paper (LP), paras 3.8 – 3.10.

<sup>23</sup> Joint Consultation Paper, para 5.10.

whether they agreed that the 1890 Act definition of “business”<sup>24</sup> is adequate also for the purposes of the 1907 Act (without express reference to “investment”).<sup>25</sup>

- 16.25 Consultees were divided in their responses. Some thought that clarification might be helpful to remove any doubt. Others thought that the definition was wide enough to include all lawful commercial activity, including investment. The Inland Revenue commented:

We have always accepted that the definition of business in the Partnership Act 1890 includes investment carried on as a commercial venture. We therefore do not consider there is a need to amend this definition.

- 16.26 Limited partnerships which are used as investment vehicles are registered by Companies House. The Inland Revenue, as mentioned above, accepts as partnerships firms which carry on investment as a commercial venture. We note also that RUPA defines “business” in substantially the same way as the 1890 Act.<sup>26</sup> We believe that there is no significant problem in practice within Britain: since the Inland Revenue and the DTI approved a statement on the use of limited partnerships as a vehicle for venture capital investment funds on 26 May 1987,<sup>27</sup> it has been generally accepted that “business” in the 1890 Act covers investment carried on as a commercial venture. We therefore think that there is no need to alter the definition of “business”.

#### **OTHER ALTERATIONS TO THE GENERAL LAW OF PARTNERSHIP**

- 16.27 There are several provisions which relate to the general law of partnership which require to be adapted in their application to limited partnerships.<sup>28</sup>
- 16.28 A partnership is formed when persons start to carry on a business together with the object of making a profit.<sup>29</sup> A partnership may have existed as a general partnership before it is converted by registration into a limited partnership or a partnership may first come into existence when registered as a limited partnership. Provision requires to be made for the latter event.
- 16.29 **We therefore recommend that where a partnership has not been formed before registration, the partnership is formed when it is registered as a limited partnership.** (Draft Bill, cl 67(3))

<sup>24</sup> 1890 Act, s 45 provides that the expression “business” includes every trade, occupation, or profession.

<sup>25</sup> Joint Consultation Paper (LP), para 3.10.

<sup>26</sup> RUPA, s 101 provides that “business” includes every trade, occupation, and profession.

<sup>27</sup> The statement explains that a limited partnership established for the purpose of raising funds for investment into companies will be regarded as carrying on a business and will represent a partnership within the definition in s 1 of the 1890 Act for the purposes of United Kingdom taxation.

<sup>28</sup> See the draft Bill, cl 58.

<sup>29</sup> Draft Bill, cl 1(2).

16.30 In Part XVIII below we also make recommendations on the adaptation of the default rules in relation to the fiduciary duties of partners.<sup>30</sup>

#### **OFFENCES**

16.31 As it is important that the information on the register is accurate and as we have recommended that default in registration formalities should not of itself remove the limitation on the liability of limited partners,<sup>31</sup> it is important that a person who provides false information to the registrar should be guilty of an offence. We recommend penalties which are equivalent to the penalties imposed in similar circumstances on company officials and on members of a limited liability partnership.<sup>32</sup> We consider that these penalties are appropriate to deter the dishonest or reckless provision of false information.

16.32 **We therefore recommend that:**

- (1) A person should be guilty of an offence if, when he makes an application to register or de-register a limited partnership, he knows that information in it is false or is aware that the information may be false;**
- (2) A person who is guilty of an offence under (1) above should be liable on summary conviction to imprisonment for up to six months or a fine not exceeding the statutory maximum, or both, or on conviction on indictment, to imprisonment for up to two years or a fine, or both;**
- (3) A person should be guilty of an offence if, when he delivers a notice to the registrar of a change in the particulars of a limited partnership, he knows that information in it is false or is aware that the information may be false; and**
- (4) A person who is guilty of an offence under (3) above should be liable on summary conviction to imprisonment for a period not exceeding six months or a fine not exceeding level five on the standard scale, or both. (Draft Bill, cl 69)**

#### **OFFENCES BY BODIES CORPORATE**

16.33 As it is common for a limited company to be the general partner in a limited partnership, and as we recommend that the general partner should bear responsibility for ensuring compliance with the statutory requirements imposed by the draft Bill, we think that it would be appropriate to provide for offences by bodies corporate.<sup>33</sup> We think that the appropriate regime is that where an officer of

<sup>30</sup> See para 18.12 below.

<sup>31</sup> See paras 16.11 and 16.14 above.

<sup>32</sup> See the Companies Act 1985, s 451 and Sched 24 and the Limited Liability Partnerships Act 2000, s 2(4).

<sup>33</sup> It is also possible for an authorised person under the FSMA to be a corporate body. See the FSMA, s 40.

a body corporate has consented to or connived at an offence or the offence results from his neglect, he as well as the body corporate should be guilty of an offence. Similar liability should be imposed on members of a body corporate who manage that body.

- 16.34 **We therefore recommend that if a body corporate commits an offence under the draft Bill with the consent or connivance of an officer of the body corporate or the offence is attributable to neglect on the part of such an officer, the officer as well as the body corporate should be guilty of the offence. If the affairs of the body corporate are managed by its members, a member of the body may similarly be guilty of an offence.** (Draft Bill, cl 70)

# **PART XVII**

## **THE LIABILITY OF THE LIMITED PARTNER**

### **INTRODUCTION**

- 17.1 In this Part we discuss some of the principal concerns about the defects in the 1907 Act. The essential feature of a limited partnership is that the liability of the limited partners is limited to the amount of their contributions. There is real uncertainty as to what a limited partner may do in relation to the limited partnership without “taking part in the management of the partnership business” and thus losing his limited liability. Resolving this uncertainty is one of our principal reform recommendations in relation to limited partnerships.
- 17.2 In addition we look at the scope of the protection afforded to limited partners and suggest some clarification. Recognising that other jurisdictions have adopted different rules in their statutory reforms of limited partnerships, we also look at capital withdrawal by limited partners and the duration of the liability of a limited partner after his withdrawal from the limited partnership.

### **WHAT CONSTITUTES “MANAGEMENT”?**

#### **The need for further guidance**

- 17.3 Section 6(1) of the 1907 Act provides:
- A limited partner shall not take part in the management of the partnership business, and shall not have power to bind the firm:
- Provided that a limited partner may by himself or his agent at any time inspect the books of the firm and examine into the state and prospects of the partnership business, and may advise with the partners thereon.
- If a limited partner takes part in the management of the partnership business he shall be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general partner.
- 17.4 This provision is deficient because it gives little guidance as to what activities short of management are permissible for limited partners. By contrast, as we stated in the Joint Consultation Paper (LP),<sup>1</sup> several other jurisdictions have provided statutory lists of activities which are not to be regarded as amounting to participation in management. We therefore invited views on whether legislation should provide further guidance on this issue and, if so, whether it should take the form of a list of permitted activities or a list of prohibitions.<sup>2</sup>

<sup>1</sup> Joint Consultation Paper (LP), paras 4.9 – 4.10 and Appendix B.

<sup>2</sup> Joint Consultation Paper (LP), para 4.16.

- 17.5 A considerable majority of consultees thought that there was a need for further guidance to allow a limited partner to know what he could and could not do. One consultee suggested that the term “management” had a clear meaning and needed no further definition. Another suggested that it would be difficult to provide guidance in practice with sufficient definition. But there was strong support for guidance, in particular from consultees with extensive practical experience of the use of limited partnerships as investment vehicles. Consultees also expressed a clear preference for that guidance to be in the form of a list of permitted activities.
- 17.6 We also observed that some jurisdictions, such as Jersey and Delaware, provide that a limited partner loses his limited liability only in relation to a person who transacts with the partnership with knowledge of the limited partner’s participation in management and in the belief that he was a general partner. We provisionally suggested that the loss of protection for a limited partner who takes part in management should not be contingent upon knowledge of a third party dealing with the partnership. Almost all consultees agreed with our provisional view.
- 17.7 **We therefore recommend that there should be a list of permitted activities in which limited partners may engage without loss of their limited liability and that the loss of limited liability should not be contingent upon knowledge of a third party dealing with the partnership.**

#### **The list of permitted activities**

- 17.8 In the Joint Consultation Paper (LP),<sup>3</sup> we provisionally proposed that there should be statutory provision that doing specified acts did not mean that a limited partner was taking part in the management of the firm.<sup>4</sup>
- 17.9 Most consultees supported the proposed list in full. Two consultees<sup>5</sup> agreed with all the activities in the list but thought that the list was too restrictive. Another suggested that the draft Bill should make it clear that the list was not intended to be exhaustive.
- 17.10 On the other hand, one consultee<sup>6</sup> opposed as undesirable any attempt to vary or clarify the law, suggesting that “management” had a clear meaning. There was a clear distinction, they suggested, between business decisions and non-business decisions. They also expressed concern over the proposal that a limited partner could be a contractor, agent or employee of the firm as there was a danger that the agent could be the managing executive. Another emphasised that a limited partner

<sup>3</sup> Joint Consultation Paper (LP), paras 4.20 – 4.33.

<sup>4</sup> The acts which we provisionally proposed were the following: (a) consulting and advising the general partner, (b) reviewing or approving the firm’s accounts, (c) being a contractor, agent or employee of the firm or of the general partner, or being a director of or shareholder in a corporate general partner and (d) voting on or approving or disapproving: (i) the winding up of the limited partnership, (ii) an amendment to the partnership agreement, (iii) a change in the nature of the firm’s activities, (iv) the admission, removal or withdrawal of a partner and the continuation of the firm thereafter and (v) a transaction involving an actual or potential conflict of interest between a general and a limited partner.

<sup>5</sup> The APP and BVCA.

<sup>6</sup> The Chancery Bar Association.

as a shareholder in or director of the general partner should not have de facto control.

- 17.11 We recognise the need to exclude management functions from the scope of the permitted activity, but observe that other consultees supported this proposal as a necessary clarification of the law.
- 17.12 Some consultees argued for a more extensive list. One sought a provision that participation in an advisory group or similar organ did not constitute management. Others<sup>7</sup> argued that the law should allow limited partners such management powers as a general partner, who alone had unlimited liability, was prepared to allow.<sup>8</sup> They argued that third parties would not be prejudiced as they enter into dealings with a limited partnership with full knowledge that all limited partners have limited liability. On the other hand, the Inland Revenue noted that there was a distinction between general and limited partners for tax purposes and suggested that the tax distinction reflected their different roles and obligations. We are not persuaded that the distinction between the roles of a general partner and a limited partner should be left to the agreement of the partners.
- 17.13 Another consultee<sup>9</sup> suggested that activities excluded from management should encompass the fixing of remuneration of professional advisers and the approval of borrowing transactions. Other activities which consultees suggested should be excluded were deciding to terminate the partnership, voting for the appointment of a partnership liquidator, and appointing an agent to remedy a default by a general partner.
- 17.14 The APP suggested that we should exclude from participation in management any activity which a limited partner carried out in another capacity, for example as an officer, representative, agent or employee of a general partner. They pointed out that it is common for limited partners also to be employees of the general partner and in that capacity to arrange the investment of the limited partnership's funds. They urged us to allow limited partners to carry out such functions not only for a general partner which is a limited company but also where the general partner was a natural person, an LLP or a partnership. They suggested that a limited partner should be allowed to take an active part in the management of a limited partnership in the capacity of a partner in a partnership, as a member of an LLP or as an employee of a natural person, where the partnership, LLP or natural person was the general partner.
- 17.15 We think that it is appropriate and helpful to those using or advising limited partnerships that there should be a list of permitted activities and that the list should not be exhaustive. There will be other high level decisions which relate to the strategic direction of the partnership which do not involve management of the partnership. An activity will not amount to management simply because it is not

<sup>7</sup> The APP and BVCA.

<sup>8</sup> The Delaware Revised Uniform Limited Partnership Act (Title 6, Chapter 17 of the Delaware Code), s 17-303(b)(8)(n) is a precedent for such an approach.

<sup>9</sup> Nabarro Nathanson.

included in the list.<sup>10</sup> We do not favour an extensive list which might blur the different roles of the limited partner and the general partner. In order to preserve flexibility to deal with changing business practice we also think that the Secretary of State should have power by subordinate legislation to amend the list of permitted activities.

17.16 Nevertheless, there should be a clear distinction between the role of a limited partner and that of a general partner. We recognise that it is possible for a limited partner to act in a different capacity, for example as a director or shareholder in a corporate general partner. Similarly, a limited partner may also be an employee of a general partner, whether the general partner is a limited company or another legal or natural person. In each case it may be possible to provide objective evidence that the limited partner was acting in a capacity other than that of limited partner. For example, if the limited partner asserts that he acted in his capacity as employee, he would have to demonstrate an employer/employee relationship and that he acted as employee.<sup>11</sup> But we are not persuaded that it is advantageous to exclude more nebulous capacities such as “representative”, “officer” or “agent” from the prohibition against taking part in management as that could be a recipe for uncertainty and potential abuse.

17.17 **We therefore recommend that a limited partner should be prohibited from taking part in the management of partnership business but that it should be provided that that prohibition does not prevent a limited partner from doing the following things:**

- (1) Taking part in a decision about the variation of the partnership agreement;**
- (2) Taking part in a decision about whether to approve, or veto, a class of investment by the limited partnership;**
- (3) Taking part in a decision about whether the general nature of the partnership business should change;**
- (4) Taking part in a decision about whether to dispose of the partnership business or to acquire another business;**
- (5) Taking part in a decision about whether a person should become or cease to be a partner;**

<sup>10</sup> Because a limited partner may be involved in certain decisions without breaching the prohibition against involvement in management we have not replicated s 6(2) of the 1907 Act by excluding the incapacity of a limited partner from the grounds (in cl 47 of the draft Bill) on which the court may remove a partner or break up a partnership. In many cases where a limited partner is a passive investor, his incapacity will not affect the running of the partnership business. There will therefore normally be no grounds under cl 47 of the draft Bill for removing the partner or breaking up the partnership.

<sup>11</sup> The limited partner might also have to demonstrate to the Inland Revenue that his share of the profits of the limited partnership was received in his capacity as a limited partner and was not remuneration arising from his employment.

- (6) **Taking part in a decision about whether the partnership should end;**
- (7) **Taking part in a decision about how the partnership should be wound up;**
- (8) **Enforcing his rights under the partnership agreement (unless those rights are to carry out management functions);**
- (9) **Approving the accounts of the limited partnership;<sup>12</sup>**
- (10) **Being engaged under a contract by the limited partnership or by a general partner in the limited partnership (unless the contract is to carry out management functions);**
- (11) **Acting in his capacity as a director or employee of, or a shareholder in, a corporate general partner;**
- (12) **Taking part in a decision which involves an actual or potential conflict of interest between a limited partner (or limited partners) and a general partner (or general partners);**
- (13) **Discussing the prospects of the partnership business;**
- (14) **Consulting or advising a general partner, or general partners, about the activities of the limited partnership or about its accounts (including doing so as a member of an advisory committee of a limited partnership).** (Draft Bill, cl 55(1) and (2) and Schedule 6)

**We also recommend that the Secretary of State should have power by subordinate legislation to amend this list (by adding, modifying or omitting a permitted activity).** (Draft Bill, cl 55(3))

#### **SCOPE OF PROTECTION OF A LIMITED PARTNER**

##### **Clarifying section 4(2) of the 1907 Act**

17.18 The 1907 Act generally limits the liability of a limited partner to the amount of his contribution. Section 4(2) achieves this by providing that the limited partners:

... shall not be liable for the debts or obligations of the firm beyond the amount so contributed.

17.19 In the Joint Consultation Paper (LP) we referred to the concern which Michael Twomey had expressed as to the scope of the protection which the provision gave to a limited partner. We suggested that it was the clear intention of the 1907 Act that except when protection is lost under the Act, a creditor of the firm can only obtain a personal judgment against a limited partner to the extent of his

<sup>12</sup> In the Joint Consultation Paper (LP), para 4.33(1)(b) we referred to “investigating, reviewing or approving” the firm’s accounts. We think that approving the accounts encompasses both investigating and reviewing them.

contribution. Nonetheless, we asked consultees if there was a need to clarify the effect of section 4(2) by stating that it excludes any form of liability, direct or indirect, beyond the amount of the limited partner's contribution.<sup>13</sup> This question generated a considerable response and the majority of consultees favoured some clarification.

17.20 Similarly, there was support for a provision to ensure that the position of a limited partner is protected in any court order against the firm,<sup>14</sup> although some consultees thought that the provision would be unnecessary.

17.21 We also asked whether, where a limited partner loses his status as such by participation in management or otherwise, he should nonetheless enjoy protection except in the event of insolvency.<sup>15</sup> Consultees generally saw no need to change the law. We agree. We see no strong policy reason for depriving a partnership creditor of recourse against a limited partner's general assets while the limited partnership remains in business, if the limited partner has by his actions lost the limitation on his liability. We think that to give this additional protection would blur the distinction between the two categories of partner. The limited partner's participation in management may involve a one-off decision or may continue over time. If it is continuing, the limited partner's liability will replicate that of a general partner as he will be liable for all partnership obligations incurred during the period of his non-compliance with the prohibition. If it is a single decision or action that constitutes taking part in management, the limited partner will be liable for the partnership obligations arising from that decision or action.

17.22 The limited partner also loses in part the limitation of his liability where he receives back all or part of his agreed capital contribution while he remains a partner. We discuss this below.<sup>16</sup>

17.23 **We therefore recommend that the protection available to a limited partner should be clarified by providing:**

**(1) That a limited partner is not personally liable (whether to third parties or by contribution to the liability of the general partner) for any partnership obligation incurred while he is a limited partner, unless he receives back all or part of his capital contribution;** (Draft Bill, cl 56)

**(2) Where a limited partner takes part in the management of the partnership business he is personally liable for any partnership obligation incurred as a result of his taking part in management**

<sup>13</sup> Joint Consultation Paper (LP), paras 4.2 – 4.7. Mr Twomey's concern was that under the 1890 Act a partner is personally liable for the debts and obligations of the firm and that under s 7 of the 1907 Act the ordinary rules of partnership law apply to limited partnerships. The 1907 Act contains no express provision to protect the limited partner from proceedings to enforce a partnership debt. See *Twomey*, para 28.95.

<sup>14</sup> Joint Consultation Paper (LP), para 4.7(2).

<sup>15</sup> This is the position in Jersey. See Limited Partnerships (Jersey) Law 1994, Art 19(3) and (4).

<sup>16</sup> See paras 17.32 – 17.33 below.

**and for any other partnership obligation during the period when he takes part in management.** (Draft Bill, cl 57)

**CAPITAL WITHDRAWAL AND THE LIABILITY OF A LIMITED PARTNER AFTER LEAVING THE FIRM**

17.24 In the Joint Consultation Paper (LP),<sup>17</sup> we observed that there were doubts as to the right of limited partners to withdraw their capital contributions and the consequences for their liabilities, whether before or after they leave the partnership.<sup>18</sup> We identified four issues:

- (1) Is there, or should there be, any obligation to restore capital out of profits?
- (2) When can capital be withdrawn?
- (3) Liability following assignment or, in Scotland, assignation; and
- (4) Should there be any time-limit to the limited partner's liability?

17.25 We deal with liability following assignment in the next Part and address the other three issues below.

**Restoration of lost capital**

17.26 We asked consultees if there should be any restriction on the payments which a limited partnership could make to limited partners (whether out of profits or otherwise) where capital contributions have been lost in the course of business.<sup>19</sup>

17.27 Most consultees appeared to share our view that the issue was not of practical importance and did not support any restriction. Some, who opposed a restriction, agreed with our view that third parties are more likely to see their protection as resting on the unlimited liability of the general partners. One suggestion was that it would be preferable to require in such a case that the capital shown in the registered particulars be amended, if necessary to zero. This would give a third party the means to discover how much capital there was in the partnership. Another suggestion was that liability should be imposed where a limited partner withdraws assets in the knowledge of the firm's potential insolvency.<sup>20</sup>

17.28 As we do not think that this is a significant practical problem and as consultees expressed no real enthusiasm for change we do not recommend any restriction on

<sup>17</sup> Joint Consultation Paper (LP), paras 4.34 – 4.37.

<sup>18</sup> 1907 Act, s 4(3) provides: A limited partner shall not during the continuance of the partnership, either directly or indirectly, draw out or receive back any part of his contribution, and if he does so draw out or receive back any such part shall be liable for the debts and obligations of the firm up to the amount so drawn out or received back.

<sup>19</sup> Joint Consultation Paper (LP), para 4.40.

<sup>20</sup> See by way of analogy the liability of a partner in a limited liability partnership to contribute to the assets of the LLP where he has withdrawn property from the LLP within two years before its insolvency and in the knowledge of its potential insolvency: Insolvency Act 1986, s 214A.

payments to limited partners where contributions have been lost in the course of business.

17.29 In response to our question whether any other change should be made to the rules relating to the contributions of limited partners,<sup>21</sup> consultees made several suggestions. One consultee adverted to the practice of making advances as well as capital contributions and suggested that it should be made clear that the restriction on withdrawal of contribution related only to the capital contribution.<sup>22</sup> Another commented on the widespread practice of making loans instead of capital contributions and suggested that one could avoid the need for loans if the law allowed the withdrawal of capital, subject to registration of the withdrawal. Another consultee urged the adoption of the approach of the Delaware legislation, which dispenses with the requirement of a capital contribution.<sup>23</sup> They argued that third parties do not rely on the capital base of a firm but on the unlimited liability of the general partners.

17.30 While we recognise that the practical utility of the prohibition against withdrawal of capital is limited, particularly in limited partnerships which are funded by loans and which have only minimal capital contributions, we see no pressing need for change. We therefore do not recommend any change, beyond clarifying that the contribution which may not be withdrawn is the capital contribution and not an advance. The capital contribution in this context is, in the default regime,<sup>24</sup> the amount of capital which the limited partner has agreed with the partners to contribute to the limited partnership and which therefore comprises his agreed capital account. It is the agreed sum of capital that the partner is putting at risk in the partnership business and is a matter of agreement between the partners. It may comprise money or property. If the capital contribution is property the partners must agree the value of that property which is then stated in the partner's capital account. The amount of the capital contribution and any variation of that contribution must be registered.<sup>25</sup> This registered capital contribution differs from an agreed advance to the limited partnership, which is not registered and may be repaid to the limited partner without compromising his limited liability.

17.31 **We therefore recommend that:**

- (1) While a person remains a limited partner he is not entitled either directly or indirectly to withdraw or receive back any part of his agreed capital contribution (“the relevant capital contribution”) to the partnership; (Draft Bill, cl 56(2))**

<sup>21</sup> Joint Consultation Paper (LP), para 4.40(3).

<sup>22</sup> In cl 13 of the draft Bill we distinguish between a partner's capital contribution, which (in the default regime) requires the agreement of all the partners, and advances made by a partner beyond the amount of the agreed capital contribution. In the context of the limited partnership the restriction on withdrawal of capital applies only to the agreed capital contribution, if any.

<sup>23</sup> See para 17.34 below.

<sup>24</sup> See the draft Bill, cl 13(2).

<sup>25</sup> Draft Bill, cl 66(3) and Sched 7, para 5.

- (2) **A partner’s “relevant capital contribution” should mean a capital contribution consisting of either or both of a sum or sums of money and property which has an agreed capital value.** (Draft Bill, cl 56(4))

17.32 The sanction which we think appropriate for such withdrawal of capital is that the limited partner should remain liable for partnership debts and obligations to the extent of the capital contribution. Thus if a limited partner has withdrawn his capital, he will be liable to creditors of the partnership to the extent of his capital contribution and creditors will be entitled to enforce their claims against his assets to that extent. For example, a limited partner may make a capital contribution of £100,000 and subsequently receive back £60,000 while he remains a limited partner. In this case a partnership creditor who is owed £80,000 by the limited partnership would be able to seek payment of his debt in full from the partnership and from the general partner and may seek payment of up to £60,000 from the limited partner who has incurred secondary liability to that extent.<sup>26</sup>

17.33 **We therefore recommend that if a limited partner withdraws or receives back all or part of his agreed capital contribution he should be personally liable for partnership obligations incurred while he is a limited partner, but that his liability should not exceed the amount of his capital contribution drawn out or received back.** (Draft Bill, cl 56(3))

17.34 Our discussions with interested parties have caused us to question the utility of a requirement on a limited partner to contribute capital. The 1907 Act does not specify the amount of a limited partner’s contribution.<sup>27</sup> It is common practice for limited partners to make a nominal contribution and to finance the limited partnership by making advances to it. Some other jurisdictions do not require the making of a contribution.<sup>28</sup> For example, the Delaware legislation allows a person to be admitted as a limited partner and receive an interest in the limited partnership:

Without making a contribution or being obligated to make a contribution to the limited partnership.<sup>29</sup>

17.35 We see no reason to compel a limited partner to make a capital contribution. Instead, we think that the appropriate rule is to give him an option to make such a

<sup>26</sup> Usually, the creditor’s primary remedy will be against the limited partnership itself but the creditor will have recourse against the general partner’s assets by virtue of his secondary liability and also the limited partner’s assets to the extent of any capital withdrawal.

<sup>27</sup> 1907 Act, s 4(2) merely provides that the limited partners “shall at the time of entering [the] partnership contribute thereto a sum or sums as capital or property valued at a stated amount...”.

<sup>28</sup> See the Limited Partnerships (Jersey) Law 1994, Art 10 and the Ontario Limited Partnership Act 1990, s 7(1).

<sup>29</sup> Delaware Revised Uniform Limited Partnership Act (Title 6, Chapter 17 of the Delaware Code), § 17-301(d).

contribution and to provide that the capital contribution may be in the form of a cash sum or sums or property valued at an agreed amount.<sup>30</sup>

- 17.36 **We therefore recommend that the requirement that a limited partner make a contribution should be replaced by an option to make a capital contribution.** (Draft Bill, cl 56(2))

#### **When may capital be withdrawn?**

- 17.37 We expressed the view that the correct interpretation of section 4(3) of the 1907 Act, which prohibits withdrawal of contribution “during the continuance of the partnership”, was that the words referred to the continuance of the firm of which the limited partner was a member. We do not think the 1907 Act restricts the withdrawal of a limited partner’s capital when he leaves the partnership. We seek to make it clear that there is no such prohibition in our recommendation in paragraph 17.31 above through the words “while a person remains a limited partner”, and the use of those words in the draft Bill.

#### **Duration of liability**

- 17.38 In the United Kingdom, a former limited partner, who has received his contribution back on ceasing to be a member, remains liable up to the amount withdrawn for any debts and obligations incurred by the partnership before his departure.<sup>31</sup> Several jurisdictions impose time limits on the liability of a limited partner.<sup>32</sup> We asked consultees if there should be a time limit to the liability of the limited partner following withdrawal of his contribution, and, if so, how long and subject to what qualifications.<sup>33</sup>
- 17.39 Consultees in England and Wales were equally divided in their views on the desirability of a time limit. There was more support for the idea in Scotland but without any consensus on the period, some consultees suggesting that it should be five years so as to equate with the short negative prescription. Those who argued against a time limit pointed out that a partner in a general partnership does not enjoy a special time limit on his liability and that the limited partner’s liability was limited to his contribution.
- 17.40 Under our recommendations the limited partner incurs no liability when he withdraws his capital contribution on ceasing to be a limited partner in the limited partnership.<sup>34</sup> The issue therefore is whether there should be a special time limit on his liability arising from withdrawal of his agreed capital contribution while he remains a limited partner. On reflection, we do not support the introduction of a

<sup>30</sup> Where the limited partner makes, or varies the amount of, an agreed capital contribution, that capital contribution must be registered. See draft Bill, cls 66, 68 and Sched 7, para 5 and also paras 15.38 and 15.51 above.

<sup>31</sup> See *Lindley & Banks*, para 30-20.

<sup>32</sup> In Jersey the time limit is six months after the date of receipt of the contribution. Guernsey sets a twelve-month period and Delaware sets three years.

<sup>33</sup> Joint Consultation Paper (LP), para 4.49.

<sup>34</sup> Clause 56(2) of the draft Bill limits the prohibition against withdrawal to the period “while a person remains a limited partner”.

time limit other than those arising in English law through limitation and in Scotland through prescription. We have recommended that there be a special time limit for the secondary liability of partners.<sup>35</sup> This should apply equally to a limited partner who incurs secondary liability by the withdrawal of all or part of his capital contribution. Thus, where a limited partner has received back all or part of his capital contribution while he remains a limited partner, he will retain secondary liability for partnership obligations to the extent of that withdrawal until that liability is extinguished by limitation or prescription.

<sup>35</sup> See the draft Bill, cl 25 and Sched 2.

# **PART XVIII**

## **THE RIGHTS AND OBLIGATIONS OF PARTNERS IN A LIMITED PARTNERSHIP**

### **INTRODUCTION**

- 18.1 In this Part we consider principally the rights and obligations of partners. In a limited partnership, these are normally regulated by a written partnership agreement. While we see less need to create default rules for limited partnerships than for general partnerships, there are a number of issues where statutory provision may give greater certainty to those who draw up partnership agreements for limited partnerships.
- 18.2 We also consider issues which may affect third parties, namely whether the limited partner should have power to apply to the court to wind up the partnership and whether he may vote in relation to the appointment of a partnership liquidator.

### **MATTERS REQUIRING THE CONSENT OF THE LIMITED PARTNERS**

- 18.3 We invited views on the proposition that (as at present),<sup>1</sup> unless there were agreement to the contrary, the consent of the limited partners should be needed for any change to the partnership agreement or any change to the nature of the business.<sup>2</sup>
- 18.4 Almost all consultees agreed with the proposition. One suggested that the default rule might be qualified so that it would not be necessary to obtain the consent of limited partners to any change to the partnership agreement which affected only the rights and duties of general partners between themselves. We think that this is an unnecessary complication in a context where default rules are rarely relied on. Consultees also agreed with our proposal that no further consent requirements should be imposed as default provisions.<sup>3</sup>
- 18.5 Under the existing law the consent of all the general partners is required for the appointment of another general partner.<sup>4</sup> Limited partners have no default rights to consent to such an appointment. Similarly, additional limited partners can be introduced without the consent of limited partners. While the partners in a particular limited partnership may choose to confer on its limited partners wider powers of control over the appointment or introduction of new partners, we saw no need for default rules on this matter. In addition it appears to be the existing law that where a partnership agreement does not permit a general partner to retire,

<sup>1</sup> 1890 Act, ss 19 and 24(8).

<sup>2</sup> Joint Consultation Paper (LP), para 5.6.

<sup>3</sup> One consultee suggested that there was a case for making the default provisions coincide with those applying to LLPs. We are not persuaded of the need to assimilate the rules of limited partnerships and LLPs as an LLP is far removed from a normal partnership.

<sup>4</sup> 1907 Act, ss 6(5)(d) and 7, 1890 Act s 24(7).

all the partners must consent to his retirement.<sup>5</sup> We proposed that there should be no further default provisions relating to the rights of limited partners over the admission or dismissal of general partners.<sup>6</sup> Consultees almost unanimously supported the proposal.<sup>7</sup>

- 18.6 We propose to give effect to consultees' views. There seems to be little concern that limited partners should have a role in choosing a general partner. Thus a limited partner who is unhappy with the management of the partnership must either assign his interest or, more drastically, seek the winding up of the partnership. We have already recommended default rules (a) that the consent of the general partner or general partners is required for a person to become a partner and (b) that a majority of general partners should decide differences as to ordinary matters connected with the partnership business.<sup>8</sup>
- 18.7 **We therefore recommend that it should remain a default rule that the consent of limited partners should be needed for (a) any change to the partnership agreement and (b) any change to the nature of the business and (c) the retirement of a general partner.** (Draft Bill, cls 4, 6(4) and 28(1))

#### **FIDUCIARY DUTIES AND OTHER DUTIES**

- 18.8 In a limited partnership it is the duty of the general partner to manage the business. It is important that he should owe fiduciary duties to limited partners who are largely passive investors in the partnership. In theory, the same fiduciary duties apply to limited partners although they are unlikely to be of practical relevance.
- 18.9 We therefore asked consultees if there should be any statutory qualification to the existing fiduciary duties which a limited partner owes to his partners or the partnership.<sup>9</sup>
- 18.10 Consultees were divided in their responses. Many favoured no qualification to the existing fiduciary duties but almost as many thought that it was anachronistic for a limited partner, who is essentially an investor, to be under a duty not to compete. The latter argued that there should not be a duty on a limited partner to account for profits from a competing business.
- 18.11 A limited partner will normally take no active role in the day to day business and affairs of a limited partnership. Involvement in management will deprive him of the privilege of limited liability. Under our recommended regime a limited partner will be subject to the overarching duty of good faith to which all partners are subject.

<sup>5</sup> See *Lindley & Banks*, para 31-21.

<sup>6</sup> Joint Consultation Paper (LP), para 5.11.

<sup>7</sup> Again one consultee argued for the assimilation of the default rules of limited partnerships with those of LLPs. Another thought that a limited partner required to be confident about the management of the partnership and that there should be default rules about the involvement of limited partners in the appointment and dismissal of general partners.

<sup>8</sup> See para 16.19 above.

<sup>9</sup> Joint Consultation Paper (LP), para 5.15.

As the limited partner will normally have only a limited role, the content of that duty will generally be narrower than that owed by general partners. This will be so particularly if the partnership agreement excludes limited partners from participation in certain of the strategic decisions which they otherwise could take without involving themselves in management. In such circumstances the limited partner will be a purely passive investor and the practical scope of the duty of good faith will be very limited. Where a limited partner participates in strategic decisions it is important that he should act in good faith in his decision making. We also consider that certain of the specific fiduciary duties of a partner should not apply to a limited partner unless it is otherwise agreed in the partnership agreement. Investment in a competing business or active involvement in that business should not in many circumstances result in a conflict of interest with his status as a limited partner. We think that there is a case for removing the default rule that a limited partner should account to the partnership for profits from a competing business. We also think that there should not be a default rule requiring him to keep the other partners informed of partnership matters and help maintain partnership records.<sup>10</sup> If a limited partnership wished to impose such a duty on its limited partners it could always do so. Under the default rules, the limited partner would still owe a duty of good faith to the partnership and the duty to account for private profits derived from, among other things, a transaction affecting the partnership.<sup>11</sup>

18.12 **We therefore recommend that:**

- (1) In the absence of an agreement to the contrary, a limited partner should not be under a duty to keep the other partners fully informed of partnership matters or a duty to account to the partnership for profits made by him in a competing business; and**
- (2) In the absence of an agreement to the contrary, a limited partner should not be under duties to ensure that accounting records are maintained and to co-operate with persons keeping partnership records.** (Draft Bill, cl 59(1))

**PROFITS AND LOSSES**

18.13 In the Joint Consultation Paper (LP), we asked consultees whether a revised 1907 Act should provide, in the absence of agreement to the contrary, that a limited partner's share of any losses should be debited against his share (if any) of future profits.<sup>12</sup> We thought that there might be some advantage in such a provision as it would articulate the difference between partners in a general partnership and limited partners. While both types of partner would, under the default rules, share equally in profits and trading losses,<sup>13</sup> limited partners do not have to contribute to the firm beyond their capital contributions in order to meet the firm's liabilities to

<sup>10</sup> See the draft Bill, cls 9(2)(a) and 15.

<sup>11</sup> See the draft Bill, cl 9(1) and (2)(b).

<sup>12</sup> Joint Consultation Paper (LP), para 5.19.

<sup>13</sup> 1890 Act, s 24(1).

third parties.<sup>14</sup> Thus during the continuance of the partnership business a limited partner's share of future profits may be reduced by his allocated share of past losses. As there is less need for default rules in relation to limited partnerships than for general partnerships, we made no provisional proposal.

- 18.14 While some consultees favoured such a provision, there was strong opposition from, among others, the Chancery Bar Association. They and several others thought that the matter could be left to an express partnership agreement. It was suggested that most limited partnerships have agreements which provide that each partner has an account to which partnership losses are debited and partnership profits credited.
- 18.15 On reflection, while the provision would represent the general understanding of how a limited partnership would operate, we think that there is no need for such a default rule. We therefore do not propose such a provision.

#### **ASSIGNMENT/ASSIGNATION BY, AND RETIREMENT OF, LIMITED PARTNERS**

- 18.16 We proposed that the rights of a limited partner to assign his share should be set out in a single section, generally reproducing the existing law.<sup>15</sup> In particular we proposed that the rights, liabilities and obligations of the assignee and assignor, following an assignment (assignment) should be expressed in the new section, and that there should be a default rule requiring the consent of all the general partners for an assignment of a limited partner's interest where it involves substitution. We also proposed that, as between partners, consent to the retirement of a limited partner should be left to agreement.<sup>16</sup> Consultees generally supported these proposals. One consultee argued that the default rule should be that a limited partner may assign his interest without the consent of the general partners. But most consultees expressed satisfaction with the present law.<sup>17</sup>
- 18.17 We think that the present law should be re-enacted in a clear way. In clause 36 of the draft Bill we have provided that the assignee of a partner's share may not take part in the management of the partnership business,<sup>18</sup> but that this provision does not prevent the assignee from becoming a partner in place of the assignor if either all the partners agree to the substitution or the substitution is in accordance with the partnership agreement. This provision, so far as it relates to consent to substitution, requires to be adapted for limited partnerships by substituting the consent of the general partners for the consent of all the partners.

<sup>14</sup> See *Reed v Young* [1986] 1 WLR 649, 655-656, *per* Lord Oliver.

<sup>15</sup> At present the default rule for the assignment of a limited partner's share, leading to his substitution as limited partner by the assignee is that such assignment requires the consent of all of the general partners. See the 1907 Act, s 6(5)(b). The rules for assignment of a partner's share, without the substitution of the assignee as partner are contained in the 1890 Act, s 31.

<sup>16</sup> Joint Consultation Paper (LP), para 5.28.

<sup>17</sup> Consultees almost unanimously supported our proposal to repeal s 10 of the 1907 Act, which requires advertisement in the Gazette when the share of a limited partner is assigned. See para 15.48 above.

<sup>18</sup> See para 13.17 above.

- 18.18 **We therefore recommend that an assignee of a partner's share should be able to become a partner in a limited partnership in place of the assignor if either (a) the general partner agrees to the substitution or, if there is more than one general partner, all of them agree to it, or (b) the substitution is made in accordance with the partnership agreement.** (Draft Bill, cl 60(3))

#### MISCELLANEOUS PROPOSALS

- 18.19 In the Joint Consultation Paper (LP) we discussed the existing rules governing the dissolution and winding up of partnerships.<sup>19</sup> We did not propose any alteration to the existing rule that the death or bankruptcy of a limited partner does not dissolve the limited partnership.<sup>20</sup> We proposed no change to the existing default rule that the other partners cannot dissolve a partnership if a limited partner has allowed his share to be charged for his own debts.<sup>21</sup> This proposal has been altered by our recommendation to allow the expulsion of a partner who allows his share to be charged.<sup>22</sup>
- 18.20 **We therefore recommend that the power to expel a partner against whom a charging order is made or whose share is arrested in execution should not apply to a limited partner.** (Draft Bill, cl 60(2))
- 18.21 We also expressed the provisional view that the grounds for dissolution of a partnership did not require to be modified for limited partnerships. In the reformed partnership regime which we propose, we describe what is presently called "dissolution" as the "break up" of a partnership. We propose that, in place of the rule in general partnerships that the partnership breaks up if at least half of the partners agree to end the partnership, a limited partnership should break up if the general partner decides, or if there is more than one general partner at least half of them agree, to end the partnership. If there are no general partners, at least half of the limited partners must agree before the limited partnership breaks up. Otherwise the events which break up a partnership which are set out in clause 38 of the draft Bill should apply also to limited partnerships.
- 18.22 **We therefore recommend that a limited partnership should break up (a) if the general partner decides, or if there is more than one general partner at least half of the general partners decide, to end the partnership, or (b) if there are no general partners, at least one half of the limited partners decide to end the partnership.** (Draft Bill, cl 61(1))
- 18.23 We also propose certain rules in relation to the winding up of a limited partnership. As we have said, it is consistent with our approach to the role of the general partner that, in the event of a break up of the limited partnership, the

<sup>19</sup> Joint Consultation Paper (LP), paras 5.29 – 5.42.

<sup>20</sup> 1907 Act, s 6(2). This has been subsumed in our recommendation that for all partnerships, the death or bankruptcy of a partner does not automatically cause the break up of the firm. See paras 8.101 – 8.110 above.

<sup>21</sup> Joint Consultation Paper (LP), para 5.36; 1907 Act, s 6(3)(c).

<sup>22</sup> See para 8.110(6) above and the draft Bill, cl 31.

general partner or general partners should have the responsibility for winding up the partnership business and affairs, unless the court orders otherwise.<sup>23</sup>

- 18.24 Several rules which apply to partners in a general partnership are appropriate also in relation to both general partners and limited partners in a limited partnership. As a limited partner has an interest in the outcome of a winding up, he should be able to apply to the court for the appointment of a partnership liquidator or a provisional liquidator. Where a liquidator or provisional liquidator is appointed, a limited partner should be under a duty to co-operate with him. In addition, a limited partner should have the right to seek an account and to refer to the court questions arising in the winding up of the limited partnership. A liquidator who wishes to resign should give notice of his intention to do so to the limited partners as well as the general partners.
- 18.25 There are other provisions where we think that there should be special rules in relation to limited partnerships. Normally, a liquidator should be required to notify only the general partners of meetings which he calls in order to present his accounts. But where a partnership agreement empowers limited partners to participate in decisions relating to the winding up of the partnership and to attend meetings which the liquidator calls, the liquidator should be under a duty to notify the limited partners of such meetings. The liquidator should be under the same duty when there are no general partners.
- 18.26 In our recommendations in relation to general partnerships, the liquidator or provisional liquidator requires the approval of the partners or the sanction of the court to exercise certain powers, such as the power to carry on the partnership business. We think that the normal rule should be that the general partner or partners should give that approval. But if the partnership agreement provides otherwise or the partnership has no general partners, limited partners should be entitled to take part in the decision to approve the exercise of such powers.
- 18.27 **We therefore recommend that:**
- (1) The general partner or general partners should have responsibility for winding up the partnership business and affairs, unless the court orders otherwise or there are no general partners;** (Draft Bill, cl 61(2))
  - (2) A limited partner should not have the right to take part in a decision by the partners to approve the exercise by the liquidator or partnership liquidator of powers which require the approval of partners, unless the partnership agreement provides otherwise or the partnership has no general partners;** (Draft Bill, cl 61(3) and (4))
  - (3) Unless the partnership agreement provides otherwise or there are no general partners, the persons entitled to attend meetings to consider the liquidator's annual accounts or final accounts should not include a limited partner, former limited partner or personal representatives of, or insolvency practitioners for, former limited partners.** (Draft Bill, cl 61(3) and (5))

<sup>23</sup> See para 16.19(6) above.

## **PART XIX**

# **SPECIAL LIMITED PARTNERSHIPS**

### **INTRODUCTION**

- 19.1 In this Part we discuss the case for a special form of limited partnership in English law which will not have separate legal personality.

### **BACKGROUND**

- 19.2 The background to this proposal is as follows. In the Joint Consultation Paper (LP)<sup>1</sup> we discussed how, since 1987, limited partnerships have become the standard structure used by venture capitalists not only for the United Kingdom but also for European funds. Scottish limited partnerships, which have separate legal personality, have been used as vehicles for investment in underwriting at Lloyd's since 1997. English limited partnerships (which do not have legal personality) and Scottish legal partnerships have both been used as vehicles for venture capital investment funds. The choice of a limited partnership with legal personality or a limited partnership without legal personality depends on the structure of the proposed investment which in turn will generally be the product of tax planning.
- 19.3 We have referred<sup>2</sup> to the increasing competition between jurisdictions to produce business organisations which will be attractive to businessmen who operate internationally and have suggested that the decision of the Court of Justice in *Centros Ltd v Erhvervs-og Selskabsstyrelsen*<sup>3</sup> has encouraged jurisdictional competition within the European Union. In the Netherlands, legislation was introduced in December 2002 to establish a public partnership which would give the partners the right to opt either for separate legal personality or to have no legal personality. Guernsey amended its Limited Partnerships Law to allow the partners in a limited partnership to elect that the partnership should have legal personality.<sup>4</sup>
- 19.4 Several consultees who responded to the Joint Consultation Paper (LP) voiced concerns about jurisdictional competition and fears that the United Kingdom would be at a competitive disadvantage if it did not modernise its law on limited partnerships as other jurisdictions had done.
- 19.5 We have discussed with the Inland Revenue our proposal to introduce separate legal personality for partnerships and limited partnerships and have received a statement of their intention to maintain the present tax policy of generally treating

<sup>1</sup> Joint Consultation Paper (LP), para 1.4.

<sup>2</sup> See para 3.30 above.

<sup>3</sup> Case C-212/97 [1999] ECR I – 1459.

<sup>4</sup> See the Limited Partnerships (Guernsey) (Amendment) Law 1997. We are not persuaded that the Guernsey model is appropriate as it lacks any provision, for example, as to the way a general partner will be liable for the entity's debts. Nevertheless, the Guernsey initiative and the recent Netherlands legislation are further evidence of the emergence of jurisdictional competition.

partnerships as transparent for tax purposes.<sup>5</sup> There remains, however, the issue of the treatment of partnerships by overseas tax authorities.

- 19.6 In their joint consultation response the APP and BVCA suggested that the tax effectiveness of the English limited partnership in the United Kingdom and in most other jurisdictions together with UK expertise were the principal reasons for the United Kingdom's success as a centre of European private equity investment. In order to preserve the benefit of tax transparency overseas, they suggested that a limited partnership should be able to elect to have legal personality or to be an aggregation as in Guernsey.
- 19.7 We have been greatly assisted by the advice of Mr John Avery Jones, who has, with others, studied host States' characterisation of other States' partnerships for tax purposes,<sup>6</sup> Mr Ross Fraser, and also representatives of the APP with whom we have had further discussions. It appears that separate legal personality in many jurisdictions is only one factor which tax authorities will take into account in deciding whether a partnership is transparent for tax purposes and that it is rarely determinative of that issue. In certain States, including Belgium and Australia, a foreign body will be taxed as a corporation if it is a legal person in its own country. In certain other jurisdictions, including France and Germany, it appears that the tax authorities would not alter their treatment of a British partnership or limited partnership, if separate personality were introduced.
- 19.8 We recognise that, if separate legal personality were mandatory, the existence of problems in some jurisdictions and uncertainty as to the response of tax authorities in other jurisdictions could severely restrict the continued use of English limited partnerships as vehicles for investment overseas.
- 19.9 In order to address this problem we have decided to develop the suggestion of the APP and BVCA and introduce in English law an option to have either a limited partnership with legal personality or a special limited partnership without legal personality.
- 19.10 We have not recommended the introduction of the special limited partnership in Scots law. Scottish partnerships have separate legal personality and do not offer the tax advantages overseas which are available to aggregate partnerships. The introduction of a partnership without legal personality into Scots law would involve a major reform of Scottish bankruptcy law which is otherwise broadly satisfactory in this area. We consider that it is sufficient, where we are simply preserving the status quo in English law for a specialised form of limited partnership, to have the special limited partnership available in one of the British jurisdictions.
- 19.11 As some time may elapse between the publication of this report and the introduction of a Partnerships Bill, there will be an opportunity to obtain rulings from overseas tax authorities on the taxation treatment of the proposed limited

<sup>5</sup> See para 3.53 above.

<sup>6</sup> See John Avery Jones and Others, "Characteristics of Other States' Partnerships for Income Tax" (2002) British Tax Review No 5 375; (2002) 56 Bulletin for International Fiscal Documentation 288.

partnership which has separate legal personality. Some of the uncertainty which surrounds any law reform may therefore be removed. It may be the case that many investors will not need to use the special limited partnership. But the existence of the special limited partnership and transitional provisions which allow existing limited partnerships to re-register either as limited partnerships or special limited partnerships should protect the use of English limited partnerships by the venture capital industry.

#### **REFORM RECOMMENDATIONS**

19.12 As the people who use limited partnerships for private venture capital investment usually prepare detailed partnership agreements to govern the rights and duties of the limited partners and the general partners as between themselves, there is no need to create a specific default code for the special limited partnership. We consider that all that is needed is the adaptation of the provisions of the draft Bill to allow for a special limited partnership which has no legal personality and to set out the rules by which the special limited partnership comes into existence, transacts with third parties and eventually ends.

19.13 At the same time, our recommended reforms in relation to the overriding duty of good faith and the statutory statement of duties of disclosure on joining a partnership<sup>7</sup> are as applicable to the special limited partnership as to any other partnership as are many default rules, for example, in relation to the sharing of profits and losses and the management of the business.

#### **The aggregate approach to partnership**

19.14 Because the special limited partnership will not have legal personality we consider that we should define it as “the relation which subsists between persons carrying on a business together under a partnership agreement”.<sup>8</sup> This accords with the aggregate approach.

#### **Mutual agency**

19.15 In accordance with the aggregate approach to partnership the partners require to be the agents of each other for the purpose of the partnership business. But the limited partner in a special limited partnership will have no implied power to bind the special limited partnership.<sup>9</sup>

#### **Liability of partners**

19.16 We consider that it is appropriate to apply the recommended rules as to the joint and several liability of partners and the secondary nature of that liability to the special limited partnership.<sup>10</sup> Thus, where a partner in a special limited

<sup>7</sup> Draft Bill, cls 9 and 10.

<sup>8</sup> Draft Bill, Sched 10, para 3(3). This is consistent with the definition in the 1890 Act.

<sup>9</sup> This is the same rule as that applied to limited partners in a limited partnership. See paras 16.22 – 16.23 above.

<sup>10</sup> Draft Bill, cls 23-25.

partnership<sup>11</sup> is liable for a partnership obligation, that obligation may be enforced against him when the amount (or the existence and amount) of the liability has been established in proceedings against the special limited partnership.

### **Liability through holding out**

- 19.17 We consider that the recommended rules about liability through holding out (including the restrictions on the continuing liability of a former partner) should apply in relation to special limited partnerships as they do in relation to limited partnerships.<sup>12</sup>

### **Changes in partners**

- 19.18 We do not propose to apply to the special limited partnership the rules relating to the admission of partners, the grounds on which a person ceases to be a partner and the terms on which an outgoing partner realises his share. These matters can and usually are expressly provided for in the partnership agreement of a limited partnership and are not necessary in a statutory code for the special limited partnership. In addition, there is no need for special provisions on this matter as, under the existing law, where the partners contract for the firm to continue on a change of membership, a partnership undergoes a “technical dissolution” when a partner leaves the firm. In other words, the firm breaks up but is not wound up.

### **The break up of the special limited partnership**

- 19.19 Because the aggregate approach to partnership is not conducive to continuity of partnership, we consider that there should be simple default rules (which are consistent with the default regime in the 1890 Act) that (a) a partnership of defined duration breaks up if the specified period expires or the venture for which it was formed is accomplished, (b) in the case of any other partnership, a general partner gives notice to the other partners of his intention to break up the partnership, and (c) in the case of any special limited partnership the firm breaks up if a partner dies or (if not an individual) is dissolved. As default rules, these are subject to any agreement to the contrary. In addition, a special limited partnership breaks up if the court pronounces an order breaking up the partnership.
- 19.20 Because the special limited partnership will not be an entity, there is no need for the concept of dissolution; the partnership relationship will end when the partnership breaks up and no entity holding property will survive. After break up, the special limited partnership would be wound up by its partners or by a partnership liquidator.<sup>13</sup> Although in many cases a well-drawn partnership agreement will provide for the distribution of the partnership’s assets on winding up, we consider that there is a case for retaining the important default rules on this subject. The rules are also relevant to the duties imposed on the partnership liquidator.<sup>14</sup>

<sup>11</sup> This is usually only the general partner.

<sup>12</sup> Draft Bill, cls 26 and 35.

<sup>13</sup> Draft Bill, cls 43, 50, 51 and Scheds 4 and 5.

<sup>14</sup> See the draft Bill, Sched 4, Part 1, para 2.

### **Registration of a special limited partnership**

- 19.21 It is necessary to adapt the registration provisions which apply to limited partnerships. First, the application should be for registration as a special limited partnership and the registration and registration certificate should record that the partnership is registered as a special limited partnership. Secondly, as the special limited partnership will not have continuing legal personality, it should be provided that there is no need to re-register a partnership merely because of a change in the partners. Otherwise, our recommended registration and de-registration regime will apply with minor amendments to the special limited partnership.
- 19.22 **We therefore recommend that in English law there should be a special limited partnership which does not have separate legal personality.** (Draft Bill, cl 73 and Schedule 10)

# **PART XX**

## **SUMMARY OF RECOMMENDATIONS**

### **THE DEFINITION OF PARTNERSHIP**

- 20.1 We recommend that a partnership should be defined for the purposes of the draft Bill as “an association formed when two or more persons start to carry on a business together under a partnership agreement”. (Paragraph 4.17; Draft Bill, cl 1(2))
- 20.2 We recommend that the definition of partnership should make it clear that a partnership must be constituted by agreement. That agreement may be express, inferred from conduct or may be partly express and partly inferred from conduct. (Paragraph 4.20; Draft Bill, cls 1(1) and (2) and 76(2))
- 20.3 We recommend that a partnership should commence when two or more persons start to carry on a business together with the object of making a profit. (Paragraph 4.24; Draft Bill, cl 1(1) and (2))
- 20.4 We recommend that it should be provided that it is the partners who carry on the business of the partnership. (Paragraph 4.30; Draft Bill, cl 6(1))
- 20.5 We recommend that it should be provided that the main functions of the partnership are to enter into contracts and own or hold property for the purposes of the partnership business, and (subject to the partnership agreement) to provide continuity for the partnership business despite a change in the partners. (Paragraph 4.32; Draft Bill, cl 6(2))
- 20.6 We recommend that in the draft Bill “business” should include every trade, profession and occupation. (Paragraph 4.35; Draft Bill, cl 1(6))
- 20.7 We recommend that there should be a statement that the partnership’s capacity as a legal person is unlimited. (Paragraph 4.42; Draft Bill, cl 7(1))
- 20.8 We recommend that except so far as is provided by or under any enactment, whether expressly or by necessary implication, a partnership should not be capable of committing an offence. (Paragraph 4.47; Draft Bill, cl 8)
- 20.9 We recommend that the guidance in section 2 of the 1890 Act for determining the existence of a partnership should be re-enacted in modern language subject to the repeal of the proviso to section 2(3)(d). (Paragraph 4.53; Draft Bill, cl 1(7) and Schedule 1)
- 20.10 We recommend that a partnership agreement may be varied in accordance with its terms or with the agreement of all existing partners (or before the formation of the partnership with the agreement of all proposed partners). (Paragraph 4.55; Draft Bill, cl 4)
- 20.11 We recommend that:
- (1) A default rule should be defined as a rule which applies in relation to a partnership if the point dealt with in the rule is not dealt with in the partnership agreement;

- (2) If a default rule applies in relation to a partnership it should be treated as if it were a term of the partnership agreement; and
- (3) The partners may modify or exclude the application of a default rule in relation to a partnership in accordance with the partnership agreement or if all the partners agree. (Paragraph 4.58; Draft Bill, cl 5)

#### **SEPARATE LEGAL PERSONALITY**

20.12 We recommend that:

- (1) A partnership should have legal personality separate from the partners but should not be a body corporate; (Draft Bill, cl 1(3)).
- (2) A partnership should be viewed as a legal person whose characteristics are determined by (a) the draft Partnerships Bill except so far as varied by contract, (b) the terms of the partnership contract (if different from the default rules of the Bill) and (c) the rules of common law and equity so far as not inconsistent with the express provisions of the draft Partnerships Bill. (Paragraph 5.40)

#### **THE AGENCY AND LIABILITY OF A PARTNER**

20.13 We recommend:

- (1) That a partner should be the agent of the partnership and not the partners; (Draft Bill, cl 6(3))
- (2) That a partnership should be bound by anything done by a partner for carrying on in the usual way business of the kind carried on by the partners; (Draft Bill, cl 16(1))
- (3) But that a partnership should not be bound if the partner has no authority to do the thing on behalf of the partnership, and the person with whom he is dealing has notice of his lack of authority or does not know or believe him to be a partner in the partnership; (Draft Bill, cl 16(2))
- (4) That the rules in (2) and (3) above are subject to the provisions of the draft Bill on the execution of deeds in England and Wales. (Paragraph 6.22; Draft Bill, cl 16(3))

20.14 We recommend that a partnership should be vicariously liable to another person for loss or injury caused by the wrongful act or omission of any partner acting in the ordinary course of the partnership business or with the actual authority of the partnership. (Paragraph 6.35; Draft Bill, cl 22)

20.15 We recommend that:

- (1) It should be provided (a) that each of the partners in a general partnership has unlimited liability and (b) that a limited partnership must have one or more general partners, each of whom has unlimited liability, and one or more limited partners, each of whom has limited liability; (Draft Bill, cl 3)
- (2) Each partner who has unlimited liability is personally liable for the whole amount of the debts and obligations of the partnership and his payment in

discharge of that liability discharges the firm's obligation and the personal liability of any other partner for that obligation to the same extent. (Paragraph 6.59; Draft Bill, cl 23(1), (3), (4) and (5))

20.16 We recommend that:

- (1) There should be the following default rules:
  - (a) That a partner should be entitled to an indemnity from the partnership in respect of (i) any payment made by him in the proper conduct of the partnership business or in connection with anything necessarily done to preserve the partnership business or property and (ii) any payment which he has made towards the discharge of his personal liability for a partnership obligation or in reasonable settlement of an alleged personal liability for a partnership obligation; (Draft Bill, cl 12(3))
  - (b) That the indemnity under (a) above should not affect any claim which the partnership or another partner may have against the partner; (Draft Bill, cl 12(4))
  - (c) That if the partnership does not pay the indemnity under (a) above, the partner should be entitled to contribution from any other liable partner on the same basis as if the amount unpaid were a debt for which he and each other liable partner were co-guarantors in the same proportions as they would be liable to pay any partnership losses; (Draft Bill, cl 12(5))
  - (d) That partner A may claim against partner B as an "other liable partner" under (c) above (i) in the case of A's liability (or alleged liability) for a partnership obligation, if B was a partner when the payment was made and was liable with A for the obligation (or, in the case of settlement of an alleged liability, would have been liable if the alleged liability had been established) or (ii) otherwise, if B was a partner when the payment was made; (Draft Bill, cl 12(6))
  - (e) That if a firm wrongly fails to pay to a partner any other amount (for example, a loan due to the partner) for which it is liable to account to him, the partner should be entitled to contribution from the other partners in the same proportions as if the amount were a partnership loss; (Draft Bill, cl 12(7))
  - (f) That the personal liability for a partnership obligation in respect of which a partner may claim indemnity or contribution should include not only the partner's liability under (a)(ii) above but also his liability to contribute under (c) or (e) above and his liability to indemnify or make a contribution to a former partner; (Draft Bill, cl 12(8))
- (2) That in order to allow partners to agree their obligations amongst themselves, the rule that a partner is personally responsible for the whole amount of any partnership obligation incurred while he is a partner (clause 23(1) of the draft Bill) should not apply to a partnership obligation owed by a partner (A) to a partner or former partner (B) if the partnership

agreement or any other agreement to which A and B are parties makes provision about whether or not B is entitled to indemnity or contribution from A in respect of the obligation; (Paragraph 6.65; Draft Bill, cl 23(2))

20.17 We recommend that:

- (1) The rule in section 17(1) of the 1890 Act that an incoming partner who joins an existing partnership does not thereby become liable to the creditors of the partnership for partnership obligations incurred before he became a partner should be re-enacted (but the capital invested by an incoming partner in an existing partnership will be available to meet prior debts); (Draft Bill, cl 23(1)) and
- (2) In this context an obligation of the partnership which results from the (a) breach of a duty in tort or delict (including quasi-delict) (b) breach of trust or (c) breach of a fiduciary duty should be treated as having been incurred at the time of the act or omission which gave rise to the breach. (Paragraph 6.80; Draft Bill, cl 23(7))

20.18 We recommend:

- (1) That a person who ceases to be a partner does not thereby cease to be liable for partnership obligations incurred while he was a partner; (Draft Bill, cl 33(1))
- (2) That, for the purposes of the draft Bill, a partnership obligation which results from a breach of a duty in tort or delict (including quasi-delict), a breach of trust or breach of a fiduciary duty should be treated as having been incurred at the time of the act or omission which gave rise to the breach; (Draft Bill, cl 23(7)) and
- (3) That a person who ceases to be a partner may be discharged from personal liability for a partnership obligation by an agreement between himself (or his estate), the partnership and the creditor of the partnership without requiring valuable consideration in English law. (Paragraph 6.88; Draft Bill, cl 33(3) and (4))

20.19 We recommend that:

- (1) Where a person who is not a partner (“A”) represents himself, or knowingly allows himself to be represented, as one, and another person (“B”) deals with the partnership in reliance on that representation, A should be liable as if he were a partner for the whole amount of any obligation which the partnership incurs to B as a result; (Draft Bill, cl 26(1), (3) and (4))
- (2) Where A is a partner at the date of the representation but is no longer a partner at the time when B deals with the firm in reliance on the representation, then subject to (4) and (5) below A should be liable to B for the whole amount of any obligation which the partnership incurs to B as a result; (Draft Bill, cl 26(2))
- (3) If A in (1) or (2) above pays an amount in or towards discharge of his personal liability (or what he reasonably and in good faith believes to be

his liability) he should be entitled to be indemnified by the partnership in respect of that amount; (Draft Bill, cl 26(5))

- (4) If A was still a partner when the representation was made ((2) above), he should not be liable if more than one year has passed since the representation before B deals with the firm in reliance on it; (Draft Bill, cl 35(1) and (2))
- (5) A should not incur liability under (2) above if notice of his withdrawal from the partnership was given to B or sent to B's last known address before he dealt with the firm in reliance on the representation; (Draft Bill, cl 35(3))
- (6) A should not be liable by holding out after he ceases to be a partner if the representation consists merely in the partners continuing to carry on the partnership business in the same partnership name or the partnership name continuing to include A's name after he ceased to be a partner; (Draft Bill, cl 35(4)) and
- (7) In order to protect the salaried partner who is an employee, the protections in paragraphs (4) – (6) above should be available to A if he is an employee of the partnership. (Paragraph 6.106; Draft Bill, cl 35(5))

#### **LITIGATION AND ENFORCING JUDGMENTS**

20.20 We recommend:

- (1) That a partnership may sue or be sued in its own name; (Draft Bill, cl 7(2))
- (2) That a creditor of a partnership may pursue claims against a partner or former partner in respect of a partnership obligation only (a) after he has established the amount (or the existence and the amount) of the liability of the partnership for the obligation by obtaining a judgment or decree or arbitral award against it in the same or earlier proceedings; (b) where the court has ordered the partnership to make a payment including an interim payment in respect of the partnership obligation; or (c) in Scotland, when the partnership obligation has been constituted in a document registered for execution in the Books of Council and Session or the sheriff court books. (Paragraph 7.22; Draft Bill, cl 24)

20.21 We recommend that rules of court should provide for service of claims and other court documents on a partnership and on the partners of the firm. (Paragraph 7.24)

20.22 We recommend that rules of court may make provision to prevent a partner from defending or to restrict the extent to which, or the way in which, a partner may defend proceedings in respect of his personal liability for a partnership obligation if he has had an opportunity to participate in earlier proceedings in which there has been a judgment or decree against the partnership establishing the existence or amount of the partnership's obligation. (Paragraph 7.26; Draft Bill, cl 25(1) and (2))

20.23 We recommend that rules of court should provide that a partnership which is suing or being sued and its partners should be under a duty to provide to the other party to the litigation, at his request by notice, the names and last known addresses, or addresses for service, of those partners who have secondary liability for the costs or expenses of the litigation or (as the case may be) for meeting the claim against the partnership if it is successful. Former partners who are involved in litigation relating to a partnership should be under a similar obligation. (Paragraph 7.29)

20.24 We recommend that:

- (1) A person who deals with a partnership should be entitled, on making a request to the partnership or to any partner, to be told the full names and an address or addresses for service of all the partners; (Draft Bill, cl 74(1))
- (2) A person who has a complaint against a partnership arising out of a previous dealing with the firm should be entitled, on making a request to the partnership or to any present or former partner, to be given such information as the partnership or the present or former partner is able to provide, after due inquiry, as to the names of every partner at the relevant time and an address for every partner which is either an address for service or his last known address; (Draft Bill, cl 74(2))
- (3) Rules of court should be able to make provision enabling a person having a prospective claim against a partnership, or against a present or former partner after he has obtained judgment against the firm, to apply to the court before bringing proceedings in respect of the claim for an order for the supply of the information in paragraph (2) above. (Paragraph 7.31; Draft Bill, cl 74(3))

20.25 We recommend:

- (1) That a creditor of a partnership may enforce a claim in respect of a partnership obligation against a partner or former partner by including the partner as a defendant/defender in the action against the partnership or by suing the partner or former partner in a separate action;
- (2) That the creditor of a partnership may enforce his claim against the assets of the partners who have secondary liability for that claim without first exhausting enforcement remedies against the assets of the partnership.
- (3) That a judgment, decree or arbitral award against a partnership should not be enforceable, by way of execution, diligence or otherwise, against the property of a partner. (Paragraph 7.64; Draft Bill, cl 25(4))

20.26 We recommend:

- (1) That in English law, a claim against a partner in respect of his secondary liability for a partnership obligation should be subject to a special limitation period. That limitation period should end on the date of the expiration of the period of limitation (if any) applicable to an action against the partnership in respect of the relevant partnership obligation or, if later, the expiration of two years from the date of judgment against the partnership establishing the amount of the partnership's liability for the obligation; (Draft Bill, cl 25(3) and Schedule 2 paras 1-3)

- (2) That in Scots law, the obligation of a partner in relation to his secondary liability for a partnership obligation should prescribe in accordance with the following special rule. The prescriptive period should begin on the date on which decree (or arbitral award) is awarded against the partnership in respect of the relevant partnership obligation and expire on whichever is the later of the following dates: (a) the date on which the prescriptive period applicable to the partnership obligation would have prescribed but for the relevant claim against the partnership which resulted in the decree (or award) and (b) the second anniversary of the date of that decree (or award). (Paragraph 7.72; Draft Bill, cl 25(3) and Schedule 2 paras 4 –10)

20.27 We recommend that in Scotland the law of arrestment and furthcoming of a partner's share in a partnership should be reformed to the following effect:

- (1) A creditor of a partner who has arrested in execution a partner's share in the partnership should be entitled to obtain a decree of furthcoming at any time before the dissolution of the partnership;
- (2) A decree of furthcoming should transfer the partner's share to the creditor;
- (3) The creditor with a decree of furthcoming should be entitled to obtain payment of that share or part of it only when the share or the relevant part of it would otherwise have become payable to the partner;
- (4) In particular the creditor with a decree of furthcoming should be entitled to receive the partner's share of the partnership's profits when that share of profits would otherwise have been payable to the partner; and
- (5) The creditor with a decree of furthcoming may realise the share either when the partner in question withdraws from the partnership or when the partnership is wound up, by obtaining payment of the share when otherwise it would have been paid to the partner; and
- (6) The arresting creditor who obtains a decree of furthcoming is not thereby entitled to take part in the management or administration of the partnership business. (Paragraph 7.75; Draft Bill, cl 37)

#### **CONTINUITY OF PARTNERSHIP AND THE OUTGOING PARTNER**

20.28 We recommend that it should be a default rule that a partnership continues when a partner joins a partnership or withdraws from a partnership, provided that there remain at all times at least two partners. This is achieved in the draft Bill by providing a comprehensive list of the circumstances in which a partnership breaks up and by excluding from that list a change in the membership of the firm (unless the partnership agreement otherwise provides). (Paragraph 8.30; Draft Bill, cl 38).

20.29 We recommend that there should be a default rule that where a partner withdraws from a partnership, he is bound on request to transfer to the partnership or to trustees for the partnership title to any partnership property which he held in his own name at the time of his withdrawal from the partnership. (Paragraph 8.35; Draft Bill, cl 34(7))

- 20.30 We recommend that a former partner, the personal representative of a deceased former partner and the insolvency practitioner in relation to a former partner should have the right to apply to the court to make an order to give relief on the ground that the partnership affairs are being conducted in a way that is prejudicial to his interests and it is just and equitable to make the order. The court should have a general discretion to make such order as it thinks fit for giving relief, including (without prejudice to the generality of the discretion) (a) requiring accounts to be drawn up, (b) requiring interim payments to be made, (c) requiring security to be provided, (d) breaking up the partnership and (e) giving directions as to the way in which the partnership is to be wound up. (Paragraph 8.48; Draft Bill, cl 53).
- 20.31 We recommend that there should be a default rule that on withdrawal from the partnership the outgoing partner (or his estate) has the following financial rights as a debt due by the partnership:
- (1) To be paid the value of his share in the partnership calculated on the hypothesis that the partnership had broken up and its assets were sold on the date of his withdrawal at a price equal to the greater of (i) the liquidation value and (ii) the value based on a sale of the entire business as a going concern without the outgoing partner. (Draft Bill, cl 32(1), (2)(a) and (3))
  - (2) To be paid interest at a commercial rate on the value of his share from the date of withdrawal. The prescribed rate of interest should initially be three per cent above the Bank of England base rate. The rate should be alterable by statutory instrument to allow for changes in economic conditions. (Draft Bill, cls 32(2)(b), 76(1))
  - (3) To be indemnified against partnership liabilities or payments made in reasonable settlement of an alleged personal liability for a partnership obligation but the indemnity is without prejudice to any claim of the partnership or the other partners against the outgoing partner. (Paragraph 8.75; Draft Bill, cl 34(1), (2) and (3))
- 20.32 We recommend that where the valuation of the outgoing partner's share in terms of paragraph 8.75(1) above results in a sum due by the outgoing partner (or his estate) to the partnership, the outgoing partner (or his estate) should be liable to pay that sum to the partnership. (Paragraph 8.78; Draft Bill, cl 32(2) and (3))
- 20.33 We recommend that if the partnership does not pay all or part of the indemnity the former partner should be entitled to either (a) indemnity from any person who was a partner when he ceased to be a partner and who continued to be a partner thereafter or (b) contribution from any person who was liable with him for the partnership obligation (or, in case of settlement of an alleged liability, would have been liable if the alleged liability had been established) of such amount as is just and equitable. (Paragraph 8.80; Draft Bill, cl 34(4) and (5))
- 20.34 We recommend that the following rules should be the default rules for resignation from a partnership of undefined duration:
- (1) A partner wishing to resign from a partnership of undefined duration should give each other partner eight weeks' notice of his resignation;

- (2) Each of the other partners should then have a right to resign from the partnership by giving not less than two weeks' notice, such notice taking effect on the same date as the expiry of the first partner's notice period;
- (3) Partners (excluding any partner who has given notice of any resignation) should be entitled to break up a partnership at any time if not less than half of the partners vote to do so. A vote to break up a partnership at the same time as a resignation notice takes effect would supersede the resignation notice and all partners will be entitled to such sums as were due to them on settlement of accounts in the winding up. (Paragraph 8.100; Draft Bill, cls 30, 34(5) and 38(2)–(4)).

20.35 We recommend that the following rules should be default rules for involuntary withdrawal from a partnership:

- (1) If a partner dies (or if a non-natural legal person ceases to exist) or goes bankrupt (or if a non-natural person, an insolvent winding up order or an award of sequestration is made) the partner ceases to be a partner on the date of death or bankruptcy; (Draft Bill, cl 28(1)(c) and 29)
- (2) The partner in question (or his estate) has the same financial rights as on voluntary withdrawal; (Draft Bill, cl 32)
- (3) Where in a partnership of defined duration one or more persons has involuntarily ceased to be a partner, any other partner may resign from the partnership by giving each other partner not less than eight weeks' notice; (Draft Bill, cl 30)
- (4) In response to the notice in (3) above each of the other partners should have a right to resign; (Draft Bill, cl 30(3))
- (5) After the death or bankruptcy of a partner, the remaining partners should be entitled to break up the partnership as in paragraph 8.100 above; (Draft Bill, cl 38(2)–(4))
- (6) In place of the existing right to dissolve the firm, the partners will have an option to expel a partner by unanimous vote (other than the offending partner) where: (a) (in English law) the partner allows his share in the partnership to be charged and (b) (in Scots law) a partner's share is arrested in execution. In each case the offending partner will have a period of grace of three months before the expulsion notice takes effect. The expulsion notice will be treated as having no effect if during the three-month period the charging order or the arrestment ceases to have effect. (Paragraph 8.110; Draft Bill, cl 31).

20.36 We recommend that contractual doctrines such as acceptance of repudiatory breach of contract and frustration and rescission for fraud or misrepresentation should be excluded by a provision which sets out exhaustively the grounds upon which a partnership breaks up and the grounds upon which the court may order the break up of a partnership. (Paragraph 8.124; Draft Bill, cls 38 and 47)

20.37 We recommend that the court should have power:

- (a) To order the removal of a partner (other than the applicant partner) on the following grounds:-
- (1) The partner is suffering from a mental or physical condition which renders him incapable of performing his duties under the partnership contract and the incapacity is likely to be permanent;
  - (2) The partner's conduct (which may or may not amount to breach of contract) is such as to affect adversely the carrying on of the partnership business;
  - (3) The partner is in serious or persistent breach of the partnership agreement or a provision of the draft Bill;
  - (4) The partnership agreement was entered into or modified as a result of fraud, misrepresentation or non-disclosure by the partner;
  - (5) An event has occurred which makes it unlawful for the partner to remain a partner;
  - (6) There is no reasonable prospect of the partnership business being carried on at a profit unless the partner is removed;
  - (7) It is just and equitable for any other reason to make the order.
- (b) To order the removal of the applicant partner where any of grounds (a) (1)–(4) above apply to a partner other than the applicant or where it is just and equitable for any other reason to make the order;
- (c) To order the break up of the partnership on the following grounds:
- (1) Any of the grounds (a) (1) – (5) above;
  - (2) An event has occurred making it unlawful for the partnership business to be carried on;
  - (3) There is no reasonable prospect of the partnership business being carried on at a profit;
  - (4) It is just and equitable for any other reason to make the order. (Paragraph 8.126; Draft Bill, cl 47 and Schedule 3)

20.38 We recommend:

- (1) That, where a partner applies for his own removal from the partnership, the court should have power to backdate the removal and give directions to put the applicant and other persons in the position they would have been in if the partner had ceased to be a partner at that date or so near that position as is just and equitable; (Draft Bill, cl 47(5) and Schedule 3 paras 1(2) and 3(2)).
- (2) That where the court orders the removal of a partner, that partner will, subject to the directions of the court, have the same rights as he would have had to realise his share in the partnership on resigning from the partnership; (Draft Bill, cls 32, 47(5) and Schedule 3 para 3(1)).

- (3) That where the court orders the removal of a partner or the break up of a partnership, it should have power to give such directions as it thinks fit for giving effect to its order; (Draft Bill, cl 47(5) and Schedule 3 para 3(1)).
- (4) That the court may combine an order to break up a partnership with an order to appoint a liquidator to wind up the partnership's affairs or to appoint a provisional liquidator; (Draft Bill, cl 47(5) and Schedule 3 para 2).
- (5) That, in an application to remove a partner, the court should have power to make an interim order prohibiting a partner from taking part in, or limiting the extent to which he may take part in the partnership business or affairs, subject to such conditions as it thinks fit and to give such directions as it thinks fit for giving effect to its interim order. (Paragraph 8.131; Draft Bill, cl 48)

20.39 We recommend that where the order of the court is on the ground of fraud, misrepresentation or non-disclosure, the following parties should, subject to the directions of the court, have the following rights against the partner at fault:

- (1) The applicant partner or partners should be entitled to be indemnified by the partner at fault in respect of any liabilities which are attributable to the fraud, misrepresentation or non-disclosure; and
- (2) Where the court orders the break up of the partnership, any partner not at fault should be entitled on a distribution of partnership assets to be paid any money paid by him to purchase his share in the partnership and what is due to him from the partnership in respect of loans or capital before any amount is paid to the partner at fault. (Paragraph 8.136; Draft Bill, cls 10(6) and 47(5) and Schedule 3 paras 4 and 5).

20.40 We recommend that the Secretary of State should be empowered, if he thinks it expedient in the public interest that a partnership should be broken up, to apply to the court for an order breaking up the partnership and the court may grant that order if it thinks it just and equitable to do so. The court may combine an order breaking up the partnership with an order appointing a liquidator or provisional liquidator. (Paragraph 8.146; Draft Bill, cl 49)

#### **PARTNERSHIP PROPERTY AND THE EXECUTION OF DEEDS**

20.41 We recommend:

- (1) That partnerships (with separate legal personality) can own property of any kind in their own name unless statutory rules exclude them from doing so; (Draft Bill, cls 7(1) and 18(1))
- (2) That property of any kind may be held in trust for such partnerships; (Draft Bill, cls 7(1) and 18(2))
- (3) That partnerships should be allowed to own British ships and British fishing vessels;
- (4) That the Hovercraft (General) Order 1972 be amended to allow English partnerships (with separate legal personality) to own hovercraft;

- (5) That Art 4(3)(g) of the Air Navigation Order 2000 should be revoked; and
- (6) That the Bodies Corporate (Joint Tenancy) Act 1899 should be extended to partnerships. (Paragraph 9.51; Draft Bill, cl 17(2))

20.42 We recommend that where a partnership (“the former partnership”) has broken up, but a partner of the former partnership or a partner who has entered into partnership with that partner in a successor partnership transfers property, or creates an interest in property, belonging to the former partnership and apparently on its behalf or in its name, the title of the recipient of that property, or interest in property, who receives it in good faith and for value shall not be challengeable on the ground that the property was in fact partnership property of the former partnership. (Paragraph 9.65; Draft Bill, cl 42)

20.43 We recommend:

- (1) That there should be a rule that property which is held in the name of one or more of the partners and which has been acquired on behalf of the partnership or contributed as capital to the partnership is partnership property and is held on trust for the partnership; (Draft Bill, cl 18(2))
- (2) That there should be a rebuttable presumption that property which is acquired with money or other assets belonging to the partnership is partnership property; (Draft Bill, cl 18(1)) but
- (3) The existing rule in section 20(3) of the 1890 Act, which creates a presumption that additional land bought out of the profits of a partnership involving the use of co-owned land is not partnership property, should be re-enacted. (Paragraph 9.80; Draft Bill, cl 19)

20.44 We recommend:

- (1) That, in English law, “partnership property” should be defined as property to which the partnership is beneficially entitled, whether or not the property is held in the partnership name; (Draft Bill cl 17(1)(a)) and
- (2) That, in Scots law, “partnership property” should be defined negatively as not including property held by the partnership in trust. (Paragraph 9.83; Draft Bill, cl 17(1)(b))

20.45 We recommend:

- (1) That, in English law, a document is validly executed by the partnership as a deed if and only if (a) it is signed by at least two partners, each of whom has authority to execute the document as a deed on behalf of the partnership and (b) it is expressed to be executed by the partnership and (c) it is delivered as a deed;
- (2) The document referred to in (1) above is presumed to be delivered upon its being executed in accordance with (1) above, unless a contrary intention is shown;
- (3) If a partnership is being wound up by the partners and there is only one partner remaining, the rule in paragraph (1)(a) above should be taken as

satisfied if the document is signed by the partner, whether or not he had authority to execute the document;

- (4) If a limited partnership has only one general partner, the rule in (a) in paragraph (1) above should be taken as satisfied if the general partner signs the document and he has authority to execute the document as a deed on behalf of the partnership;
- (5) If the partner is not an individual a document should be treated (for the purposes of this provision) as signed by that partner if it is signed by an individual who has authority to sign on behalf of the partner; (Draft Bill, cl 20);
- (6) In favour of a purchaser in good faith and for valuable consideration there is a presumption of due execution; (Draft Bill, cl 20(7) and (8)) and
- (7) In Scots law, the formal validity of a document signed by a partnership in accordance with the Requirements of Writing (Scotland) Act 1995 is not affected by a partner's lack of authority to sign the document, but the partnership or another interested party should be able to seek the reduction of such a document if the partner had no authority or apparent authority to sign the document on behalf of the partnership. (Paragraph 9.98; Draft Bill, cl 21)

#### **PARTNERS' FINANCIAL AND MANAGEMENT RIGHTS, EXPULSION AND RETIREMENT**

20.46 We recommend that:

- (1) The default rule (currently section 24(1) of the 1890 Act) which provides for equality between partners should be confined to profits and losses and should not refer to capital; (Draft Bill, cl 11)
- (2) As a default rule, partners should be entitled to a commercial rate of interest on advances which they make to a partnership; (Draft Bill, cls 13 (1), (4) and (5) and 76(1))
- (3) There should be no statutory rules providing for decision making by special majorities but the distinction between "ordinary matters" which can be decided by majority vote and other matters which require unanimity should remain the default rule and it should be clarified that the question whether a partnership should raise or defend legal proceedings is an ordinary matter; (Draft Bill, cl 14(1), (3), (4) and (5)).
- (4) There should be a default rule that the agreement of all the partners is required for a partner to be entitled, or required, to contribute capital to the partnership or vary the amount of his capital contribution; (Draft Bill, cl 13(1) and (2))
- (5) Other default rules of section 24 of the 1890 Act (the requirement of unanimity for a change in the nature of the partnership business, no entitlement to remuneration, no entitlement to interest on capital, entitlement to take part in the management, unanimous agreement to the

introduction of a new partner) should be re-enacted. (Draft Bill, cls 6(4), 12(1) and (2), 13(1) and (3), 14(1) and (2) and 27)

- (6) A partner's right to indemnity should be clarified so that he should be entitled to indemnity from the partnership where in good faith and reasonably he pays (or contributes towards) a claim made against the partnership. (Paragraph 10.30; Draft Bill, cl 12(3)(b), (5) and (8))

#### **PARTNERS' DUTIES**

20.47 We recommend:

- (1) That there should be a statutory statement that a partner must act in good faith towards the partnership and each of the other partners in relation to any matter affecting the partnership; (Draft Bill, cl 9(1))
- (2) That that overriding duty of good faith, not being a default rule, should not be capable of being excluded by the partnership agreement and that partners must act in good faith in the context of the particular rights and duties to which they agree in their partnership agreement; (Draft Bill, cl 9(1) and (3))
- (3) That the specific duties in sections 29 and 30 of the 1890 Act (to account for private profits and not to compete with the partnership) be re-stated as default rules in the draft Bill: in each case the partnership may consent to the receipt of the profits or the competition; (Draft Bill, cl 9(2), (5) and (6))
- (4) That a partner must keep each of the other partners fully informed of matters affecting the partnership of which the other partners would reasonably expect to be kept informed; (Draft Bill, cl 9(2) and (4))
- (5) That any modifications of the rules in (3) and (4) above must be in ways that are compatible with the duty of good faith in (1) above. (Paragraph 11.32; Draft Bill, cl 9(3))

20.48 We recommend, as default rules, that:

- (1) A partner should be under a duty to ensure that proper accounting records are kept of transactions affecting the partnership in which he is involved and of which the other partners would reasonably expect such records to be kept;
- (2) A partner should be under a duty to ensure that such records are made available, on request, to the partnership and each of the other partners; and
- (3) A partner should be under a duty to co-operate with any person who keeps partnership records or draws up partnership accounts on behalf of the partnership. (Paragraph 11.34; Draft Bill, cl 15)

20.49 We recommend that persons who negotiate to enter into partnership with a prospective partner should be under a duty to disclose to the prospective partner anything known to them (or which they reasonably ought to have known) which a

(hypothetical) prudent prospective partner would reasonably expect to be disclosed in order to decide whether to enter into partnership with those persons. This duty may be waived by the prospective partner. In return the prospective partner should be under a duty to disclose to the other prospective partners (or partners in an existing partnership which he plans to join) anything known to him (or which he reasonably ought to have known) which a (hypothetical) prudent partner would reasonably expect to be disclosed in order to decide whether to enter into partnership with the prospective partner. Again, that duty may be waived. (Paragraph 11.40; Draft Bill, cl 10)

20.50 We recommend that there should not be a statutory default definition of the standard of care owed by a partner to the partnership and the other partners. (Paragraph 11.66)

20.51 We recommend that partners should owe all duties arising out of the duty of good faith both to the partnership and to the partners. (Paragraph 11.70; Draft Bill, cl 9(1))

#### **WINDING UP PARTNERSHIPS AND SETTLING PARTNERS' ACCOUNTS**

20.52 We recommend:

- (1) That the winding up of a partnership should be a three-step process: (1) the break up of the partnership which commences the winding up, (2) the winding up and (3) the dissolution of the partnership on completion of the winding up. The partnership would continue as a legal entity until dissolution (Step 3); (Draft Bill, cls 38, 39(1) and (2) and 45)
- (2) That a partnership should continue to exist as an entity (for certain limited purposes) when the number of partners is reduced to one; (Draft Bill, cls 39(1) and (2) and 43)
- (3) That when a partnership breaks up it may be wound up by one or more of the partners but that where only one partner remains, his authority to bind the firm is limited to acts which are necessary to wind up the firm and complete any transactions begun but unfinished at the time of the break up; (Draft Bill, cl 43(1) and (4))
- (4) That after a partnership breaks up (and there are two or more partners remaining) the partners may agree (unanimously) to carry on the partnership business with a view to the beneficial winding up of the partnership and to confer authority on a partner or partners for that purpose; there should be a default rule that other matters connected with the winding up may be decided by majority; (Draft Bill, cl 43(2), (3), (5) and (6)) and
- (5) That the third step (dissolution) should not occur until all of the partnership property and property held by the firm on trust has been distributed and all claims and liabilities of the partnership have been discharged or extinguished through the passage of time. (Paragraph 12.23; Draft Bill, cls 39(2) and 45)

20.53 We recommend that on or after the break up of a partnership a person may not cease to be a partner voluntarily and that a person whose resignation notice has led

to the break up of a partnership is to be treated as continuing to be a partner during the winding up of the partnership. (Paragraph 12.25; Draft Bill, cl 40)

20.54 We recommend that:

- (1) Partners will continue to be able to wind up the partnership themselves;
- (2) Partners will continue to be able to appoint an agent to wind up the partnership on their behalf;
- (3) The courts in England and Wales will continue to have power to appoint a receiver or a receiver and manager to a partnership, and in Scotland the courts will continue to have power to appoint a judicial factor; and
- (4) In addition there should be a new statutory system for winding up a solvent partnership under court supervision, involving the appointment of a partnership liquidator. (Paragraph 12.49)

20.55 We recommend that:

- (1) Only the court should have power to appoint a partnership liquidator to a partnership which has broken up; (Draft Bill, cl 50(1))
- (2) The following persons should have the right to apply to the court for the appointment of a partnership liquidator:
  - (a) A partner,
  - (b) A person who ceased to be a partner on or after the break up of the partnership,
  - (c) The personal representative of a deceased former partner who but for his decease would have been entitled to take part in the winding up,
  - (d) The insolvency practitioner in relation to a former partner who but for his insolvency would have been entitled to take part in the winding up, and
  - (e) A creditor of the partnership. (Draft Bill, cl 50(2) and (5))
- (3) In addition, the court on ordering the break up of a partnership, on the application of a former partner (or his personal representative or insolvency practitioner) who claims that the partnership affairs are being conducted in a way that is prejudicial to his interests, should be empowered to appoint a partnership liquidator, if it considers the appointment to be necessary or expedient. (Paragraph 12.53; Draft Bill, cl 53(4) and Schedule 3, para 2)

20.56 We recommend that:

- (1) The court should have power on an application to appoint a partnership liquidator to appoint a provisional liquidator; (Draft Bill, cl 51)

- (2) The duty of the provisional liquidator should be to preserve partnership property and property held by the partnership on trust pending the determination of the application to appoint a partnership liquidator; and (Draft Bill, Schedule 5, para 2)
- (3) The court should have discretion to confer on the provisional liquidator such of the statutory powers of a partnership liquidator (being the powers exercisable with or without sanction or approval) as it considers expedient for the performance of his duty. The provisional liquidator may also exercise such powers with the unanimous approval of the partners. (Paragraph 12.56; Draft Bill, Schedule 5, para 3)

20.57 We recommend that:

- (1) The liquidator should not be required to have a statutory qualification but the court should be given discretion to appoint a suitable person;
- (2) The court should be given discretion to determine whether any and what security is to be given by a liquidator (or provisional liquidator) on his appointment; (Draft Bill, cls 50(3) and 51(4)) and
- (3) Rules of court should provide for the appointment of the liquidator (or provisional liquidator) and the giving, varying and release of security. (Paragraph 12.60)

20.58 We recommend that:

- (1) All the powers of the partners cease on the appointment of the partnership liquidator, except so far as the liquidator sanctions their continuance; (Draft Bill, Schedule 4, Part 1, para 1(1))
- (2) All powers of the partners should be suspended on the appointment of a provisional liquidator, except so far as the provisional liquidator sanctions their continuance; (Draft Bill, Schedule 5, para 1(1))
- (3) Partnership property should not vest automatically in the partnership liquidator on his appointment;
- (4) A partnership liquidator should nonetheless have a right to apply to the court to vest all or any part of the partnership property in him by his official name; (Draft Bill, Schedule 4, Part 1, para 6)
- (5) The partners should be under a duty to co-operate with the partnership liquidator (or provisional liquidator) in the performance of his duties from the time of his appointment; (Draft Bill, Schedule 4, Part 1, para 1(2) and Schedule 5, para 1(2))
- (6) Persons interested in the winding up (namely a person who ceased to be a partner on or after the break up, (if deceased) his personal representative or (if insolvent) an insolvency practitioner appointed in relation to him) should owe a duty of good faith towards the partnership and the partners in relation to the functions of the partnership liquidator or provisional liquidator; (Draft Bill, Schedule 4, para 1(3) and Schedule 5, para 1(3)) and

- (7) The appointment of a partnership liquidator (or provisional liquidator) should not restrict the rights of creditors of, or claimants against, the partnership from pursuing and enforcing their claims against the partnership (or the partners with subsidiary liability) or from applying to wind up the partnership, or in Scotland to sequestrate the partnership's estate. (Paragraph 12.66)

20.59 We recommend that the duties of the partnership liquidator should be (a) to get in and realise the partnership's assets; (b) to pay the partnership's debts and discharge its liabilities to persons other than partners (c) to distribute any remaining proceeds of realisation in accordance with the default rules or any substitute provisions in the partnership agreement and (d) to secure that all trust property is transferred to the person entitled to it or a trustee for that person. (Paragraph 12.68; Draft Bill, Schedule 4, Part 1, para 2)

20.60 We recommend that:

- (1) A contract entered into by a liquidator (or provisional liquidator) in the performance of his functions should be taken as entered into on behalf of the partnership, unless the contract provides that he should be personally liable on it; and
- (2) If the liquidator (or provisional liquidator) assumes personal liability under the contract, he should be entitled to an indemnity out of partnership property in respect of that liability. (Paragraph 12.70; Draft Bill, Schedule 4, Part 1, para 5 and Schedule 5, para 4)

20.61 We recommend that:

- (1) The court should be able to give the partnership liquidator wide powers to carry out the winding up of the partnership without requiring the approval of the partners or the sanction of the court for the exercise of these powers; and
- (2) The following powers should be exercisable without approval or sanction:
  - (a) Power to bring or defend any action or other legal proceeding in the name or on behalf of the partnership;
  - (b) Power to sell any partnership property by public auction or private contract;
  - (c) Power to do all acts and execute, in the name and on behalf of the partnership, all deeds, receipts and other documents;
  - (d) Power to prove, rank and claim in the bankruptcy, insolvency or sequestration of any debtor of the partnership or any partner or former partner and to receive dividends from the insolvent's estate;
  - (e) Power to borrow any money required on the security of the partnership's assets;
  - (f) Power to appoint an agent to do any business which it would be unreasonable for the liquidator to have to do himself; and

- (g) Power to do all such things as may be necessary for winding up the partnership's business and affairs and distributing the proceeds of the realisation of partnership property. (Paragraph 12.74; Draft Bill, Schedule 4, Part 1, para 3 and Part 3)

20.62 We recommend that:

- (1) The partnership liquidator be empowered to exercise the following powers only with the unanimous approval of the partners or the sanction of the court:
  - (a) Power to carry on the partnership business for the beneficial winding up of the partnership; (Draft Bill, Schedule 4, Part 1, para 3 and Part 2, para 21)
  - (b) Power to make a compromise or arrangement with alleged creditors or claimants against the partnership; (Draft Bill, Schedule 4, Part 1, para 3 and Part 2, para 19)
  - (c) Power to compromise debts and liabilities subsisting or supposed to subsist between the partnership and other persons, including partners or former partners; (Draft Bill, Schedule 4, Part 1, para 3 and Part 2, para 20)
- (2) The partnership liquidator should have power to distribute partnership property in its existing form instead of realising the property and distributing the proceeds of realisation (a) if permitted to do so in the partnership agreement, (b) with the unanimous approval of the partners or (c) with the sanction of the court. (Paragraph 12.78; Draft Bill, Schedule 4, Part 1, para 4)

20.63 We recommend that:

- (1) The draft Bill should include a power to make subordinate legislation to empower a partnership liquidator to disclaim onerous property (with the approval of the partners or the sanction of the court); (Draft Bill, Schedule 4, Part 1, para 7)
- (2) In Scotland, a partnership liquidator should be empowered (with approval of the partners or sanction of the court) to terminate a lease of land or buildings of which the partnership is the tenant, where he has not disposed of the partnership's interest in the lease within one year after the date of his appointment and he is satisfied that a provision in the lease or a rule of law prevents the disposal of the interest. The liquidator should give the landlord a specified period of notice depending on the type of lease. In an agricultural lease the notice should be either a period of between one and two years ending in the term of Whitsun or Martinmas or such period as is agreed with the landlord. In any other lease the period should be six months or such shorter period of notice as is required by any other enactment. The termination should not affect any claim for compensation or damages in respect of the termination of the lease by any person (including a landlord or sub-tenant). The claim for damages or compensation should be a claim against the partnership and not the

liquidator personally. (Paragraph 12.83; Draft Bill, Schedule 4, Part 1, para 8)

20.64 We recommend that:

- (1) If the winding up by the partnership liquidator continues for more than one year, he should be obliged to summon a meeting of the partners and any person interested in the winding up at the end of the first year after the date of his appointment and of each succeeding year;
- (2) The partnership liquidator must lay before the meeting a full and true account of his conduct of the winding up during the preceding year; (Draft Bill, Schedule 4, Part 1, para 10)
- (3) As soon as he has completed the winding up of the partnership's business, the partnership liquidator must prepare a full and true account of the winding up, summon a meeting of the partners and any person interested in the winding up and lay the account before that meeting and explain it; (Draft Bill, Schedule 4, Part 1, para 11)
- (4) If the partnership liquidator fails to make up accounts or to summon a meeting, he should be guilty of an offence; (Draft Bill, Schedule 4, Part 1, paras 10(5) and 11(8)) and
- (5) Any partner or person interested in the winding up who is not satisfied with the way in which the partnership liquidator is conducting the winding up may apply to the court for an order that an account be taken of the partnership's affairs. (Paragraph 12.86; Draft Bill, Schedule 4, Part 1, para 12)

20.65 We recommend that:

- (1) The partnership liquidator, a partner, a person interested in the winding up, a creditor of the partnership or a person who ceased to be a partner before the break up of the partnership may apply to the court to determine any question arising in the winding up of the partnership; and
- (2) The court should have discretion whether to determine the application, to impose such terms and conditions as it thinks fit on its determination and to make any other order on the application. (Paragraph 12.88; Draft Bill, Schedule 4, Part 1, para 13)

20.66 We recommend that:

- (1) If a partnership is unable to pay its debts and there is no reasonable prospect of it becoming able to pay its debts, the partnership liquidator should be under a duty, within one month of the insolvency, to apply to the court for a winding up order (in England and Wales) or (in Scotland) for sequestration of the estate of the partnership; (Draft Bill, Schedule 4, para 9)
- (2) If the partnership liquidator has reasonable grounds for believing that the court does not have jurisdiction to make the orders in (1) above, he should

be under a duty to apply to the court for directions; (Draft Bill, Schedule 4, Part 1, para 9)

- (3) If the partnership liquidator fails without reasonable excuse to comply with (1) or (2) above, he should be guilty of an offence; (Draft Bill, Schedule 4, Part 1, para 9)
- (4) The partnership liquidator should have (in English law) standing to present an application to the court for the partnership to be wound up under the successor order to the Insolvent Partnerships Order 1994 and the existing time limit for presenting an application for winding up a partnership should not apply to a partnership liquidator; and
- (5) The partnership liquidator should have title and interest (in Scots law) to apply to the court for sequestration of the partnership's estate and the estate of an insolvent partner under the Bankruptcy (Scotland) Act 1985. (Paragraph 12.94; Draft Bill, Schedule 4, Part 4)

20.67 We recommend that (a) if for any reason there is no partnership liquidator acting, the court should have power to appoint a partnership liquidator and (b) the court may, on cause shown, remove a partnership liquidator and appoint another. (Paragraph 12.96; Draft Bill, Schedule 4, Part 1, para 15)

20.68 We recommend that:

- (1) A partnership liquidator should be able to resign his office by giving notice to the court, each partner, each person interested in the winding up, and (if he was appointed on an application by a creditor) the creditor; (Draft Bill, Schedule 4, Part 1, para 14)
- (2) A partnership liquidator may apply for release in the first instance by summoning a meeting of the partners and any persons interested in the winding up, which failing by application to the court; (Draft Bill, Schedule 4, Part 1, para 16) and
- (3) The release should have effect to discharge the partnership liquidator of all liability to the partnership, the partners, former partners and the estates of former partners in respect of any act or omission in the exercise of his functions and otherwise in relation to his conduct as liquidator (unless the liquidator has obtained his release by fraud or deliberate concealment of wrongdoing). (Paragraph 12.99; Draft Bill, Schedule 4, Part 1, para 16)

20.69 We recommend that all expenses properly incurred in the winding up, including the remuneration of the partnership liquidator and any provisional liquidator should be payable out of the partnership's assets in priority to all other claims. (Paragraph 12.101; Draft Bill, Schedule 4, Part 1, para 17)

20.70 We recommend that:

- (1) A provisional liquidator should be able to resign his office by giving notice to the court, each partner, each person interested in the winding up, and (if he was appointed on an application by a creditor) the creditor; (Draft Bill, Schedule 5, para 5)

- (2) A provisional liquidator should cease to hold office on the determination of the application to the court to appoint a partnership liquidator; (Draft Bill, Schedule 5, para 7)
- (3) If for any reason there is no provisional liquidator acting, the court may appoint a provisional liquidator and the court may, on cause shown, remove a provisional liquidator and appoint another; (Draft Bill, Schedule 5, para 6)
- (4) A provisional liquidator (or if he has died his personal representative) should be able to apply for release to the court and the court may order his release from the time specified in the order; (Draft Bill, Schedule 5, para 8(1) and (2))
- (5) On release a provisional liquidator should be discharged from all liability to the partnership, partners, former partners and the estates of former partners in respect of any act or omission in the exercise of his functions and otherwise in relation to his conduct as provisional liquidator, (unless the liquidator has obtained his release by fraud or deliberate concealment of wrongdoing). (Paragraph 12.104; Draft Bill, Schedule 5, para 8(3))

20.71 We recommend that the Secretary of State should be empowered to make rules for the purpose of giving effect to the provisions of the draft Bill in relation to the solvent winding up of partnerships and in particular to provide for the remuneration of the partnership liquidator and the provisional liquidator. (Paragraph 12.106; Draft Bill, Schedule 4, Part 1, para 18 and Schedule 5 para 9)

20.72 We recommend that the following should be the default rules on settlement of partners' accounts in a winding up:

- (1) First, partners are to pay any sums which they are due to the partnership.
- (2) Secondly, the assets of the partnership, including the sums repaid by partners in (1) above, are to be distributed in the following manner and order:
  - (a) In paying the debts of the partnership to persons who are not partners;
  - (b) In paying to each partner what is due from the partnership to him (other than in respect of capital);
  - (c) In paying to each partner rateably what is due from the partnership to him in respect of capital; and
  - (d) In dividing the ultimate residue, if any, among the partners in the proportion in which profits are divisible.
- (3) If the partnership has insufficient assets to pay sums due to third party creditors and to repay to partners the sums due to them (other than in respect of capital), the partners individually shall contribute to the partnership towards that deficiency in the proportions in which they were liable to share partnership losses;

- (4) The partners who are liable to contribute under (3) above are those who are personally liable for the partnership obligations or who would be personally liable for an indemnity granted by the partnership to a former partner in respect of those obligations;
- (5) If a partner is not liable or, as a result of insolvency, is not able to make his contribution to the deficiency in (3) above, the other partners shall contribute the additional amount needed to meet the deficiency in the proportions in which those partners are liable (as between themselves) to contribute to that deficiency; and
- (6) In this context a “partner” includes a person who ceased to be a partner on or after the break up. (Paragraph 12.128; Draft Bill, cl 44)

**MISCELLANEOUS REFORMS, AND PROPOSALS WE HAVE NOT TAKEN FORWARD**

- 20.73 We recommend that section 3 of the 1890 Act (which postpones the rights of certain creditors of a partnership) should not be re-enacted in the draft Partnerships Bill. (Paragraph 13.5)
- 20.74 We recommend that section 18 of the 1890 Act is not re-enacted. (Paragraph 13.9)
- 20.75 We recommend that sections 23(2) and (3) of the 1890 Act should be re-enacted in modern language. (Paragraph 13.12; Draft Bill, cl 46)
- 20.76 We recommend that assignees of a partner’s share (whether by voluntary assignment or by involuntary assignment on death, insolvency or otherwise) should not be allowed to take part in the management of the partnership business or affairs. Such assignees should not be entitled to inspect the partnership’s records. (Paragraph 13.17; Draft Bill, cl 36)
- 20.77 We recommend that section 37 of the 1890 Act (publicity for departure of a partner or break up of partnership) should be re-enacted in modern language. (Paragraph 13.20; Draft Bill, cl 41)
- 20.78 We recommend that the substance of section 40 of the 1890 Act should be re-enacted: where a partner in a fixed term partnership has paid a premium to another partner in respect of the formation of the partnership and the partnership breaks up before the end of its term, the court should have power to order the repayment of the whole or part of the premium. (Paragraph 13.22; Draft Bill, cl 52)
- 20.79 We recommend that the Business Names Act 1985 should be amended in consequence of our recommended reforms of partnership law. (Paragraph 13.24; Draft Bill, cl 75 and Schedule 11)
- 20.80 We recommend that section 70 of the Criminal Procedure (Scotland) Act 1995 should be amended to provide for the prosecution of partnerships as well as bodies corporate. (Paragraph 13.26)
- 20.81 We recommend that a partnership should not be capable of engaging a partner as an employee. (Paragraph 13.43; Draft Bill, cl 7(4))

## **TRANSITIONAL PROVISIONS**

20.82 We recommend that:

- (1) There should be a transitional period of two years starting with the commencement date of the new Partnerships Act; (Draft Bill, cl 79(4))
- (2) During the transitional period a partnership formed before the commencement date (“an old partnership”) will, subject to (3) below, continue to be governed by the mandatory and default rules of the 1890 Act; (Draft Bill, cl 79(1))
- (3) If during the transitional period an old partnership decides, by unanimous decision which is signed and in writing, that the provisions of the new Partnerships Act should apply to it before the end of the transitional period, the new provisions will apply from the date of, or provided for in, that decision; (Draft Bill, cl 79(3)(b))
- (4) At the end of the transitional period the provisions of the new Partnerships Act will apply to all partnerships whenever formed; (Draft Bill, cl 79(3)(a))
- (5) A partner in an old partnership may, during the transitional period unilaterally elect that the partnership shall after the end of the transitional period continue to be governed by the default rules of the 1890 Act. The election must be in writing and be signed by the electing partner; (Draft Bill, cl 79(3)(d))
- (6) Partnerships formed after the commencement date, whether or not during the transitional period, will, from their commencement, be subject to the provisions (including, where applicable, the new default rules) of the new Partnerships Act; (Draft Bill, cl 79(1) and (2))
- (7) A “new” partnership, which is created during the transitional period merely by a change in membership of an old partnership, will not be treated as formed after the commencement date (for the purposes of (6) above) provided (a) its membership is substantially the same as the old partnership and (b) it succeeds to the whole or substantially the whole of the business of the old partnership. This rule applies also to subsequent “new” partnerships so created during the transitional period; (Draft Bill, cl 79(3)(c))
- (8) Neither the default scheme under the 1890 Act nor the default scheme under the new Partnerships Act will apply to a partnership whose agreement provides for different terms. (Paragraph 14.21)

20.83 We recommend that there should be a transitional provision that the partnership property of an old partnership on the date when the provisions of the Partnerships Act first apply to that partnership will be treated as partnership property under the new Partnerships Act for so long as it would have been treated as partnership property under the 1890 Act. (Paragraph 14.24; Draft Bill, cl 79(2))

**ESTABLISHING AND OPERATING A LIMITED PARTNERSHIP (1): REGISTRATION AND DE-REGISTRATION**

- 20.84 In the light of our proposals on registration discussed above, we recommend that:
- (1) A limited partnership should exist from the date of registration of the limited partnership as stated in the certificate of registration; (Draft Bill, cls 54(1) and 67)
  - (2) The registrar should be obliged to register the partnership or proposed partnership as a limited partnership, if satisfied that the statutory requirements are complied with, and to supply it with a registration certificate. (Paragraph 15.21; Draft Bill, cl 67(1))
- 20.85 We recommend that the certificate of registration of a limited partnership should contain the following information: (a) the name of the limited partnership, (b) the fact of its registration as a limited partnership and (c) the date of registration. (Paragraph 15.23; Draft Bill, cl 67(2))
- 20.86 We recommend that:
- (1) The certificate of registration should be conclusive evidence (a) that all registration formalities have been complied with, (b) that the partnership was registered as a limited partnership on the date stated in the certificate and (c) that the partnership name is as specified in the certificate; (Draft Bill, cl 71(1))
  - (2) The certificate of a change in the name of a partnership should be conclusive evidence (a) that the partnership was registered as having a new name on the date specified in the certificate and (b) that its partnership name is as specified in the certificate; (Draft Bill, cl 71(2))
  - (3) A copy or extract from an original document sent to the registrar should if signed by the registrar be admissible in evidence in all legal proceedings as of equal validity with the original document. (Paragraph 15.25; Draft Bill, cl 71(3))
- 20.87 We recommend that:
- (1) The requirement for the registration of a principal place of business, initially in the United Kingdom, should be abolished and be replaced by the requirement to have a registered office in England or Wales, or in Scotland; (Draft Bill, cl 62)
  - (2) The register should contain the following information concerning the limited partnership:
    - (a) The name under which the partnership is registered;
    - (b) The name and address of the proposed general partner (or, if there is more than one, all of them);
    - (c) The name of each limited partner and the amount of any capital contribution made by him to the partnership;

- (d) Whether the registered office of the partnership is in England or Wales, or in Scotland;
- (e) The address of the registered office;
- (f) If the partnership existed before registration, the date of formation of the partnership. (Paragraph 15.38; Draft Bill, cl 66)

20.88 We recommend that a change of partnership name will not have effect until the change is registered. To effect such a change a notice must be delivered to the registrar who, if satisfied that the statutory requirements in relation to the name are met, must alter the register and supply the partnership with a certificate of the change of name. The certificate will be conclusive evidence of the partnership name and the registration of the new name on the date specified in the certificate. (Paragraph 15.41; Draft Bill, cls 68 and 71(2) and Schedule 7, para 1)

20.89 We recommend that a person should become a limited partner only on his registration as such. Notice that a person is a proposed limited partner, specifying his name and any capital contribution to the partnership, should be delivered to the registrar. If the proposed limited partner is a general partner in the partnership (and is applying to become a limited partner) the notice must state that fact. On receiving the notice the registrar must register the person as a limited partner (and, where the applicant was a general partner, record the fact that the partner has ceased to be a general partner in the partnership). (Paragraph 15.43; Draft Bill, cls 54(1) and 68 and Schedule 7, para 3)

20.90 We recommend that a person should become a general partner on the date agreed between him and the limited partnership and that notification of his joining the limited partnership as a general partner should be made to the registrar within twenty-eight days after he joins. (Paragraph 15.45; Draft Bill, cl 68 and Schedule 7, para 5)

20.91 We recommend that:

- (1) A person should cease to be a general partner in accordance with the rules of law in relation to general partnerships or the terms of the partnership agreement but he may incur liability to third parties by holding out until his change of status is published in the register; (Draft Bill, cls 26 and 68 and Schedule 7, para 5(5))
- (2) Subject to paragraph (3) below, a person should not cease to be a limited partner until his change of status is published in the register; (Draft Bill, cls 54(2) and 68 and Schedule 7, para 4(7))
- (3) A person should cease to be a limited partner on death or (if a non-natural person) dissolution and the fact that he has ceased to be a general partner or limited partner (as the case may be) should be registered within twenty-eight days after the death or dissolution. (Paragraph 15.49; Draft Bill, cls 54(3) and 68 and Schedule 7, paras 4(1) and 5)

20.92 We recommend that a limited partnership should, during its continuance, be under a duty to deliver to the registrar a notice of any of the following changes within 28 days of the event:

- (1) A change of name of an existing general or limited partner;
  - (2) A change of address of an existing general partner; and
  - (3) An increase or withdrawal of the capital contribution of a limited partner. (Paragraph 15.51; Draft Bill, cl 68 and Schedule 7, para 5)
- 20.93 We recommend that a limited partnership may change the address of its registered office only by delivering notice of the change to the registrar who must alter the register. The change in address should have effect only from the date when it is registered. (Paragraph 15.53; Draft Bill, cl 68 and Schedule 7, para 2)
- 20.94 We recommend that, on the application of a general partner or another person who has authority to make the application on behalf of the partnership, the registrar should be empowered to register a correction to the register and that, if he does so, he should be required to supply the partnership with a revised certificate. (Paragraph 15.55; Draft Bill, cl 68 and Schedule 7, para 6)
- 20.95 We recommend that the registrar should be empowered to approve the form and means by which a document may be delivered to him and that where the registrar directs that documents are to be delivered to an authorised person at a specified address, delivery of a document to another address should not be treated as delivery. (Paragraph 15.57; Draft Bill, cl 68 and Schedule 9, para 1)
- 20.96 We recommend that the registrar should be empowered to keep the registered information in any form he thinks fit, provided that it is possible to inspect the information and to produce a copy of it in legible form. The registrar should be required to keep original documents, which are sent to him, for ten years. (Paragraph 15.59; Draft Bill, cl 68 and Schedule 9, para 2)
- 20.97 We recommend that any person should be entitled to inspect information kept by the registrar and to require a copy of information kept in the register or a certified copy of, or extract from, the original of any document. A person should also be able to require a certificate of the registration of a limited partnership or a certificate of the registration of a change in the name of a limited partnership. (Paragraph 15.61; Draft Bill, cl 68 and Schedule 9, para 3)
- 20.98 We recommend that the Secretary of State should have power to make regulations to:
- (1) Impose fees in respect of (i) registration of a limited partnership or of information relating to such a partnership, (ii) the inspection of the register or any documents or information relating to a limited partnership or (iii) the provision of a certificate or an extract or copy of any document;
  - (2) Provide for the performance by the assistant registrar or other officers of acts which the registrar is required to perform in relation to limited partnerships; and
  - (3) Make provision for the translation of documents delivered to the registrar which relate to limited partnerships whose registered office is in Wales. (Paragraph 15.63; Draft Bill, cl 68 and Schedule 9, para 4)
- 20.99 We recommend that a limited partnership should not be registered by a name:

- (1) Which is the same as a name appearing in the registrar's index of company and corporate names, unless the person whose name appears in the index consents;
- (2) The use of which as the name of the partnership would in the opinion of the Secretary of State constitute an offence; or
- (3) Which in the opinion of the Secretary of State is offensive. (Paragraph 15.66; Draft Bill, cl 63(3) – (5))

20.100 We recommend that:

- (1) The name of a limited partnership must end with either “limited partnership” or the abbreviation “lp” or “LP” ; (Draft Bill, cl 63(1))
- (2) If the registered office of the limited partnership is in Wales the alternative suffix may be “partneriaeth cyfyngedig” or the abbreviation “pc” or “PC”; (Draft Bill, cl 63(2))
- (3) The name of the limited partnership (which includes the suffix) and the address of its registered office must be stated on any partnership document. (Paragraph 15.71; Draft Bill, cl 65(1) and (2))

20.101 We recommend that only (a) a limited partnership, (b) a partner in a limited partnership, (c) a partnership registered outside Great Britain and in which one or more of the partners by registration has limited liability for partnership obligations (“oversea limited partnership”) and (d) a partner in an oversea limited partnership should be allowed to use the expression “limited partnership”, its Welsh equivalent or contractions or imitations of those expressions at the end of their business names. Any other person using those expressions in the last words of their business name or title should be guilty of an offence. (Paragraph 15.78; Draft Bill, cl 64)

20.102 We recommend that:

- (1) The registrar should have power to de-register a limited partnership:
  - (a) If the registrar receives an application for de-registration after all the partners of the limited partnership (or former partners of a dissolved limited partnership) have agreed; (Draft Bill, cl 68 and Schedule 8, para 1) or
  - (b) If after inquiry the registrar has reasonable grounds for believing that one of the grounds for doing so exists; (Draft Bill, cl 68 and Schedule 8, para 2)
- (2) The grounds for de-registering a limited partnership referred to in paragraph (1)(b) above are (a) that it has been dissolved, (b) that it does not have one or more general partners and one or more limited partners, (c) that it does not have a registered office and (d) that where a limited partnership, which was not previously a general partnership, has been formed by registration, the partners have not begun to carry on business together during a period of at least two years immediately after registration; (Draft Bill, cl 68 and Schedule 8, para 2(2) and (4))

- (3) Before the registrar de-registers a limited partnership under paragraph (1)(b) above, the registrar must have made preliminary inquiries by sending two letters to the registered office of the limited partnership, the second letter following six weeks after the first letter. In the letters the registrar should state his belief that a ground for de-registering exists and invite a reply showing why the partnership should not be de-registered. Where there are reasonable grounds for believing that the partnership does not have a registered office the letters of inquiry may be sent to the general partner or partners and to any limited partner whose address is known to the registrar; (Draft Bill, cl 68 and Schedule 8, para 3)
- (4) In addition, before de-registering under either of paragraph (1)(a) or (b) above, the registrar must publish a de-registration warning in the Gazette at least three months before he de-registers a limited partnership; (Draft Bill, cl 68 and Schedule 8, paras 1(1)(b), 2(1)(c) and 4)
- (5) If the registrar de-registers a limited partnership, he must publish notice of the fact in the Gazette and de-registration takes effect on the date specified in the notice; (Draft Bill, cl 68 and Schedule 8, para 5)
- (6) If the de-registered partnership re-registers itself as a limited partnership, the court should be able on the application of the partnership or any partner, within 3 years of de-registration, to make an order to backdate the limited liability of the limited partners to the date of de-registration and otherwise to put the limited partnership and other persons in the position they would have been in if the limited partnership had not been de-registered; (Draft Bill, cl 68 and Schedule 8 para 6(1), (5) and (6))
- (7) The court may make the order in paragraph (6) above if it is satisfied (a) either that the application for de-registration had not been properly authorised or that none of the grounds for de-registering the partnership existed when it was de-registered and (b) that it is just and equitable to do so. (Paragraph 15.83; Draft Bill, cl 68 and Schedule 8, para 6(2), (3) and (4))

**ESTABLISHING AND OPERATING A LIMITED PARTNERSHIP (2): THE GENERAL PARTNER AND OTHER MATTERS**

20.103 We recommend that a general partner should be defined as a person who is a partner in a limited partnership but is not a limited partner. (Paragraph 16.4; Draft Bill, cl 54(4))

20.104 We recommend that:

- (1) General partners should be fully responsible for the registration formalities and (subject to (4) below) should have authority to sign the original registered particulars and any amendments, and where applicable authorised managers should have the same responsibility and authority except for signing the original application for registration;
- (2) Where there is default of registration formalities, the general partner or general partners, or where applicable the authorised manager, should be liable for daily fines similar to those which apply to companies;

- (3) Default in registration formalities should not of itself remove the limited liability of the limited partners; and
- (4) A limited partner should sign a notice of a person ceasing to be a limited partner only if (a) he is the person ceasing to be a limited partner and is to become a general partner and (b) the partnership does not have one or more general partners and limited partners should sign an application to de-register a limited partnership only if there are no general partners. (Paragraph 16.14; Draft Bill, cls 66(2) and 68; Schedule 7, paras 1(3), 2(3), 3(4), 4(4), 4(5), 5(2), 5(7), 6(1); Schedule 8, paras 1(4) and (5))

20.105 We recommend that:

- (1) There should be a default rule that any difference arising as to ordinary matters connected with the partnership business may be decided by the general partner, or if there is more than one general partner, by a majority of them. (Draft Bill, cl 59(4))
- (2) There should be a default rule that differences about other matters relating to the partnership must be decided by the general partner, or if there is more than one general partner, all of them; (Draft Bill, cl 59(5))
- (3) There should be a default rule that a decision whether a limited partner should be given authority to act on behalf of the partnership is not an ordinary matter; (Draft Bill, cl 59(6))
- (4) There should be a default rule that a person may become a partner in a limited partnership only with the consent of the general partner, or if there is more than one general partner, all of them, or, if there are no general partners, all the limited partners; (Draft Bill, cl 60(1) and (3))
- (5) A general partner who without reasonable excuse fails to ensure that the name of the limited partnership and the address of its registered office are stated on any partnership document should be guilty of an offence and liable to a fine; (Draft Bill, cl 65(3))
- (6) There should be a default rule that, unless the court orders otherwise or there are no general partners, the general partner, or if there is more than one general partner, all of them are responsible for winding up the partnership. (Paragraph 16.19; Draft Bill, cl 61(2))

20.106 We recommend that a limited partner should not take part in the management of the partnership business. (Paragraph 16.21; Draft Bill, cl 55(1))

20.107 We recommend that a limited partner should have no implied authority to bind the partnership. (Paragraph 16.23; Draft Bill, cl 59(2))

20.108 We recommend that where a partnership has not been formed before registration, the partnership is formed when it is registered as a limited partnership. (Paragraph 16.29; Draft Bill, cl 67(3))

20.109 We recommend that:

- (1) A person should be guilty of an offence if, when he makes an application to register or de-register a limited partnership, he knows that information in it is false or is aware that the information may be false;
- (2) A person who is guilty of an offence under (1) above should be liable on summary conviction to imprisonment for up to six months or a fine not exceeding the statutory maximum, or both, or on conviction on indictment, to imprisonment for up to two years or a fine, or both;
- (3) A person should be guilty of an offence if, when he delivers a notice to the registrar of a change in the particulars of a limited partnership, he knows that information in it is false or is aware that the information may be false; and
- (4) A person who is guilty of an offence under (3) above should be liable on summary conviction to imprisonment for a period not exceeding six months or a fine not exceeding level five on the standard scale, or both. (Paragraph 16.32; Draft Bill, cl 69)

20.110 We recommend that if a body corporate commits an offence under the draft Bill with the consent or connivance of an officer of the body corporate or the offence is attributable to neglect on the part of such an officer, the officer as well as the body corporate should be guilty of the offence. If the affairs of the body corporate are managed by its members, a member of the body may similarly be guilty of an offence. (Paragraph 16.34; Draft Bill, cl 70)

#### **THE LIABILITY OF THE LIMITED PARTNER**

20.111 We recommend that there should be a list of permitted activities in which limited partners may engage without loss of their limited liability and that the loss of limited liability should not be contingent upon knowledge of a third party dealing with the partnership. (Paragraph 17.7)

20.112 We recommend that a limited partner should be prohibited from taking part in the management of partnership business but that it should be provided that that prohibition does not prevent a limited partner from doing the following things:

- (1) Taking part in a decision about the variation of the partnership agreement;
- (2) Taking part in a decision about whether to approve, or veto, a class of investment by the limited partnership;
- (3) Taking part in a decision about whether the general nature of the partnership business should change;
- (4) Taking part in a decision about whether to dispose of the partnership business or to acquire another business;
- (5) Taking part in a decision about whether a person should become or cease to be a partner;
- (6) Taking part in a decision about whether the partnership should end;
- (7) Taking part in a decision about how the partnership should be wound up;

- (8) Enforcing his rights under the partnership agreement (unless those rights are to carry out management functions);
- (9) Approving the accounts of the limited partnership;
- (10) Being engaged under a contract by the limited partnership or by a general partner in the limited partnership (unless the contract is to carry out management functions);
- (11) Acting in his capacity as a director or employee of, or a shareholder in, a corporate general partner;
- (12) Taking part in a decision which involves an actual or potential conflict of interest between a limited partner (or limited partners) and a general partner (or general partners);
- (13) Discussing the prospects of the partnership business;
- (14) Consulting or advising a general partner, or general partners, about the activities of the limited partnership or about its accounts (including doing so as a member of an advisory committee of a limited partnership). (Draft Bill, cl 55(1) and (2) and Schedule 6)

20.113 We also recommend that the Secretary of State should have power by subordinate legislation to amend this list (by adding, modifying or omitting a permitted activity). (Paragraph 17.17; Draft Bill, cl 55(3))

20.114 We recommend that the protection available to a limited partner should be clarified by providing:

- (1) That a limited partner is not personally liable (whether to third parties or by contribution to the liability of the general partner) for any partnership obligation incurred while he is a limited partner, unless he receives back all or part of his capital contribution; (Draft Bill, cl 56)
- (2) Where a limited partner takes part in the management of the partnership business he is personally liable for any partnership obligation incurred as a result of his taking part in management and for any other partnership obligation during the period when he takes part in management. (Paragraph 17.23; Draft Bill, cl 57)

20.115 We recommend that:

- (1) While a person remains a limited partner he is not entitled either directly or indirectly to withdraw or receive back any part of his agreed capital contribution (“the relevant capital contribution”) to the partnership; (Draft Bill, cl 56(2))
- (2) A partner’s “relevant capital contribution” should mean a capital contribution consisting of either or both of a sum or sums of money and property which has an agreed capital value. (Paragraph 17.31; Draft Bill, cl 56(4))

20.116 We recommend that if a limited partner withdraws or receives back all or part of his agreed capital contribution he should be personally liable for partnership obligations incurred while he is a limited partner, but that his liability should not exceed the amount of his capital contribution drawn out or received back. (Paragraph 17.33; Draft Bill, cl 56(3))

20.117 We recommend that the requirement that a limited partner make a contribution should be replaced by an option to make a capital contribution; (Paragraph 17.36; Draft Bill, cl 56(2))

#### **THE RIGHTS AND OBLIGATIONS OF PARTNERS IN A LIMITED PARTNERSHIP**

20.118 We recommend that it should remain a default rule that the consent of limited partners should be needed for (a) any change to the partnership agreement and (b) any change to the nature of the business and (c) the retirement of a general partner. (Paragraph 18.7; Draft Bill, cls 4, 6(4) and 28(1))

20.119 We recommend that:

(1) In the absence of an agreement to the contrary, a limited partner should not be under a duty to keep the other partners fully informed of partnership matters or a duty to account to the partnership for profits made by him in a competing business; and

(2) In the absence of an agreement to the contrary, a limited partner should not be under duties to ensure that accounting records are maintained and to co-operate with persons keeping partnership records. (Paragraph 18.12; Draft Bill, cl 59(1))

20.120 We recommend that an assignee of a partner's share should be able to become a partner in a limited partnership in place of the assignor if either (a) the general partner agrees to the substitution or, if there is more than one general partner, all of them agree to it, or (b) the substitution is made in accordance with the partnership agreement. (Paragraph 18.18; Draft Bill, cl 60(3))

20.121 We recommend that the power to expel a partner against whom a charging order is made or whose share is arrested in execution should not apply to a limited partner. (Paragraph 18.20; Draft Bill, cl 60(2))

20.122 We recommend that a limited partnership should break up (a) if the general partner decides, or if there is more than one general partner at least half of the general partners decide, to end the partnership, or (b) if there are no general partners, at least one half of the limited partners decide to end the partnership. (Paragraph 18.22; Draft Bill, cl 61(1))

20.123 We recommend that:

(1) The general partner or general partners should have responsibility for winding up the partnership business and affairs, unless the court orders otherwise or there are no general partners; (Draft Bill, cl 61(2))

(2) A limited partner should not have the right to take part in a decision by the partners to approve the exercise by the liquidator or partnership liquidator of powers which require the approval of partners, unless the

partnership agreement provides otherwise or the partnership has no general partners; (Draft Bill, cl 61(3) and (4))

- (3) Unless the partnership agreement provides otherwise or there are no general partners, the persons entitled to attend meetings to consider the liquidator's annual accounts or final accounts should not include a limited partner, former limited partner or personal representatives of, or insolvency practitioners for, former limited partners. (Paragraph 18.27; Draft Bill, cl 61(3) and (5))

#### **SPECIAL LIMITED PARTNERSHIPS**

- 20.124 We recommend that in English law there should be a special limited partnership which does not have separate legal personality. (Paragraph 19.22; Draft Bill, cl 73 and Schedule 10)

*(Signed)* ROBERT TOULSON, *Chairman, Law Commission*  
HUGH BEALE  
STUART BRIDGE  
MARTIN PARTINGTON  
ALAN WILKIE

MICHAEL SAYERS, *Chief Executive*

RONALD D MACKAY, *Chairman, Scottish Law Commission*  
GERARD MAHER  
KENNETH G C REID  
JOSEPH M THOMSON  
COLIN J TYRE

JANE L MCLEOD, *Secretary*  
10 October 2003

# **APPENDIX A**

## **Draft Partnerships Bill**

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**The draft Partnerships Bill begins on the following page with a Contents section. The draft Bill is then set out with the Clauses on left hand pages and Explanatory Notes on the corresponding right hand pages.**

**Appendix B begins on page 472.**

# Partnerships Bill

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Make provision about partnerships; and for connected purposes.

**B**E IT ENACTED by the Queen’s most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

**PART 1**

INTRODUCTION

**1 Meaning of partnership agreement and partnership**

- (1) A partnership agreement is an agreement between two or more persons for carrying on a business together with the object of making a profit. 5
- (2) For the purposes of this Act, a partnership is an association formed when two or more persons start to carry on a business together under a partnership agreement.
- (3) A partnership is a legal person but not a body corporate.
- (4) This is subject to Part 4 (provision for special limited partnerships, which are not legal persons). 10
- (5) A partnership is—
  - (a) a general partnership, or
  - (b) a limited partnership registered under section 67.
- (6) In this Act “business” includes every trade, profession and occupation. 15
- (7) Schedule 1 provides examples of circumstances which do not by themselves establish that persons are carrying on a business together.

**2 Bodies excluded from scope of this Act**

None of the following is a partnership for the purposes of this Act—

# EXPLANATORY NOTES

## INTRODUCTION

### Clause 1

1. Subsection (1) introduces the concept of the partnership agreement. This subsection and subsection (2) make it clear that without this agreement between the partners, a business venture is not a partnership to which the law of partnerships applies. This agreement may be explicit or implicit (see clause 76(2)). This reflects the existing law.
2. Subsection (2) governs the moment that a partnership comes into being. It is intended to reflect the existing law on this point under the Partnership Act 1890 (the “1890 Act”), as settled by the House of Lords in *Khan v Miah* [2000] 1 WLR 2123. See the report, paragraphs 4.16 - 4.24.
3. Subsection (3) provides that a partnership is a separate legal person. This is an innovation in the law of England and Wales. It is already the case under the 1890 Act in Scotland. For the background to and reasons for this change to the law in England and Wales, see the report, paragraphs 5.5 - 5.40. A partnership is not governed by the common law of corporations. It is a *sui generis* legal person and its characteristics will be determined by (a) the draft Bill, (b) the partnership agreement (which may in certain respects vary and supplement provisions of the draft Bill) and (c) the rules of common law and equity so far as consistent with the draft Bill. See the report, paragraphs 5.38 - 5.39 and 5.40 (2).
4. Subsection (5) introduces the concept of the limited partnership. Under the current law, limited partnerships are dealt with in a separate piece of legislation modifying and supplementing the 1890 Act (the Limited Partnerships Act 1907 (the “1907 Act”). In the draft Bill, the statutory provisions on limited partnerships are integrated with those on general partnerships. See the report, Parts XV - XVIII.
5. Subsection (6) provides that a partnership may be created whatever the nature of the business. This reproduces the existing law. See the report, paragraphs 4.33 - 4.35.
6. Subsection (7) introduces Schedule 1 which provides guidance on whether, on a given set of facts, people are in business together. It does this by setting out examples of arrangements that do not, by themselves, establish that people are in business together. It is broadly intended to reproduce the existing law under section 2 of the 1890 Act in a clear and unambiguous form. See the report, paragraphs 4.48 - 4.53.
7. All new general partnerships (and all existing general partnerships after the transitional period) will have separate legal personality under the draft Bill. It will, however, be possible for a new (or existing) limited partnership to elect to remain without separate legal personality. This option, and the law which applies if it is exercised, is governed by Part 4 of the draft Bill and referred to in subsection (4). It is expected that this option will be exercised only by sophisticated financial vehicles. For the background to this recommendation on limited partnerships, see the report, Part XIX.

### Clause 2

8. This clause ensures that business vehicles other than a partnership constituted under Scots law or English law are not governed by the draft Bill. This reproduces and clarifies the law under the 1890 Act (section 1(2)). See the report, paragraph 4.40.

- 
- (a) a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000 (c. 12);
  - (b) any other body corporate (wherever incorporated);
  - (c) a partnership constituted under the law of a country or territory outside Great Britain; 5
  - (d) any other association or body formed under any other enactment, letters patent or Royal Charter or under the law of a country or territory outside the United Kingdom.
- 3 Liability of partners**
- (1) Each of the partners in a general partnership has unlimited liability (as to which, see section 23). 10
  - (2) A limited partnership must have –
    - (a) one or more general partners each of whom has unlimited liability, and
    - (b) one or more limited partners each of whom has limited liability (as to which, see section 56) so long as he complies with section 55 (restricted role of limited partners). 15
- 4 Partnership agreements**
- A partnership agreement may be varied in accordance with its terms or –
- (a) before formation of the partnership, with the agreement of all proposed partners; 20
  - (b) after formation, with the agreement of all existing partners.
- 5 Default partnership rules**
- (1) In this Act “default rule” means a rule that applies in relation to a partnership if the point dealt with in the rule is not dealt with in the partnership agreement.
  - (2) If a default rule applies in relation to a partnership, it is to be treated as if it were a term of the partnership agreement. 25
  - (3) The application of a default rule in relation to a partnership may be modified or excluded –
    - (a) in accordance with the terms of the partnership agreement, or
    - (b) if all the partners agree. 30

## PART 2

### GENERAL PARTNERSHIPS

#### *Carrying on of partnership business and capacity*

- 6 The carrying on of the partnership business**
- (1) The function of the partners is to carry on the partnership business. 35
  - (2) The main functions of the partnership are –
    - (a) to enter into contracts and own or hold property for the purposes of the partnership business, and

# EXPLANATORY NOTES

## **Clause 3**

9. A central feature of the law of partnerships is that the partners are personally liable in full for liabilities of the partnership. Subsection (1) introduces this important concept, which is fleshed out in clause 23. Subsection (2) sets out the different position of limited partners in a limited partnership. See the report, paragraphs 6.57 and 6.59(1).

## **Clause 4**

10. This clause provides how the partnership agreement (as defined by clause 1(1)) may be altered. See the report, paragraphs 4.54 - 4.55, 18.3 - 18.4 and 18.7.

## **Clause 5**

11. The partnership agreement may contain detailed rules governing the relationship between the partners. But it may not. Indeed, a partnership agreement may not be express at all: it may be inferred from the fact that a business is being carried on (see note on clause 1 above). If a partnership agreement is silent on a matter (for example, how profits are to be shared) and the partners do not agree, how is this to be resolved? The answer may be provided by a “default rule” contained in the draft Bill. The draft Bill contains a number of these rules. This clause introduces the concept and explains how they work. A “default rule” applies unless the partners have agreed to deal with the subject matter of the rule in some other way.
12. The purpose of subsection (2) is to ensure that the breach by a partner of a default rule gives the partnership and other partners the same remedies as the breach of an identically worded term of the partnership agreement. Subsection (3) sets out the way in which partners may modify or exclude a default rule. See the report, paragraphs 4.56 - 4.58.

## **GENERAL PARTNERSHIPS**

### ***Carrying on of partnership business and capacity***

## **Clause 6**

13. The introduction of separate legal personality for partnerships does not alter the fact that the partners own and manage the business and remain fully liable for its debts.
14. The separate legal personality of a partnership under the draft Bill is designed to clarify and simplify the legal analysis of its activities. In particular, separate legal personality provides a simple structure for a partnership’s contractual relationships, and for its ownership of property. It also gives legal reality to the economic fact that the partnership which exists after a change in membership is (unless otherwise agreed) the same partnership which existed before. These features of separate legal personality are the subject of subsection (2). See the report, paragraphs 4.25 - 4.32.

- 
- (b) subject to the partnership agreement, to provide continuity for the partnership business despite a change in the partners.
- (3) The partners are agents of the partnership (but not of each other).
- (4) It is a default rule that a change in the nature of the partnership business (whether or not it involves a change in the partnership agreement) requires the agreement of all the partners. 5
- 7 Capacity of partnership**
- (1) A partnership’s capacity as a legal person is unlimited.
- (2) A partnership may, in particular, sue and be sued in its name.
- (3) Subsection (1) is subject to subsection (4) and section 8. 10
- (4) A partnership is not capable of engaging a partner as an employee.
- 8 Incapacity to commit offences (England and Wales)**
- Except so far as is provided by or under any enactment (whether expressly or by implication) a partnership is not capable of committing an offence.
- Good faith and disclosure* 15
- 9 Overriding duty of good faith**
- (1) A partner must act in good faith towards –  
(a) the partnership, and  
(b) each of the other partners,  
in relation to any matter affecting the partnership. 20
- (2) In particular, a partner must –  
(a) keep each of the other partners fully informed of partnership matters;  
(b) account to the partnership for any secret profit;  
(c) account to the partnership for any profits of a competing business.
- (3) The mutual rights and duties of the partners, and the mutual rights and duties of the partnership and the partners, (whether arising under this Act or the partnership agreement) are subject to the duty imposed by subsection (1). 25
- (4) “Partnership matters” means matters affecting the partnership of which the other partners would reasonably expect to be kept informed.
- (5) “Secret profit” means any benefit which the partner derives, without the agreement of all the other partners, from –  
(a) a transaction affecting the partnership, or  
(b) the use by him of partnership property or trust property or the partnership name or business connection. 30
- (6) “Competing business” means a business carried on by him, without the agreement of all the other partners, which competes with and is of the same nature as the partnership business. 35

## EXPLANATORY NOTES

15. Under the existing law in England and Wales, the relationship between partners is one of mutual agency. In Scots law, a partner is the agent of the partnership. As mutual agency is not consistent with separate legal personality, the draft Bill provides that partners are agents of the partnership entity and not of each other. Principles of agency law will apply. This is the effect of subsection (3). See the report, paragraphs 6.10 - 6.22(1).
16. Subsection (4) provides that the nature of the partnership business can (by default) be changed only with unanimous agreement. See the report, paragraphs 10.29 and 10.30(5).

### **Clause 7**

17. Subsection (1) ensures that, generally, no-one can challenge the validity of an act of a partnership on the grounds that the act was not within its capacity. In other words, the introduction into the law of partnerships of separate legal personality will not bring with it the doctrine of *ultra vires* which once applied in the field of company law. See the report, paragraphs 4.41 - 4.42, 9.23 - 9.49 and 9.51 (1) - (2).
18. Subsection (3) introduces two provisos to this statement of a partnership's unlimited capacity. First, a partnership is not capable of employing a partner (subsection (4)). This is to ensure that employment law does not apply to the relationship between the partnership and the partners. See the report, paragraphs 13.41-13.43. The second proviso relates to the application of the criminal law to partnerships (on which see clause 8).
19. Subsection (2) ensures that the partnership entity can be a party to litigation. The existing rules in England and Wales already adopt an approach to partnership litigation which is similar to an entity approach. However, in Scots law, there is a need to modernise the existing rules which, oddly, are less oriented towards an entity approach. See the report, paragraphs 7.4 - 7.9, 7.20 and 7.22(1).

### **Clause 8**

20. This clause gives a clear rule in England and Wales that a partnership is not capable of committing an offence unless it is provided otherwise (expressly or by implication) in any enactment. The application of the criminal law to partnerships in England and Wales may need to be reviewed as an independent exercise in due course. See the report paragraphs 4.43 - 4.47.
21. In Scotland, where partnership already has a form of separate legal personality, a partnership is capable of committing certain criminal offences. This clause does not therefore apply in Scotland.

### ***Good faith and disclosure***

#### **Clause 9**

22. This clause states the fundamental duty of good faith which partners owe to each other and adapts that to the introduction of separate personality of the partnership.
23. Subsection (1) states the fundamental duty and makes clear that a partner owes that duty both to the partnership and to each of the other partners. See the report, paragraphs 11.67 - 11.70.
24. Subsections (2), (4), (5) and (6) restate the specific fiduciary duties which were stated in sections 28 - 30 of the 1890 Act. The Bill does not attempt further to codify fiduciary duties of a partner but leaves it to the courts to develop this area of law.
25. Subsection (3) makes it clear that while partners are free to shape by agreement amongst themselves the precise duties which they undertake to each other and to the firm, they may not exclude the duty of good faith. Partners must show good faith in the performance of the duties which they undertake. See the report, paragraphs 11.29 - 11.32.

**10 Duties of disclosure on forming or joining partnership**

- (1) If two or more persons are about to form a partnership, each prospective partner must disclose to the other prospective partners anything known to him which a prudent prospective partner would reasonably expect to be disclosed in order to decide whether or not to form the partnership. 5
- (2) Subsections (3) and (4) apply if a person (“the prospective partner”) is about to become a partner in an existing partnership.
- (3) The partners must disclose to the prospective partner anything known to them which a prudent prospective partner would reasonably expect to be disclosed in order to decide whether or not to become a partner. 10
- (4) The prospective partner must disclose to the partners anything known to him which prudent partners would reasonably expect to be disclosed in order to decide whether or not to admit him as a partner.
- (5) The duties under this section may be waived (in whole or in part) by agreement between the prospective partners (or between the prospective partner and the partners). 15
- (6) The only remedies for breach of a duty under this section are those provided by section 47 and Schedule 3.
- (7) For the purposes of this section, anything which a person reasonably ought to know is to be treated as known to him. 20

*Partners: share of profits, management of the business etc.*

**11 Partner’s share of profits and losses**

- (1) This section contains a default rule.
- (2) The partners are entitled to share any partnership profits, and are liable to bear any partnership losses, in equal proportions. 25
- (3) “Partnership profits”, in relation to a partner, means profits of the partnership business which accrue while he is a partner.
- (4) “Partnership losses”, in relation to a partner, means losses of the partnership business incurred while he is a partner.

**12 Remuneration, expenses, personal liabilities etc.**

- (1) This section contains default rules. 30
- (2) A partner is not entitled to remuneration from the partnership for acting in the partnership business.
- (3) But a partner is entitled to be indemnified by the partnership in respect of a payment made by him – 35
  - (a) in the proper conduct of the partnership business or in connection with anything necessarily done for the preservation of the partnership business or property, or
  - (b) to discharge the whole or a part of his personal liability for a partnership obligation or in reasonable settlement of an alleged personal liability for a partnership obligation. 40

# EXPLANATORY NOTES

## **Clause 10**

26. This clause imposes a duty of disclosure on those about to form a partnership. If a partnership already exists, it imposes a similar duty on the existing partners and on the prospective partner. Note that the duty of good faith in clause 9 (which applies only between current partners and the partnership) does not apply in these situations.
27. The duty in this clause is objective in two senses. First, the information which must be disclosed is that which a prudent hypothetical partner (or prospective partner) would reasonably expect to receive in the circumstances (subsections (1), (3) and (4)). Secondly, someone who unjustifiably fails to discover (and hence disclose) such a fact is as much in breach of the duty as the person who discovers and fails to disclose it (subsection (7)). Subsection (5) provides that, if parties are happy to enter into partnership without this safeguard, then they can waive it.
28. There is some doubt about the existence and nature of a duty of disclosure under the existing law. See the report, paragraphs 11.35 - 11.40. Subsection (6) refers forward to the remedies for breach of this duty.

## ***Partners: share of profits, management of the business etc.***

## **Clause 11**

29. When a partnership makes money, or loses it, how are the profits to be shared out, or the losses borne? This clause sets out a default rule that profits and losses of the partnership are to be shared equally. This reproduces the existing law. See the report, paragraphs 10.24, 10.25 and 10.30(1).

## **Clause 12**

30. In what circumstances may a partner claim money from the partnership, or from fellow partners? This clause sets out some default rules to answer this question.
31. Subsection (2) provides that a partner is not entitled to claim remuneration unless the partners agree otherwise. The default position is that a partner gets an equal share of the profits or bears an equal share of the losses of the partnership (see clause 11). See the report, paragraphs 10.29 and 10.30(5).
32. Subsection (3) sets out the circumstances in which a partner may obtain reimbursement from the partnership for money paid from personal funds. Paragraph (a) deals with expenses incurred for the benefit of the partnership. This is the existing law. Paragraph (b) deals separately with payments which a partner makes to discharge his personal liability for debts, or other obligations, owed by the partnership. "Personal liability for a partnership obligation" is defined in subsection (8). It also clarifies that a partner is entitled to indemnity when, acting in good faith and reasonably, he pays a claim against the partnership which turns out not to be due. See the report, paragraphs 6.60 - 6.65(1)(a) and (f), 10.29 and 10.30(6).

- 
- (4) The indemnity does not affect any claim which the partnership or another partner may have against the partner.
- (5) If the partnership does not pay the indemnity (or part of it), the partner is entitled to contribution from any other liable partner on the same basis as if the amount unpaid were a debt for which he and each other liable partner were co-guarantors in the same proportions as they would be liable to bear any partnership losses. 5
- (6) “Other liable partner” means a partner of his who –
- (a) in the case of his liability (or alleged liability) for a partnership obligation, was a partner when the payment was made and was liable with him for the obligation (or, in the case of settlement of an alleged liability, would have been liable if the alleged liability had been established), or 10
  - (b) otherwise, was a partner when the payment was made.
- (7) If the partnership wrongly fails to pay to a partner any other amount for which it is liable to account to him, he is entitled to contribution from the other partners in the same proportions as if the amount were a partnership loss. 15
- (8) “Personal liability for a partnership obligation” includes –
- (a) a liability under subsection (5) to make a contribution to a partner in respect of the partnership obligation to indemnify him under subsection (3), 20
  - (b) a liability under subsection (7) to make a contribution to a partner in respect of the partnership obligation to account to him for an amount,
  - (c) a personal liability under section 23(1) for a partnership obligation, and
  - (d) a liability under section 34(4) to indemnify (or make a contribution to) a former partner in respect of the partnership obligation to indemnify him under section 34(2). 25

### **13 Capital contribution etc. by partner**

- (1) This section contains default rules.
- (2) No partner is entitled, or may be required, to – 30
- (a) contribute capital to the partnership, or
  - (b) vary the amount of his capital contribution to the partnership, unless he and all the other partners agree.
- (3) If a partner contributes capital to the partnership, he is not entitled to interest on it. 35
- (4) If a partner makes an advance to the partnership beyond the amount (if any) of the capital he has agreed to contribute, he is entitled to receive interest from the partnership at the prescribed rate from the date of the advance.
- (5) “The prescribed rate” has the meaning given by section 76(1).

### **14 Management etc. of partnership business and affairs 40**

- (1) This section contains default rules.
- (2) A partner is entitled to take part in the management of the partnership business and affairs.

## EXPLANATORY NOTES

33. Subsection (4) ensures that this right to reimbursement does not relieve a partner of liability for damages for any wrong committed to a partnership or other partner. See the report, paragraphs 6.60 and 6.65(1)(b).
34. A partnership may be obliged to account to a partner for an amount as a result of the operation of subsection (3) or otherwise (for example, under the partnership agreement). If the partnership does not pay, what rights does that partner have against other partners? The answer is provided by subsections (5)-(7). These give an unpaid partner personal rights to contribution from other partners. Subsection (7) deals with a partner's right to contribution in relation to, for example, a loan to a partnership or undrawn profits. See the report, paragraphs 10.30(6), 6.60 - 6.64 and 6.65(1)(c)-(e).
35. Note that these subsections, like the clause as a whole, are default rules. Contrast the (mandatory) rules on secondary liability of partners for partnership obligations owed to third parties in clause 23. It is not impossible that a partner might have a claim against other partners under the mandatory rules in clause 23 rather than the default rules under this clause. This will be the case if the amount owed by the partnership to the partner is not an internal partnership matter but is owed to the person in a capacity other than as a partner, for example, a partner may be owed an amount due to damage to that partner's car caused by the driving of a partnership employee in the course of his employment.
36. The rules in this clause broadly reflect the existing law as adapted for separate legal personality.

### Clause 13

37. Suppose a partner puts money (or other assets) into the partnership. How is that to be treated, as between the partners? This clause provides some default rules to answer this question.
38. Subsection (2) provides that, in order for a contribution to be classified as capital or for a capital contribution to be varied, this must be agreed by all the partners. That agreement need not be express (see clause 76(2)). The following subsections set out some consequences of this classification. Subsection (3) provides that the partner is not entitled to interest on a contribution classified as capital. Subsection (4) provides that a partner is, on the other hand, entitled to interest on other amounts he contributes. The amount of interest is linked to the base rate. This last point is a change in the law. Otherwise, these rules reflect, with clarifications, the existing law. See the report, paragraphs 10.26, 10.28 and 10.30(2), (4) and (5).
39. Note that other consequences may flow from the classification of an amount as "capital". For example, it may affect a partner's share of the profits (if the partnership departs from the default rule in clause 11 and shares profits in proportion to capital contributed). It may also affect a partner's share of the partnership's assets on a winding up (see the default rule in clause 44).

### Clause 14

40. This clause provides default rules about management and how differences of opinion between partners are to be resolved.
41. Subsection (2) ensures that the views of each partner count. This reflects the existing law under the 1890 Act (section 24(5)).

- 
- (3) Differences about ordinary matters connected with the partnership business or affairs may be decided by a majority of the partners.
- (4) But differences about other matters connected with the partnership business or affairs must be decided by all the partners.
- (5) The question whether a partnership should take legal or arbitral proceedings against, or defend such proceedings brought by, another person (whether or not a partner) is an ordinary matter. 5
- (6) The partnership agreement cannot be varied under subsection (3) or (4) (see section 4).
- 15 Accounting and partnership records 10**
- (1) This section contains default rules.
- (2) A partner must –
- (a) ensure that proper accounting records are kept of transactions affecting the partnership in which he is involved and of which the other partners would reasonably expect such records to be kept, and 15
- (b) ensure that the records are made available, on request, to the partnership or any other partner.
- (3) A partner must cooperate with any person who is keeping partnership records or drawing up partnership accounts on behalf of the partnership.
- Power of partners to bind partnership 20*
- 16 Partnership bound by acts of partners carrying on business in usual way**
- (1) A partnership is bound by anything done by a partner for carrying on in the usual way business of the kind carried on by the partners.
- (2) But the partnership is not bound if –
- (a) the partner has no authority to do the thing on behalf of the partnership, and 25
- (b) the person with whom the partner is dealing –
- (i) has notice that the partner has no authority, or
- (ii) does not know or believe him to be a partner in the partnership.
- (3) This section is subject to section 20 (execution of deeds (England and Wales)). 30
- Partnership property*
- 17 Partnership property**
- (1) In this Act “partnership property” –
- (a) in England and Wales, means property to which the partnership is beneficially entitled (whether or not the property is held in the partnership name), and 35
- (b) in Scotland, does not include property held by the partnership in trust.
- (2) The Bodies Corporate (Joint Tenancy) Act 1899 (c. 20) applies in relation to the acquisition, holding and devolution of real or personal property in joint

## EXPLANATORY NOTES

42. The effect of subsections (3) and (4) is that the resolution of a difference of opinion will depend on whether the issue is an “ordinary matter”. If it is, the majority can impose its will on the rest (subsection (3)). If not, unanimity is required (subsection (4)). This reflects the existing law under the 1890 Act (section 24(8)).
43. The question of whether an issue is an “ordinary matter” will depend on the facts of the case. What may be an ordinary matter for one partnership may not be for another. And what may be ordinary for a partnership at one time may not be so later. So, in general, the draft Bill, like the 1890 Act, does not give further guidance on this issue. An exception has been made to this general approach in subsection (5) which provides that a difference of opinion over whether a partnership should engage in legal proceedings (litigation or arbitration), whether as claimant/pursuer or defendant/defender, will (by default) be decided by majority. This is already the case in Scotland; in England and Wales there is doubt over the current position. See also clause 6(4) which provides that the nature of the partnership business can (by default) be changed only with unanimous agreement. See the report, paragraphs 10.27, 10.29, 10.30(3) and (5).
44. Note that the effect of a difference of opinion between partners over whether to admit someone to partnership is dealt with separately in clause 27 and variation of the partnership agreement is dealt with in clause 4.

### **Clause 15**

45. It is part of the duty of good faith that partners should keep each other fully informed about partnership matters (clause 9(2)(a)). This clause provides a default rule in line with that duty on the retention of accounting information and the compilation of accounts.
46. The term “partnership records” in subsection (3) is used rather than the term “partnership books” which appears in section 24(9) of the 1890 Act. The new term is more appropriate in the era of electronic records. The clause does not, unlike section 24(9), require the records to be kept in a particular place. Otherwise, this default rule, read with clause 9(2)(a), is intended to reproduce, with clarifications, the law currently governed by section 24(9) and section 28 of the 1890 Act. See the report, paragraphs 11.33 - 11.34.

### ***Power of partners to bind partnership***

#### **Clause 16**

47. A partnership may confer express authority on a partner to do certain things on its behalf. A partner who acts within the terms of such authority will bind the partnership by his acts. But what is the position if the partnership does not expressly confer authority on a partner? This clause gives the answer by providing that the ordinary authority of a partner to bind the firm extends to anything done for carrying on in the usual way business of the kind carried on by the partners.
48. Moreover, any limitation of that authority will not affect a person dealing with a partner unless he has notice of the partner’s lack of authority or does not think he is a partner. This is the effect of subsection (2) and reflects the existing law (see the 1890 Act, section 5). For reasons which we discuss in the report we have not reproduced other provisions of the 1890 Act relating to the agency of a partner. See the report, paragraphs 6.10 - 6.22.

### ***Partnership property***

#### **Clause 17**

49. The introduction of separate legal personality into English law enables a partnership to own property in its own right. As a result, the definition of partnership property in this clause is shorter and simpler than that in section 20(1) of the 1890 Act. The definitions are different in England/Wales and Scotland because of differences in property and trust law; there is no difference in policy. See the report, paragraphs 9.81 - 9.83. Subsection (2) ensures that a partnership can be a joint tenant in English law. See the report, paragraphs 9.50 and 9.51(6).

tenancy by a partnership as it applies in relation to the acquisition, holding and devolution of such property by a body corporate.

## 18 Rules for identifying partnership property

- (1) If property is acquired out of partnership property, it is to be regarded (unless the contrary is shown) as having been acquired on behalf of the partnership. 5
- (2) Property which is held in the name of one or more of the partners but which has been –
  - (a) acquired on behalf of the partnership, or
  - (b) contributed to the partnership as capital,is to be regarded as held by the partner or partners in trust for the partnership. 10
- (3) This section is subject to section 19.

## 19 Land acquired out of partnership profits

- (1) This section applies in relation to land (“the original land”) which –
  - (a) is co-owned by persons who are partners as to profits made by its use, but
  - (b) is not partnership property.15
- (2) If, out of those profits, the partners acquire land which is to be used in the same way as the original land, the acquired land –
  - (a) is to be regarded as co-owned by the partners in the same manner as the original land was co-owned by them at the date of the acquisition, but
  - (b) is not to be regarded as partnership property.20
- (3) Subsection (2) is subject to any agreement to the contrary.
- (4) Land is “co-owned” by the partners if it is owned by them –
  - (a) as joint tenants or tenants in common, or
  - (b) in Scotland, as joint property or common property.25

### *Execution of documents*

## 20 Execution of deeds (England and Wales)

- (1) A document is validly executed by a partnership as a deed for the purposes of section 1(2)(b) of the Law of Property (Miscellaneous Provisions) Act 1989 (c. 34) only if it is –
  - (a) executed in accordance with subsection (2), and
  - (b) delivered as a deed.30
- (2) A document is executed in accordance with this subsection if it is –
  - (a) signed by at least two partners, each of whom has authority to execute the document as a deed on behalf of the partnership, and
  - (b) expressed (in whatever form of words) to be executed by the partnership.35
- (3) A document is to be presumed to be delivered for the purposes of subsection (1)(b) upon its being executed in accordance with subsection (2), unless a contrary intention is shown. 40

# EXPLANATORY NOTES

## **Clause 18**

50. In a particular case, there may be doubt over whether an asset is the private property of a partner (or group of partners) or of the partnership. Subsection (1) provides a rebuttable factual presumption about property bought with partnership money or acquired by barter with partnership property which will remove some such doubts. See the report, paragraphs 9.25 - 9.49, 9.51 (1), 9.73 and 9.80(2).
51. The purpose of subsection (2) is to clarify the legal analysis which applies to property held on behalf of the partnership (either as a result of the operation of the presumption in subsection (1) or otherwise). The effect of the subsection is that it is held on trust for the partnership. See the report, paragraphs 9.25, 9.51(2), 9.77 and 9.80(1).
52. The rules in this clause are designed to produce the same outcomes as in the existing law of partnerships.

## **Clause 19**

53. This clause provides a different presumption from that in subsection (1) of the previous clause in a very narrow range of circumstances. It is likely to apply principally in agricultural partnerships. It reflects the existing law in section 20(3) of the 1890 Act. See the report, paragraphs 9.79 and 9.80(3).

## ***Execution of documents***

### **Clause 20**

54. This clause applies only to England and Wales and provides rules to govern the way in which the partnership may execute a deed on its own behalf. Under the current law there are a number of legal and practical problems associated with the execution of partnership deeds. For example, all partners have to sign a deed, or be present when it is signed, for it to be binding on the whole partnership. The introduction of separate legal personality enables these to be removed. Under this clause, a partnership deed generally requires the signature of at least two partners (not agents of the partners or other agents of the partnership). See the report, paragraphs 9.94 - 9.96 and 9.98(1) - (5).
55. Clause 20 contains several exceptions to the basic rule that at least two partners must sign a deed for it to be executed on behalf of the partnership. If a partnership is being wound up and there is only one partner then that partner will be able to execute a deed (subsection (4)). In addition, where a limited partnership has only one general partner that partner will also be able to validly execute a deed (subsection (5)). Where there are no partners left during the winding up (for example, there were only 2 partners and both have died) a liquidator could be appointed and could execute a deed (Schedule 4, paragraph 24).
56. Subsection (3) contains a rebuttable presumption of delivery once a deed has been executed. An equivalent provision for companies is contained in section 36A(5) of the Companies Act 1985.

- (4) If—
- (a) a partnership is being wound up under section 43 (winding up by partners), and
  - (b) there is only one partner remaining in the partnership,
- subsection (2)(a) is to be taken to be satisfied if the document is signed by the partner (whether or not he has authority to execute the document). 5
- (5) If a limited partnership has only one general partner, subsection (2)(a) is to be taken to be satisfied if—
- (a) the document is signed by the general partner, and
  - (b) he has authority to execute the document as a deed on behalf of the partnership. 10
- (6) In the case of a partner which is not an individual, a document is signed by a partner for the purposes of this section if it is signed by an individual who has authority to sign on behalf of the partner.
- (7) In favour of a purchaser, a document which has been signed by two or more persons, each of whom purports to sign—
- (a) as a partner, or
  - (b) as an individual who has authority to sign on behalf of a partner which is not an individual,
- is to be taken to have been signed in accordance with subsection (2)(a). 15 20
- (8) “Purchaser” means a purchaser in good faith for valuable consideration and includes a lessee, mortgagee or other person who for valuable consideration acquires an interest in property.

## 21 Reduction of certain documents signed by partnerships (Scotland)

A document which is signed by a partnership in accordance with paragraph 2(1) (subscription of documents by partnerships) of Schedule 2 to the Requirements of Writing (Scotland) Act 1995 (c. 7) by virtue of having been signed on the partnership’s behalf by a partner is reducible if the partner had no authority or apparent authority to sign the document on the partnership’s behalf. 25 30

### *Vicarious liability of partnership for wrongs*

## 22 Vicarious liability of partnership for loss or injury caused by partner

A partnership is liable for loss or injury to another person caused by a partner’s wrongful act or omission if the act or omission—

- (a) occurs in the ordinary course of the partnership business, or
- (b) is authorised by the partnership. 35

### *Secondary liability of partners*

## 23 Unlimited liability of partners

- (1) Each partner who has unlimited liability is personally liable for the whole amount of any partnership obligation incurred while he is a partner. 40

## EXPLANATORY NOTES

57. Subsection (6) provides for signing where bodies corporate or partnerships are partners.
58. The authority of a partner to execute a deed does not fall within the ordinary authority conferred by clause 16(1). A partner must specifically have authority to execute a deed in order for that partner to enter into a deed that binds the partnership (clause 20(2)).
59. However, an exception to this rule has been made for the purchaser in good faith and for valuable consideration. The third party purchaser will have no way of knowing whether a partner has the authority required to execute a deed. Under subsections (7) and (8) such a purchaser will still be able to rely on the deed, even if the partners did not have the requisite authority to execute a deed. An equivalent provision for companies is contained in section 36A(6) of the Companies Act 1985.

### **Clause 21**

60. In Scots law the rules for formal validity of documents are in the Requirements of Writing (Scotland) Act 1995. This clause clarifies the relationship between the 1995 Act and the rules as to the agency of a partner so that formal validity is not affected by a partner's lack of authority to sign the document, but the partnership or interested party will be able to seek the reduction of such a document if the partner had no authority to sign it on behalf of the partnership. See the report, paragraphs 9.97 and 9.98(7).

### ***Vicarious liability of partnership for wrongs***

#### **Clause 22**

61. This clause sets out when a partnership is liable for the wrongful acts or omissions of its partners.
62. The partnership will be liable for resulting loss or injury caused to another if a partner's wrongful act or omission occurred in the ordinary course of the partnership business or was authorised by the partnership. A partnership may be vicariously liable under this clause to a partner, which is not the case under the equivalent provision of the 1890 Act (section 10). The expression "wrongful act or omission" is intended to have the same broad meaning as the House of Lords gave to the same phrase in section 10 in *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48, [2003] 1 All ER 97, [2002] 3 WLR 1913 and [2003] 1 Lloyd's Rep 65. See the report, paragraphs 6.28 - 6.46.

### ***Secondary liability of partners***

#### **Clause 23**

63. Clause 3(1) introduced the concept of unlimited personal liability of partners for partnership obligations. This clause explains what that means.
64. Subsection (1) establishes which partners have unlimited personal liability for a partnership obligation: they are those who were partners when the partnership obligation was "incurred". Subsection (7) states when a partnership obligation is incurred in the case of a breach of duty in tort (delict), a breach of trust or a breach of fiduciary duty. Note that a partnership obligation which results from a breach of duty in *contract* will be taken to have arisen at the moment the contract was entered into; subsection (7) does not mention this because it is the effect of the general law. See the report, paragraphs 6.54 - 6.59(2), 6.73 - 6.80 and 6.88(2).

- (2) But a partner (“A”) is not personally liable under subsection (1) for a partnership obligation owed to a partner or former partner (“B”) if –  
(a) the partnership agreement (including any default rules), or  
(b) another agreement to which A and B are parties,  
makes provision about whether or not B is entitled to indemnity or contribution from A in respect of the obligation. 5
- (3) Subsection (1) does not affect the liability of the partnership for the partnership obligation.
- (4) If a partner pays an amount to discharge the whole or a part of his personal liability for a partnership obligation, the partnership obligation is discharged to the extent of the amount paid. 10
- (5) If a partnership obligation is –  
(a) discharged in whole or in part (whether or not as a result of subsection (4)), or  
(b) otherwise reduced or extinguished, 15  
the personal liability of any partner for that partnership obligation is discharged or reduced or extinguished to the same extent.
- (6) In this Act “partnership obligation” includes –  
(a) any partnership debt, and  
(b) any other liability of the partnership. 20
- (7) For the purposes of this Act, a partnership obligation which results from –  
(a) breach of a duty in tort or delict (including quasi-delict),  
(b) breach of trust, or  
(c) breach of a fiduciary duty,  
is to be treated as having been incurred at the time of the act or omission that gave rise to the breach. 25

## 24 Secondary nature of partner’s liability

A partner may not in any proceedings be held personally liable under section 23(1) for a partnership obligation unless –

- (a) there has been a judgment, decree or arbitral award against the partnership establishing the amount of the partnership obligation in the same or earlier proceedings, 30
- (b) the court has ordered the partnership to make a payment (or interim payment) in respect of the partnership obligation, or
- (c) in Scotland, the partnership obligation is constituted in a document registered for execution in the Books of Council and Session or the sheriff court books. 35

## 25 Partner’s secondary liability: supplementary

- (1) Rules of court may make provision –  
(a) preventing a partner from defending, or 40  
(b) restricting the extent to which, or the way in which, a partner may defend,  
proceedings in respect of his personal liability for a partnership obligation if he has had an opportunity to participate in related proceedings.

## EXPLANATORY NOTES

65. Subsection (2) ensures that these rules do not interfere with the rules which partnerships are free to determine for themselves on the position as between partners and former partners. Default rules on these issues are in clause 12(5) and 12(7) (current partners) and clause 34(4) (former partners). See the report, paragraphs 6.62 and 6.65(2).
66. Subsections (3) - (5) establish the relationship between the partnership obligation (defined by subsection (6)) and the personal liability of the partners (as imposed by subsection (1)). The effect of these subsections is that the liabilities of the partners and the partnership are, so far as the third party is concerned, joint and several. See the report, paragraphs 6.58 and 6.59(2).
67. This clause is intended to replicate the effect of the existing law of partnerships on this issue, in the context of separate legal personality and in the absence of mutual agency, while making clear that the joint and several liability of the partners and partnership as against a third party leaves partners free to determine their liability amongst themselves by agreement.

### Clause 24

68. This clause sets out an important procedural protection enjoyed by partners in relation to their personal liability for partnership obligations. A third party may proceed against a partner (on the basis of a personal liability for a partnership debt) only (i) in the same proceedings as he obtains or after he has obtained a judgment/decree or arbitral award against the partnership (paragraph (a)); (ii) where there is some other court order requiring it to pay (paragraph (b)); (iii) (in Scotland) when the partnership obligation has been constituted in a document registered for execution (paragraph (c)).
69. Note that it is not sufficient for the third party to establish liability only: the judgment/decree, or order, or registered document, must specify the amount payable by the partnership. Note, however, that the third party is not obliged to attempt to extract any payment from the partnership before doing so against the partner.
70. The purpose of the clause is to ensure that a partner is not required by the court to pay a partnership obligation until the amount of the partnership obligation has been established against the partnership. Normally, this will allow all those potentially liable for the claim to put their case. But note that the claimant/pursuer is not required to sue all or indeed any of the partners when establishing his claim against the partnership. This position is similar to that achieved in England and Wales in the absence of separate legal personality under rules of court (Order 81 of the Rules of the Supreme Court). See the report, paragraphs 7.21 - 7.22(2), 7.55 - 7.62 and 7.64(1) and (2).

### Clause 25

71. This clause contains further provisions on a partner's personal liability under clause 23(1).
72. Subsections (1) and (2) give a power to make rules of court limiting a partner's right to defend a claim in respect of his personal liability for a partnership obligation. Such a rule might be introduced, for example, to prevent a partner from raising points which had already been fully aired and decided in the action against the partnership in which he had an opportunity to participate. See the report, paragraphs 7.25 - 7.26.

- (2) “Related proceedings” means earlier proceedings in which there has been a judgment or decree against the partnership establishing the existence or amount of the partnership obligation.
- (3) Schedule 2 makes provision about the periods of limitation and prescription applicable to a partner’s personal liability for partnership obligations. 5
- (4) A judgment, decree or arbitral award against a partnership in respect of a partnership obligation is not enforceable, by way of execution, diligence or otherwise, against the property of a partner.

*Liability of non-partners by holding out*

**26 Non-partners who are liable by “holding out”** 10

- (1) If—
- (a) a person (“A”) who is not a partner in a partnership represents himself, or knowingly allows himself to be represented, as one, and
  - (b) a person (“B”) deals with the partnership in reliance on the representation, 15
- A is personally liable for the whole amount of any partnership obligation incurred to B as a result.
- (2) Subsection (1) also applies if A—
- (a) is a partner at the time the representation is made or communicated to B, but 20
  - (b) is no longer a partner at the time B deals with the partnership in reliance on the representation.
- (3) Subsection (1) applies—
- (a) even if A does not know that the representation has been made or communicated to B in particular, and 25
  - (b) whether the representation is made or communicated in writing, by conduct or otherwise.
- (4) Sections 23(2) to (5), 24 and 25 apply in relation to A’s personal liability under subsection (1) as if it were a personal liability of a partner under section 23(1).
- (5) A is entitled to be indemnified by the partnership in respect of a payment made by him to discharge the whole or a part of his personal liability under subsection (1) for a partnership obligation or in reasonable settlement of an alleged personal liability of his under subsection (1). 30
- (6) The indemnity does not affect any claim which the partnership or a partner may have against A. 35
- (7) This section is subject to section 35 (restrictions on liability of former partners or employees by “holding out”).

*Changes in partners*

**27 Admission of new partners**

- (1) It is a default rule that a person may become a partner in a partnership only with the agreement of all the existing partners. 40

## EXPLANATORY NOTES

73. How long does a third party claimant who has obtained judgment against the partnership have to issue proceedings against an individual partner? The answer is provided by Schedule 2 (which is introduced by subsection (3)). The third party has two years from the date of judgment against the partnership, or until the limitation/prescriptive period against the partnership expires, whichever is longer. This rule has no counterpart in the existing law. See the report, paragraphs 7.65 - 7.72.
74. Subsection (4) abolishes the rule in Scotland which allows diligence against partners on a decree against the partnership by stating as a rule, throughout Great Britain, that a judgment against a partnership is not enforceable against the property of a partner. A creditor who wishes to enforce against the property of a partner must also obtain judgment against him. See the report, paragraphs 7.63 and 7.64(3).

### ***Liability of non-partners by holding out***

#### **Clause 26**

75. This clause deals with the situation where as a result of a representation a non-partner (A) appears to a third party (B) to be a partner and, in reliance on the representation, B deals with the partnership and ends up being owed some money which the partnership does not pay. The clause sets out the circumstances in which A is personally liable to B.
76. Subsection (4) ensures that, if A is personally liable in this way, that liability is treated like a secondary liability of a partner, governed by clause 23. See the report, paragraphs 6.99 and 6.106(1).
77. Subsection (5) gives A an indemnity from the partnership for any amount paid out to satisfy this personal liability. The partners will be secondarily liable for that indemnity under clause 23. A will, in this way, often get his money back. A will not be able to do so only if (1) the partnership and the partners have inadequate funds; or (2) A is liable independently to the partnership or partners (for example in negligence). Subsection (6) ensures that the indemnity in subsection (5) is not taken to rule out the second possibility.
78. It may well be the case that A will have been a partner in the past. The draft Bill provides some rules, in clause 35, referred to in subsection (7), limiting the circumstances in which such a person may become liable under this clause. These rules enable someone who leaves a partnership to take steps to reduce the risk of personal liability arising under this clause. Clause 35 protects former salaried partners as well as former partners.
79. This clause is a statutory application of the law of estoppel/personal bar. It reproduces, with substantial clarifications, the existing law under the 1890 Act (section 14). See the report, paragraphs 6.96 - 6.106(1) - (3).

### ***Changes in partners***

#### **Clause 27**

80. Just as agreement is necessary between all the prospective partners before a partnership forms (clause 1), so agreement is necessary - between all the existing partners and the prospective partner - before a prospective partner can join a partnership. Subsection (1) ensures that this is the case. The rule is a default rule, so if a partnership agreement provides that the agreement of a smaller proportion of partners will suffice, then that will be effective.

- (2) The agreement may be inferred, in particular, from the fact that he starts to carry on the partnership business together with the existing partners with the object of making a profit.

## 28 How persons cease to be partners

- (1) A person ceases to be a partner in a partnership only if – 5
- (a) a term of the partnership agreement under which he ceases to be a partner (whether or not a default rule) has effect in relation to him,
  - (b) he and all the other partners agree that he is to cease to be a partner,
  - (c) he dies or (if not an individual) is dissolved,
  - (d) the partnership is dissolved, or 10
  - (e) an order under section 47(1)(a) or (b) (removal of partner) has effect in relation to him.
- (2) The following provisions contain default rules as to the circumstances in which a person ceases to be a partner –
- (a) section 29 (insolvency), 15
  - (b) section 30 (power to resign), and
  - (c) section 31 (power to expel a partner).
- (3) This section and section 30 are subject to section 40 (restriction on ceasing to be a partner on or after break up of the partnership).

## 29 Ceasing to be partner on ground of insolvency 20

- (1) This section contains default rules.
- (2) A partner who is an individual ceases to be a partner if –
- (a) a bankruptcy order is made against him under Part 9 of the 1986 Act, or
  - (b) an award of sequestration is made under section 5 of the 1985 Act in respect of his estate. 25
- (3) A partner which is a company ceases to be a partner if a winding-up order is made against it under Chapter 6 of Part 4 of the 1986 Act.
- (4) A partner which is a partnership ceases to be a partner if –
- (a) a winding-up order is made against it under a provision of the 1986 Act (as applied by an order under section 420 of that Act), or 30
  - (b) an award of sequestration is made under section 6 of the 1985 Act in respect of its estate.
- (5) “The 1986 Act” means the Insolvency Act 1986 (c. 45).
- (6) “The 1985 Act” means the Bankruptcy (Scotland) Act 1985 (c. 66).

## 30 Power to resign 35

- (1) This section contains default rules which apply to –
- (a) a partnership which is not one of defined duration, or
  - (b) a partnership of defined duration in which one or more persons has at any time ceased to be a partner involuntarily.
- (2) A partner may resign from the partnership at any time by giving each other partner not less than 8 weeks’ notice of his intention to do so. 40

## EXPLANATORY NOTES

81. All agreements in the draft Bill may be inferred from conduct (clause 76(2)). Subsection (2) indicates that an inference as to the existence of the agreement required under subsection (1) is appropriate if the purported partner starts to carry on business with the existing partners for profit; it is not necessary for any of the parties to have turned their mind to the question of partnership specifically. This reflects the existing law. See the report, paragraphs 10.27 and 10.30(5).

### **Clause 28**

82. Subsection (1) provides an exhaustive list of ways in which someone can cease to be a partner. Subsection (2) provides more detail on the first of these by listing the relevant default rules.
83. Under the 1890 Act, if a person ceases to be a partner, the partnership is always “dissolved”. Under the draft Bill, however, one of two things may happen. One possibility is that the partners continue in business as before. So, for example, one partner in a three partner firm might resign under the default rule (in clause 30) and the other two might decide to continue. The other possibility is that the partnership “breaks up” which is the first step in the process of winding up the partnership (see clause 38 and following). This would be the result if, for example, two partners in a three partner firm resigned under the default rule in clause 30.
84. If a partnership breaks up (whether as a result of a partner ceasing to be a partner or otherwise), the rules on ceasing to be a partner change, as specified in clause 40. This is referred to in subsection (3). The reasons for the change in the rules in this situation are set out in the explanatory note to that clause. See the report, paragraphs 8.82 - 8.136.

### **Clause 29**

85. This clause provides a default rule under which a partner who becomes insolvent (as defined in subsections (2), (3) and (4)) ceases to be a partner. Under the 1890 Act (section 33) the rule was that the insolvency of a partner brought the partnership to an end. See the report, paragraphs 8.101 and 8.110(1).

### **Clause 30**

86. This clause provides a default rule entitling partners to resign. Under the current law the default arrangement is the partnership at will. It is dissolved immediately when any partner gives notice. It is created where partners do not define the period during which they are to be in partnership and may also come about on the expiry of a period defined in a partnership agreement. Under the draft Bill, the new default position is that, whilst a partner has a right to resign (under this clause), resignation will leave the remaining partners in a continuing partnership.
87. A partner who leaves a continuing partnership will, by default, be paid by the partnership for his partnership share (see clause 32) and receive an indemnity from the partnership and remaining partners (see clause 34). In those circumstances, there is a danger that a partner might be tempted to leave a partnership which was experiencing difficulties before his colleagues in order to receive a larger payout and more valuable set of indemnities. Two aspects of the draft Bill are designed to prevent this. First, this clause enables partners who receive notice of a partner’s resignation to resign with effect from the same date. Secondly, partners who have not issued notices of resignation may decide to wind the partnership up at any time.
88. Subsection (1) sets out the partnerships to which the default right to resign applies. The right does not, in general, apply in a “partnership of defined duration”. (This phrase is defined in clause 76(1).) The reason is that, in such a partnership, the partners have agreed to be locked in: it would be inappropriate for a default rule to override that agreement. The exception to this is if a partner in such a partnership has died, or ceased to be a partner because of insolvency. In such circumstances, it would not be right to lock partners in unless they specifically contemplated this possibility.

- (3) If—
- (a) there are three or more partners in the partnership, and
  - (b) a partner gives a resignation notice under subsection (2) or the partnership agreement,
- any of the other partners may resign from the partnership at the same time as that notice takes effect by giving each remaining partner not less than two weeks' notice of his intention to do so. 5
- (4) “Partnership of defined duration” has the meaning given by section 76(1).
- (5) “Involuntarily” means because of—
- (a) his death or (if not an individual) dissolution, or 10
  - (b) his insolvency.
- (6) “Remaining partner” means a partner who has not given a resignation notice under subsection (2) or (3) or the partnership agreement.
- (7) This section is to be read with section 38(2) to (4) (events which break up a partnership). 15

### 31 Power to expel partner

- (1) This section contains default rules which apply to a partner if—
- (a) an order is made under section 46 charging his share in the partnership, or
  - (b) the whole or a part of his share in the partnership is subject to an arrestment in execution in respect of a debt which is not a partnership debt. 20
- (2) The other partners are entitled to give him a notice expelling him from the partnership.
- (3) The expulsion notice takes effect at the end of the period of 3 months starting with the day on which it is given. 25
- (4) But the expulsion notice is to be treated as having no effect if, before the end of the 3 month period—
- (a) the order under section 46 is revoked, or
  - (b) the arrestment is recalled or withdrawn or otherwise ceases to have effect. 30

### 32 Realisation of former partner's share (other than on winding up)

- (1) This section contains a default rule which applies if a person ceases to be a partner in a partnership before the break up of the partnership.
- (2) The former partner is entitled to be paid by, or is liable to pay to, the partnership—
- (a) the amount given by subsection (3), and
  - (b) interest on it at the prescribed rate from the date on which he ceases to be a partner. 35
- (3) The amount is that to which he would have been entitled, or for which he would have been liable, if on that date—
- (a) the partnership had broken up,
  - (b) the partnership assets were realised for the greater of— 40

## EXPLANATORY NOTES

89. Subsection (2) confers the right to resign. A partner must give 8 weeks' notice, or more, of his resignation to every other partner. There are no presumptions in the draft Bill about when notice is to be taken to have been given. So a partner must ensure that each other partner actually gets at least 8 weeks' notice. If a partner gives a valid notice then he will cease to be a partner on the expiry of the notice (unless the partnership breaks up on or before that date).
90. Subsection (3) gives a recipient of a resignation notice under subsection (2) the right to resign with effect from the same moment by giving not less than two weeks' notice. Subsection (7) refers to clause 38(2) - (4). Those subsections contain a default rule under which at least half of the partners who have not given notices of resignation may decide to wind up the partnership at any time. If they do so at the same time as, or before, the resignation notices take effect, then all the partners will be treated alike in the winding up (see clause 40). Subsection (3) and clause 38(2)-(4) will thus enable partners to prevent a partner from escaping his responsibility for partnership obligations at their expense by exercising his default right to resign from a continuing partnership. See the report, paragraphs 8.19 - 8.30, 8.82 - 8.100(1) and (2), 8.103 - 8.104, and 8.110(3) and (4).

### Clause 31

91. This clause provides a default power of expulsion. It is very narrow. The only circumstance (in England and Wales) in which a partner may be expelled under this default rule is if the benefit of the financial rights attaching to his status as partner are, by order of the court (under clause 46), transferred to a judgment creditor. The reason for this is that a partner who is financially embarrassed in this way, and is no longer interested financially in the partnership, may no longer have its best interests at heart. Similarly, in Scotland, a partner may be expelled where the whole or a part of his share in the partnership is arrested in execution in respect of a debt which is not a partnership debt. See the report, paragraphs 8.107 - 8.109 and 8.110(6).
92. Under the current law, there is no default power to expel. This clause replaces section 33(2) of the 1890 Act which gave an option to dissolve the partnership where a partner's share had been charged.

### Clause 32

93. Under the draft Bill a partner may leave a continuing partnership. If that happens, what are the former partner's rights and obligations in relation to the partnership and the remaining partners? This clause, and clause 34, provide default rules to answer this question.
94. Subsection (2) converts the outgoing partner's share in the partnership into a debt owed to him by the partnership, or by him to the partnership (according to the financial position of the partnership and the status of his account with the partnership) when he leaves. Subsection (3) specifies how the valuation exercise is to be carried out. It is designed to give the outgoing partner the value of his share in the partnership based on the market value of the partnership if it could be sold as a going concern, or the market value of partnership property. This reflects the terms on which many retiring parties are bought out in current practice. See the report, paragraphs 8.62 - 8.68, 8.74 - 8.75(1) and (2), 8.77 - 8.78 and 8.110(2).

- (i) the market value of the partnership property, and
- (ii) the market value of the partnership business if sold as a going concern without him, and
- (c) the partnership assets were then distributed under the default rules in section 44 (distribution of partnership’s assets on winding up) or any substitute provisions in the partnership agreement. 5

### 33 Liability of former partner for obligations incurred while a partner

- (1) A person who ceases to be a partner does not by doing so cease to be personally liable under section 23(1) for partnership obligations incurred while he was a partner. 10
- (2) Sections 23(2) to (5), 24 and 25 apply to a former partner as they apply to a partner.
- (3) An agreement between a former partner, the partnership and a creditor to discharge the former partner from his personal liability for a partnership obligation does not require valuable consideration. 15
- (4) Subsection (3) extends to England and Wales only.

### 34 Former partners: indemnity and contribution, and return of property

- (1) This section contains default rules.
- (2) A former partner is entitled to be indemnified by the partnership in respect of a payment made by him to discharge the whole or a part of his personal liability for a partnership obligation or in reasonable settlement of an alleged personal liability for a partnership obligation. 20
- (3) The indemnity does not affect any claim which the partnership or a partner may have against the former partner.
- (4) If the partnership does not pay the indemnity (or part of it), the former partner is entitled to –
  - (a) indemnity from any person who was a partner when he ceased to be a partner and who continued to be a partner after he ceased to be a partner, or
  - (b) contribution from any person who was liable with him for the partnership obligation (or, in the case of settlement of an alleged liability, would have been liable if the alleged liability had been established) of such amount as is just and equitable. 30
- (5) Subsection (4) does not apply if the former partner ceased to be a partner on or after the break up of the partnership (in which case the relevant default rules are in section 44 (distribution of partnership’s assets on winding up)). 35
- (6) “Personal liability for a partnership obligation” includes –
  - (a) a personal liability under section 23(1) for a partnership obligation, and
  - (b) a liability under subsection (4) to indemnify (or make a contribution to) a former partner in respect of the partnership obligation to indemnify him under subsection (2). 40
- (7) A former partner must, on request, transfer any partnership property which is held in his name to –
  - (a) the partnership, or

# EXPLANATORY NOTES

## Clause 33

95. Subsections (1) and (2) ensure that a partner does not escape unlimited personal liability for partnership obligations already incurred (arising under clause 23) on leaving the partnership. This reflects the existing law. Of course, a former partner is likely to receive an indemnity from the partnership and remaining partners on departure (and does so under the default rules in clause 34). But this does not affect the position as between the former partner and a third party claimant.
96. Subsection (3) ensures that an agreement between a creditor and the former partner and the partnership that the former partner is no longer to be liable for the debt is enforceable. This clarifies an uncertainty in the existing English law. See the report, paragraphs 6.86 - 6.88(1) and (3).

## Clause 34

97. What rights does a former partner have against the partnership and continuing partners if he has to make a payment from his personal assets for a partnership liability? This clause contains default rules answering this question (just as clause 12 contains default rules containing the answer to the same question in relation to current partners).
98. Subsection (2) enables a former partner who has made such payments to claim reimbursement from the partnership. The indemnity conferred by this provision is identical to that conferred on current partners who make such payments (in clause 12(3)(b)) and covers payments made reasonably and in good faith in settlement of an alleged liability. There is no need to indemnify a former partner for expenses incurred (as is provided for current partners in clause 12(3)(a)) as the former partner is no longer carrying on the business.
99. Subsection (3) makes it clear that, as for current partners, the indemnity does not prevent a partner or the partnership from making a claim against the former partner.
100. Subsection (4) provides for the situation where the partnership does not pay the indemnity to which the former partner is entitled. The former partner is entitled to look to two sets of partners. First (paragraph (a)) he is entitled to look to those who were partners at the moment the former partner left the partnership. They were the people who “bought out” his share under the default rule in clause 32. Secondly, he is entitled to look to the partners who were liable with him for the partnership obligation he paid (paragraph (b)) for a “just and equitable” contribution.
101. Note that the fact that these provisions are default rules does not mean that a partnership can decide not to pay a former partner under this rule by changing it. If the default rule applied when a former partner left the partnership then rights will have accrued under it. Note also that, if the former partner is owed money by the partnership for any reason other than the indemnity in clause (2) (for example if the partnership fails to pay an amount owing under the default rule in clause 32) he will be entitled to apply to court for an order under clause 53.
102. The purpose of subsection (5) is to ensure that, if the partnership is being wound up, the correct default rules governing the rights of the partners (as between each other) apply.
103. Subsection (7) ensures that a partnership can recover its property from former partners. See the report, paragraphs 8.69 - 8.73, 8.75(3), 8.79 - 8.80 and 8.100(3).

- (b) a trustee for the partnership.

### 35 Restrictions on liability of former partners or employees by “holding out”

- (1) This section limits the circumstances in which a person (“A”) who has ceased to be a partner in a partnership may be held personally liable under section 26(1) for a partnership obligation incurred to a person (“B”) who dealt with the partnership in reliance on a representation that A was a partner. 5
- (2) A is not liable if the representation was made or communicated to B—
- (a) while A was still a partner, but
  - (b) more than one year before B dealt with the partnership in reliance on it.
- (3) A is not liable if— 10
- (a) the representation was made or communicated to B while A was still a partner, and
  - (b) before B dealt with the partnership in reliance on the representation, notice that A was ceasing, or had ceased, to be a partner was given to B (or sent to B’s last known address). 15
- (4) A is not liable if the representation consists merely in—
- (a) the partnership business continuing to be carried on in the same partnership name, or
  - (b) the partnership name continuing to include A’s name, after A has ceased to be a partner. 20
- (5) In this section, references to a partner in a partnership include an employee of the partnership.

### 36 Position of assignees etc. of partner’s share

- (1) This section applies if the whole or a part of the share in a partnership of a partner (“A”) is assigned (whether voluntarily or as a result of death, insolvency or otherwise) to another person (“B”). 25
- (2) B may not—
- (a) take part in the management or administration of the partnership business or affairs, or
  - (b) inspect any partnership records. 30
- (3) But that does not affect any of B’s rights to receive amounts in respect of the whole (or part) of—
- (a) A’s share in the partnership profits, or
  - (b) A’s entitlement on ceasing to be a partner or on the winding up of the partnership. 35
- (4) Nothing in this section prevents a person to whom a partner has assigned the whole of his share absolutely from becoming a partner in place of the assignor if—
- (a) all the partners agree to the substitution, or
  - (b) the substitution is made in accordance with the partnership agreement. 40

# EXPLANATORY NOTES

## Clause 35

104. A non-partner may be liable to a third party, as if a partner, if he held himself out as a partner (under clause 26). This clause mitigates the severity of that rule for former partners, and for former salaried partners (who are employees who appear to the outside world as partners).
105. Subsections (2) and (3) limit the operation of clause 26 in cases in which the representation was true when made. Subsection (2) means that a former partner can be absolutely sure that no liability will arise on the basis of such a representation once a year has elapsed since the representation. Subsection (3) enables a former partner to remove all possibility that a liability will become due to particular third parties, by sending them notice of his departure. See clause 41 in relation to notices. Subsection (4) clarifies that the continued use of the partnership name, even if it includes the former partner's name, does not amount to a representation which could give rise to such a liability. Subsection (5) extends the protection in this clause to former salaried partners. It would not be right for them to be in a worse position than former partners.
106. The rules in this clause are different in some respects from those in the 1890 Act (sections 36 and 14). See the report, paragraphs 6.100 - 6.104 and 6.106(4) - (7).

## Clause 36

107. In a limited company, the management of the business is under the control of the board of directors, but profits are owned by the shareholders. In a partnership, there is no such distinction. The partners fill both roles. If a partner purports to assign his rights in the partnership to another person (or if this happens by operation of law, for example on death or insolvency) the question arises: do the rights attaching to both of these roles transfer, or only some of them? This clause provides the answer: the assigning partner cannot transfer his rights to manage the business or to access internal information. That which he transfers is his share (whole or part) in the partnership profits or his entitlement on ceasing to be a partner or on the winding up of the partnership. Subsection (4) clarifies that this does not, however, prevent the assignee becoming a partner in the usual way (eg if the existing partners agree, or in accordance with the relevant term(s) of the partnership agreement).
108. This clause broadly reflects the existing law in the 1890 Act (section 31). See the report, paragraphs 13.13 - 13.17.

**37 Position where partner’s share is arrested in execution (Scotland)**

- (1) This section applies where the whole or a part of a partner’s share in the partnership is subject to an arrestment in execution.
- (2) The arresting creditor is not prevented from raising an action of furthcoming in pursuance of the arrestment, and the court is not prevented from granting decree in any such action, by reason only that, at the time the action is commenced or the decree granted, the share or part arrested is not yet payable to the partner. 5
- (3) But any decree of furthcoming granted in pursuance of the arrestment cannot be enforced in respect of the share or part arrested until it becomes payable to the partner. 10
- (4) The arresting creditor is not, by virtue only of the arrestment or any decree of furthcoming granted in pursuance of it, entitled to take part in the management or administration of the partnership business or affairs.

*Break up of partnerships* 15

**38 Events which break up a partnership**

- (1) A partnership breaks up only if –
  - (a) the number of partners falls below two,
  - (b) a term of the partnership agreement under which the partnership is to end (whether or not a default rule) takes effect (unless all the partners agree, within a reasonable period, to continue the partnership), or 20
  - (c) an order under section 47(1)(c), 49 or 53(2)(d) has effect in relation to the partnership.
- (2) Subsections (3) and (4) contain default rules which apply to –
  - (a) a partnership which is not one of defined duration, or 25
  - (b) a partnership of defined duration in which one or more persons has at any time ceased to be a partner involuntarily.
- (3) If at least half the partners decide that the partnership should end, it ends on the date agreed by the partners who so decided.
- (4) If a partner has given a resignation notice under section 30(2) or (3) or the partnership agreement, he is to be treated as not being a partner for the purpose of subsection (3). 30
- (5) If subsection (1)(b) applies, the partnership breaks up on the date provided for by the partnership agreement.
- (6) An agreement to end (or to continue) a partnership may be inferred, in particular, from the fact that the partners have ceased (or continue) to carry on the partnership business together with the object of making a profit. 35
- (7) “Involuntarily” means because of –
  - (a) his death or (if not an individual) dissolution, or
  - (b) his insolvency. 40

# EXPLANATORY NOTES

## **Clause 37**

109. This clause applies to Scotland only. It clarifies and develops the existing law of arrestment and furthcoming in so far as it applies to the methods by which a creditor who has arrested in execution a partner's share in the partnership can realise that share. It also makes clear that the arrestment and furthcoming does not entitle the creditor to take part in the management of the partnership business. See the report, paragraphs 7.73 - 7.75.

## ***Break up of partnerships***

### **Clause 38**

110. One of the advantages of the introduction of separate legal personality for partnerships is that it enables the partnership to survive various events, such as a change in partners, or an illegality affecting a partner, which under the current law bring the partnership to an end. In some circumstances, of course, it is right that the partnership should come to an end. When is this to be the case under the draft Bill, and how will a partnership come to an "end" in the context of separate legal personality? This clause, and the ensuing clauses, provide answers to those questions, by setting out an exhaustive list of the circumstances in which a partnership breaks up and the effects of break up.
111. Subsection (1) introduces the concept of "break up". Break up is the first stage of the demise of a partnership. In that respect it is the equivalent of "dissolution" under the current law. (Note that "dissolution" is used in a quite different sense in the draft Bill to signify the end, rather than the beginning, of the winding up process (see clause 45)). A partnership can break up only in one of the three sets of circumstances specified in this subsection.
112. Subsection (3) contains a default rule under which at least half the partners may at any time elect to break up the partnership. Thus, if a vote is tied, where all the partners have voted, the partnership will break up. As partnership is a consensual arrangement, it would not be right to require it to continue unless a majority of those involved agree. The exception to this (subsection (2)) is a partnership of defined duration (as defined in clause 76(1)) in which no-one has died or become insolvent. In such a partnership, the partners have committed themselves to staying together.
113. Subsection (4) clarifies the way in which this default rule is to operate if a partner has tendered a resignation notice. We anticipate that in some partnerships the resignation of a certain 'key' partner or partners may cause all the other partners to consider whether the partnership should continue or should be broken up under (3). Under subsection (4) the partner who has given a resignation notice cannot vote under subsection (3). Neither does the partner who has resigned count as one of the total number of partners for the purposes of the vote. This is to allow the remaining partners to consider whether they wish to continue given the fact of the resignation under subsection (4).
114. All agreements referred to in the draft Bill may be inferred from conduct (clause 76(2)). Subsection (6) provides specifically that agreements to end or continue a partnership may be inferred simply from the fact that the business stops or continues; the partners need not consider the question of "break up" itself. This subsection is similar to clause 27(2) in indicating the way in which the provisions of the draft Bill are to be interpreted in cases in which the partners may not be aware of the legal effect of their actions, or indeed that they are in partnership at all. See the report, paragraphs 8.19 - 8.30, 8.89 - 8.99, 8.100(3), 8.101 - 8.106, 8.110(5) and 12.13 - 12.23(1).
115. Another important effect of this clause is that it excludes contractual doctrines such as acceptance of repudiatory breach of contract, frustration and rescission for fraud or misrepresentation. See the report, paragraphs 8.119 - 8.124 and 8.84.

**39 Effects of break up**

- (1) Once a partnership breaks up, the partnership business may be carried on only in so far as permitted under –
  - (a) section 43 (winding up of partnership by partners),
  - (b) Schedule 4 (winding up of partnership by liquidator), or 5
  - (c) Schedule 5 (functions of provisional liquidator).
- (2) But a partnership which has broken up is not dissolved as a legal person until the conditions specified in section 45 are satisfied.
- (3) This section and the other provisions of this Act are subject to –
  - (a) any provision of the Insolvency Act 1986 (c. 45) (as applied by an order under section 420 of that Act (insolvent partnerships)), and 10
  - (b) the Bankruptcy (Scotland) Act 1985 (c. 66).

**40 Restriction on ceasing to be a partner on or after break up**

- (1) If, on the break up of a partnership, a person ceases to be a partner, he is nevertheless to be treated as continuing to be a partner during the winding up of the partnership. 15
- (2) Subsection (1) does not apply if he ceases to be a partner involuntarily.
- (3) After the break up of a partnership (and before its dissolution), a person ceases to be a partner only if he does so involuntarily.
- (4) “Involuntarily” means because of –
  - (a) his death or (if not an individual) dissolution,
  - (b) his insolvency,
  - (c) his expulsion, or
  - (d) his removal under an order under section 47(1)(a) or (b). 20

*Changes in partners and break up of partnerships: supplementary* 25

**41 Publicity for departure of partner or break up of partnership**

- (1) If a person ceases to be a partner in a partnership, he or any partner –
  - (a) is entitled to publish notice of the fact, and
  - (b) may require the partnership or any other partner to give any necessary consents. 30
- (2) If a partnership breaks up, any partner or any person who ceased to be a partner on or after the break up –
  - (a) is entitled to publish notice of the break up, and
  - (b) may require the partnership or any other partner to give any necessary consents. 35
- (3) “Necessary consent” means consent to any act which is necessary or proper for publishing the notice and cannot be done without the agreement of the partnership or partner.

**42 Protection for property acquired after break up**

- (1) In this section “successor” means a partnership – 40

# EXPLANATORY NOTES

## **Clause 39**

116. This clause explains the effect of “break up” and introduces the two ways in which the winding up may be done under the draft Bill: by the partners under clause 43 (which is expected to be the norm, as under the existing law), or by a liquidator under clause 50 and Schedule 4. Subsection (1) also mentions the other possibility following break up which is that the court appoints a “provisional liquidator” (whose duties are set out in Schedule 5) to safeguard the partnership’s assets pending a decision on whether a liquidator should be appointed. Subsection (2) ensures that the partnership will continue to exist as an entity after break up (see clause 45).
117. The provisions in the draft Bill relating to the winding up of a partnership are not designed to deal with the partnership which is insolvent. In such cases, separate insolvency legislation is needed. Hence, subsection (3), which makes the draft Bill subject to the current partnership insolvency and partnership bankruptcy legislation (namely, the Insolvency Act 1986 in England and Wales and the Bankruptcy (Scotland ) Act 1985 in Scotland). See the report, paragraphs 12.13 -12.23.

## **Clause 40**

118. Clause 30 and clause 38(3) - (4) contain default rules under which a partnership may break up on a particular date, either because all or all but one of the partners have tendered resignation notices, or because at some point at least half of those who have not yet tendered resignation notices decide to break it up. If the partnership breaks up in such a way, then all the partners involved will (1) have equal rights to be involved in the winding up, whether that is conducted by themselves or by a liquidator; (2) be personally liable as partners for any partnership obligation incurred during the winding up. The purpose of this clause is to ensure that this is the case. Its effect is that, as a general rule, all those who were partners at the moment immediately before break up continue to be treated as partners until the partnership is dissolved.
119. The exception to this rule is if a partner ceases to be a partner involuntarily, as set out in subsection (4). Such people will no longer be involved in the winding up, or be personally liable for partnership obligations incurred after they ceased to be partners. They will, however, together with all the remaining partners (and people treated as partners by virtue of subsection (1)) be treated alike when gathering in and distributing partnership assets, under the default rule in clause 44. See the report, paragraphs 12.24 - 12.25.

## ***Changes in partners and break up of partnerships: supplementary***

### **Clause 41**

120. Those who leave a continuing partnership may, in limited circumstances, find themselves liable to third parties for partnership obligations incurred after they leave (see clause 26). They can limit their chance of incurring such liability by publicising their departure (see clause 35). This clause ensures that such people are entitled to take steps to protect themselves by publicising their departure. The clause reflects the existing law in the 1890 Act (section 37). See the report, paragraphs 13.18 - 13.20.

### **Clause 42**

121. The legal analysis of property ownership under the existing law in England and Wales (in the absence of separate legal personality) is difficult. Particular problems include (1) the *sui generis* nature of the partners’ property rights, and (2) the correct analysis of what happens to property rights when a partner joins or leaves. The introduction of separate legal personality removes the first problem: the entity itself can own property, or be the beneficiary of a trust. The second problem largely disappears also: the partnership under the draft Bill will usually continue to exist despite changes in membership. However, there may still be occasions on which it does not. This clause is designed to ensure that, in such situations, property transfers subsequently made to third parties in good faith are not invalidated. See the report, paragraphs 9.52 - 9.65.

- (a) formed on or after the break up of a partnership which has not been dissolved (“the former partnership”), and
  - (b) at least one of whose partners is a partner in the former partnership.
- (2) Subsection (3) applies if the successor purports to transfer property to another person (“the acquirer”) who – 5
  - (a) acts in good faith,
  - (b) provides valuable consideration, and
  - (c) has no notice that the property is not partnership property of the person purporting to transfer it.
- (3) The acquirer’s title to the property (and that of any person to whom the property is subsequently transferred) cannot be challenged on the ground that the property was in fact partnership property of the former partnership. 10
- (4) For the purposes of this section, the transfer of property to a person includes –
  - (a) in England and Wales, the grant to him of an interest created out of the property, and 15
  - (b) in Scotland, the creation in his favour of a subordinate real right over the property.

*Winding up and dissolution of partnership*

**43 Winding up by partners**

- (1) If a partnership breaks up, it may be wound up under this section by one or more of the partners. 20
- (2) Subsection (3) applies if, after the break up, there are two or more partners.
- (3) The partnership business may be carried on –
  - (a) if the partners agree that it should be carried on, and
  - (b) so far as is necessary for the beneficial winding up of the partnership. 25
- (4) Otherwise, the authority of a partner to bind the partnership continues so far as is necessary to –
  - (a) wind up the partnership, and
  - (b) complete any transactions begun but unfinished at the time of the break up. 30
- (5) It is a default rule that differences about other matters connected with the winding up of the partnership under this section may be decided by a majority of the partners.
- (6) An agreement under subsection (3) may confer authority on one or more of the partners for the purpose of carrying on the partnership business in accordance with that subsection. 35

**44 Distribution of partnership’s assets on winding up**

- (1) This section contains default rules about –
  - (a) the way in which a partnership’s assets must be dealt with after its break up, and 40
  - (b) the settlement of accounts between the partners before its dissolution.

# EXPLANATORY NOTES

## ***Winding up and dissolution of partnership***

### **Clause 43**

122. Typically, a partnership which has broken up will be wound up by the partners. This clause sets out the partners' rights and obligations in such a situation.
123. For the purpose of winding up there will usually be more than one partner (see clause 40 of the draft Bill, the note on it and the further notes on this clause.) In such a case, subsection (3) clarifies that the partners can agree to carry on the partnership business so far as is necessary for the beneficial winding up of the partnership. Such an agreement can confer authority on one or more of the partners for that purpose. See subsection (6). The partners will continue to have authority as agents of the partnership under the general law and under the draft Bill.
124. In the situation where there is only one remaining partner, he will have power to wind up the partnership entity and to complete any transactions begun but unfinished at the time of break up. See subsection (4). He will not be able to continue the partnership business by entering into new transactions. It would be open to him to continue as a sole trader while winding up the partnership, but, if he wanted to use any partnership assets for his own business, he would require to negotiate with interested parties such as the personal representative of a deceased former partner. Subsection (4) will also apply where there is more than one remaining partner but the remaining partners do not agree to carry on the partnership business under subsection (3).
125. It is possible that the partners might disagree about a decision which needs to be taken during the winding up. How is such a difference of opinion to be decided? Subsection (5) provides a default rule that a simple majority will bind all of the partners. In the absence of such a rule, it might appear that the standard default rules on decision-making in clause 14 would require unanimity. That would be likely to create stalemates. A partner disgruntled by the outcome of a vote under subsection (5) would be entitled to apply to court for the appointment of a liquidator; and he could try to protect existing assets by the immediate appointment of a provisional liquidator (see clauses 50 and 51). But until any order is made, he would be bound, under this default rule, by the majority. This is new: under the existing law, in the event of dispute, an application to court is required. See the report, paragraphs 12.20 - 12.21 and 12.23(2) - (4).
126. It is important to note that the expression "partners" in this clause includes those who are treated as partners by clause 40. See the note to that clause for the reasons for this. There may be other people who are interested in the winding up (i.e. have financial rights from and/or obligations to the partnership), in particular those who have left the partnership involuntarily since the break up. If such people object to a decision made in the winding up, including a decision to continue the business, they have a right to apply for the appointment of a liquidator or provisional liquidator under clauses 50 and 51. They may also apply for other orders under clause 53. See the note to that clause.

### **Clause 44**

127. When a partnership is wound up (whether by the partners or a liquidator), it will be necessary to gather in and distribute the partnership's assets. This clause provides default rules about how this should be done. Partners may agree different rules for the distribution of partnership assets. Creditors are ultimately protected by the unlimited liability of the partners.

- (2) In this section “partner” includes a person who ceased to be a partner on or after the break up.
- (3) The partnership’s assets must be dealt with as follows –
- Step 1*  
Each partner must pay to the partnership any amount which he owes to it. 5
- Step 2*  
The partnership must pay its debts and discharge its liabilities to persons other than partners.  
If the partnership does not have sufficient assets to do this in full, the partners must contribute amounts, in the same proportions as they would be liable to bear any partnership losses, in order to make up the shortfall. 10
- Step 3*  
The partnership must pay to each partner any amount (other than in respect of capital) which it owes to him.  
If the partnership does not have sufficient assets to do this in full, the partners must contribute amounts, in the same proportions as they would be liable to bear any partnership losses, in order to make up the shortfall. 15
- Step 4*  
The partnership must pay to each partner any amount which it owes to him in respect of capital. 20  
If the partnership does not have sufficient assets to do this in full, it must pay the remaining assets to the partners in proportion to their respective capital contributions.
- Step 5*  
The partnership must distribute any surplus among the partners in the same proportions as they would be entitled to share any partnership profits. 25
- (4) A partner is not required to contribute –
- (a) under Step 2 or 3 in respect of a partnership obligation for which he is not secondarily liable,
  - (b) under Step 3 in respect of a partnership obligation to indemnify another partner under section 12(3) if he would not be liable under section 12(5) to make a contribution to that partner in respect of the obligation, or
  - (c) under Step 3 in respect of an amount which is owed to another partner and to which section 12(7) applies, if he would not be liable under that provision to make a contribution to that partner in respect of the amount. 35
- (5) If a partner –
- (a) is not required to contribute an amount under Step 2 or 3 because of subsection (4), or
  - (b) is unable, as a result of his insolvency, to contribute an amount required under Step 2 or 3, 40
- the other partners must contribute that amount according to the proportions in which they are liable (as between themselves only) to contribute under that Step.
- (6) A partner is “secondarily liable” for a partnership obligation if – 45

## EXPLANATORY NOTES

128. Subsection (2) ensures that the default rules in this clause apply to all those who were partners immediately before break up (see clause 40) including those who ceased to be partners involuntarily on or after break up. So, for example, if a partner dies after break up, his estate is not entitled to be involved in the winding up and is not secondarily liable for partnership obligations incurred thereafter; but the estate is bound by the default rules in this clause, and entitled to be paid out under them.
129. Subsection (3) sets out the way in which the partners, or the liquidator, must, by default, deal with the partnership's assets. The rules largely reflect those which apply under the existing law (1890 Act, section 44) with the following difference: if a partner puts capital into a partnership and the partnership loses it, the other partners are not obliged, under this default rule, to contribute to that loss. Under the current law, the default position is that the loss is borne equally.
130. The purpose of subsections (4), (5) and (6) is to ensure that partners are not obliged to contribute amounts to the partnership during the winding up for which they could not be sued by a creditor (subsection (4)(a) and (6)), or in respect of which they could not be pursued by a partner under the relevant default rules (subsections (4)(b) and (4)(c)). For example, suppose a partner joined a partnership and the next day it was wound up under the default rules before new liabilities were incurred and the partnership did not have sufficient funds either to pay the creditors or to repay the partners' loans to the partnership. Such a partner would be relieved of the obligation to dip into his personal assets during the winding up by these subsections.
131. The purpose of subsection (6)(b) is to deal with a case in which the partnership has insufficient funds, at Step 2 of subsection (3), to pay a creditor who could not sue a particular partner (A) directly (because the obligation was incurred before A joined) but who could sue a former partner to whom A had given an indemnity (under the default rule in clause 34(4) or otherwise). The effect of subsection (6)(b) is that A, will, under these default rules, have to contribute to the partnership to make up a shortfall in respect of the partnership obligation. See the report, paragraphs 12.119 - 12.128.

- (a) he is personally liable under section 23(1) for the obligation, or
- (b) he is potentially liable under section 34(4) to indemnify (directly or indirectly) a former partner in respect of the obligation.

#### 45 Dissolution

- (1) A partnership which has broken up is dissolved when six conditions are satisfied. 5
- (2) The first condition is that all partnership property has been distributed to the persons entitled to it.
- (3) The second is that any trust property has been transferred to –
  - (a) the person entitled to it, or 10
  - (b) a trustee for that person.
- (4) The third is that there are no outstanding liabilities (or contingent liabilities) of the partnership.
- (5) The fourth is that there is no risk of the partnership incurring any liabilities in the future as a result of any past acts or omissions. 15
- (6) The fifth is that there are no outstanding claims by or against the partnership.
- (7) The sixth is that, if a liquidator has been appointed under section 50, the liquidator has ceased to hold office without being replaced.
- (8) “Claims” means claims made in legal or arbitral proceedings.

*Court’s powers in relation to partnerships* 20

#### 46 Order charging partner’s share (England and Wales)

- (1) The court may, on the application by summons of a judgment creditor of a partner, make an order charging the partner’s share in the partnership with the amount of the judgment debt and any interest on it.
- (2) The court may, by the same or a subsequent order, give such orders or directions as the case may require and may, in particular –
  - (a) appoint a receiver of the partner’s share in the partnership;
  - (b) give such directions for accounts and inquiries as could have been given if the charge had been made in favour of the judgment creditor by the partner. 30
- (3) If a sale of the partner’s share in the partnership is directed, the other partner or partners may purchase the share.

#### 47 Order removing partner or breaking up partnership

- (1) On the application of a partner in a partnership, the court may make –
  - (a) an order removing another partner from the partnership, 35
  - (b) an order removing the applicant from the partnership, or
  - (c) an order breaking up the partnership.
- (2) The grounds for making an order under subsection (1)(a) are –

# EXPLANATORY NOTES

## **Clause 45**

132. “Dissolution” in the draft Bill is used to refer to the end of the winding up process (in contrast with the current law in which, the term refers to the *start* of the winding up process). It marks the expiry of the life of the legal entity created by clause 1. When does dissolution occur? This clause provides the answer.
133. The effect of this clause is that a partnership will continue in existence until it is no longer needed for any of the purposes for which it was created. In particular, the effect of subsection (2) is that it will never be a defence to a claim by a partnership that the partnership has been dissolved; and the effect of subsection (5) is that it will never be a defence to a claim against a partnership that the partnership has been dissolved. As a result of these two features, it has not been necessary to provide in the draft Bill either a mechanism for reinstatement of a dissolved partnership, or for transfer of assets and liabilities from a dissolved partnership to the partners. See the report, paragraphs 12.13 - 12.22 and 12.23(1) and (5).

## ***Court’s powers in relation to partnerships***

### **Clause 46**

134. A judgment against a partner for a debt (or liability) that is not a partnership debt cannot give rights against the partnership. But his share in the partnership may be a valuable asset. Under this clause the judgment creditor can obtain a charging order over it. The clause reflects the existing law under the 1890 Act, section 23. It does not apply in Scotland because it would be difficult to introduce such a right in the context of the existing law of diligence. See the report, paragraphs 13.10 - 13.12.
135. If a creditor obtains an order against a partner under this clause (or where, in Scotland, the whole or part of a partner’s share in the partnership is subject to an arrestment in execution in respect of a debt which is not a partnership debt) this provides by default, grounds on which he may be expelled (clause 31).

### **Clause 47**

136. Partners may disagree amongst themselves. If they do, the partnership agreement, the draft Bill and the general law should make clear how the dispute should be resolved. So, for example, in a partnership governed by the default rules in clause 14, a dispute about whether a particular business deal should be concluded should be decided by a simple majority. However, there may be allegations that a partner is in breach of a term of the partnership agreement, or the duty of good faith, or is acting illegally or contrary to the best interests of the partnership. If the partners are not be able to agree a way forward amongst themselves in such circumstances, what course of action is available to them? This clause provides that they may apply to court for relief.
137. Under the existing law there has until recently been some doubt about the application of contractual doctrines such as repudiatory breach or frustration in such cases. The recent decision of the House of Lords in *Hurst v Bryk* [2002] 1 AC 185 has given guidance on this question. The approach of the draft Bill is consistent with the approach of Lord Millett in that case as adapted for a law of partnerships with separate legal personality. Under the draft Bill, acceptance of a repudiatory breach of contract will not cause a partnership to break up (see clause 38).
138. A practical problem with the non-application of contractual doctrines under the current law is that the court is not at present empowered to make orders removing particular partners while allowing the partnership business to continue. It can only order that the partnership be wound up (1890 Act, section 35), although it can by a *Syers v Syers* order require the buyout of a partner in a winding up instead of the realisation of the partnership’s assets. The draft Bill (under this clause and clause 48) changes this. Subsection (1) provides that, on application by a partner, the court may make three kinds of order: an order removing a partner other than an applicant; an order removing the applicant; or an order breaking up the partnership. Only the third kind of order results in the winding up of the partnership. A partner might apply for his own removal in a number of situations - for example, if he had been induced to enter into partnership on the basis of a misrepresentation; or if he profoundly disagrees with the course of action decided upon by the other partners.

- 
- (a) the partner is incapable (whether on physical or mental grounds) of performing his duties under the partnership agreement and the incapacity is likely to be permanent,
- (b) the partner’s conduct is such as to affect adversely the carrying on of the partnership business, 5
- (c) the partner is in serious or persistent breach of a provision of this Act or the partnership agreement,
- (d) the partnership agreement was entered into or modified as a result of fraud, misrepresentation or non-disclosure by the partner,
- (e) an event has occurred making it unlawful for the partner to remain a partner, 10
- (f) there is no reasonable prospect of the partnership business being carried on at a profit unless the partner is removed, or
- (g) it is just and equitable for any other reason to make the order.
- (3) The grounds for making an order under subsection (1)(b) are – 15
- (a) one or more of the grounds in subsection (2)(a) to (d) applies in relation to a partner other than the applicant, or
- (b) it is just and equitable for any other reason to make the order.
- (4) The grounds for making an order under subsection (1)(c) are – 20
- (a) one or more of the grounds in subsection (2)(a) to (e) applies in relation to a partner other than the applicant,
- (b) an event has occurred making it unlawful for the partnership business to be carried on,
- (c) there is no reasonable prospect of the partnership business being carried on at a profit, or 25
- (d) it is just and equitable for any other reason to make the order.
- (5) Schedule 3 contains further provisions about orders under this section.
- 48 Section 47: interim orders**
- (1) This section applies if –
- (a) an application has been made under section 47(1)(a) for the removal of a partner (“P”) from a partnership, and 30
- (b) the application has not yet been determined.
- (2) On an application under this section, the court may make an order prohibiting P from taking part in, or limiting the extent to which P may take part in, the partnership business or affairs until the application under section 47(1)(a) has been determined. 35
- (3) An application under this section may be made by any partner other than P.
- (4) The order may include –
- (a) such conditions as the court thinks fit, and
- (b) such directions as it thinks fit for giving effect to the order. 40
- 49 Order breaking up partnership on application of Secretary of State**
- (1) The Secretary of State may apply to the court if it appears to him that it is expedient in the public interest that a partnership should be broken up.

## EXPLANATORY NOTES

139. Subsections (2), (3) and (4) set out the grounds on which the three types of order may be made. These provisions draw on, modify and supplement those specified in the 1890 Act on which the court may make an order winding up the partnership. Two notable additions are the ground of illegality (which under the existing law automatically dissolves the partnership without the intervention of the court: 1890 Act, section 34) and the ground of fraud or misrepresentation (which under the existing law provides a ground for rescission of the partnership agreement: 1890 Act, section 41). See the report, paragraphs 8.119 - 8.127.
140. Subsection (5) introduces Schedule 3 which gives applicants and the court further powers and guidance on the orders available, and their effect. See the report, paragraphs 8.128 - 8.129 and 8.131(1) - (4).

### **Clause 48**

141. An application to remove a partner (under the previous clause) may be urgent, for example if the partner is allegedly defrauding the partnership. This clause ensures that, in appropriate cases, the court has the power to prohibit the partner from doing specific things, or indeed from doing anything at all in relation to the partnership, pending resolution of the issues raised by the application. This is not possible under the existing law except by interim injunction or interim interdict. See the report, paragraphs 8.130 and 8.131(5).

### **Clause 49**

142. A partnership which becomes illegal will continue in existence, and all its partners will continue as partners, unless and until a court order alters the position. An application for an order, either to break up a partnership or to remove one or more of the partners, may be made by partners under clause 47. This clause additionally enables the Secretary of State to apply for an order to break up an illegal partnership if that is in the public interest. An order under this clause is likely to be accompanied (as permitted by subsection (3)) by an order for the appointment of a provisional liquidator under clause 51 (and of a liquidator under clause 50 in due course). This is new law. See the report, paragraphs 8.140 - 8.146.

- (2) On an application under this section, the court may make an order for the partnership to be broken up if it thinks it just and equitable to do so.
- (3) An application for an order under this section may include an application for an order under section 50 or 51.
- (4) An order under this section – 5
  - (a) must specify the date on which the partnership breaks up,
  - (b) may be combined with an order under section 50 or 51 (whether or not such an order was applied for in accordance with subsection (3)), and
  - (c) may include such directions as the court thinks fit for giving effect to the order. 10
- (5) Subsection (4)(c) authorises, in particular, a direction restricting the rights conferred on a specified partner by section 43 or Schedule 4.

## 50 Order appointing liquidator

- (1) On an application in respect of a partnership which has broken up, the court may make an order appointing a liquidator for the purpose of winding up the partnership and distributing its property. 15
- (2) The application may be made by –
  - (a) a partner,
  - (b) a person interested in the winding up, or
  - (c) a creditor of the partnership. 20
- (3) An order may require the liquidator to give security (or, in Scotland, caution) for the proper performance of his functions.
- (4) Schedule 4 contains further provisions about winding up by a liquidator.
- (5) In this section, sections 51 and 53 and Schedules 4 and 5 “person interested in the winding up” means – 25
  - (a) a person (“A”) who ceased to be a partner on or after the break up,
  - (b) if A has died, his personal representative, or
  - (c) if A ceased to be a partner under the default rules in section 29 (insolvency) or any substitute provisions in the partnership agreement, the insolvency practitioner appointed in relation to him. 30

## 51 Order appointing provisional liquidator

- (1) This section applies if –
  - (a) an application has been made under section 50 for the appointment of a liquidator for a partnership, and
  - (b) the application has not yet been determined. 35
- (2) On an application under this section in respect of the partnership, the court may make an order appointing a provisional liquidator.
- (3) The application may be made by –
  - (a) a partner,
  - (b) a person interested in the winding up, or 40
  - (c) a creditor of the partnership.

## EXPLANATORY NOTES

### Clause 50

143. Under the 1890 Act, the options available to partners, if the winding up of a solvent partnership proves contentious, are unsatisfactory. The draft Bill provides for a new procedure by which a solvent partnership may be wound up by a court-appointed official, a liquidator. The powers and duties of a liquidator are found in Schedule 4. An application for the appointment of a liquidator will be made under this clause.
144. Subsection (1) provides that the application may only be made after the partnership has broken up. Typically, the application will be made if a dispute arises during the winding up. Alternatively, a dispute may be foreseen or have arisen before the partnership breaks up. In that case, the appointment can be made at the same time as an order breaking the partnership up (Schedule 3, para 2).
145. An application for the appointment of a liquidator under this clause may be made by two categories of people other than current partners: first, other people “interested in the winding up” may apply. These are people who stand to receive a payout (or who may be obliged to contribute) in the winding up as if they were partners. Secondly, creditors may apply. The draft Bill does not specify the grounds on which an application may be granted. The courts will be free to appoint a liquidator when it is expedient. As the creditor is, ultimately, protected by the secondary liability of partners, it is not expected that such an application will be granted in favour of a creditor unless he shows that the partners are unable or unwilling to wind the partnership up properly. See the report, paragraphs 12.50 - 12.53(1) and (2).
146. Subsection (3) enables, but does not require, the court to order a liquidator to provide security. See the report, paragraphs 12.58 - 12.59 and 12.60(2) and (3).

### Clause 51

147. An application for the appointment of a liquidator may be urgent. For example, a partner may suspect that some other partners are on the point of making off with a major partnership asset. In such cases, this clause enables the court to appoint a “provisional liquidator” whose function is to safeguard the partnership assets pending resolution of the application to appoint the liquidator. The powers and duties of the provisional liquidator are in Schedule 5. This is new law. See the report, paragraphs 12.54 - 12.56.

- 
- (4) An order may require the provisional liquidator to give security (or, in Scotland, caution) for the proper performance of his functions.
- (5) Schedule 5 contains further provisions concerning the functions of the provisional liquidator.
- 52 Order for repayment of premium on premature break up of partnership** 5
- (1) This section applies if –
- (a) a partner (“P”) in a fixed term partnership has paid a joining premium to another partner, and
  - (b) the partnership breaks up before the end of the term.
- (2) On an application by P, the court may order the whole or a part of the premium to be repaid. 10
- (3) In deciding whether to make an order, the court must have regard to –
- (a) the terms of the partnership agreement, and
  - (b) the actual duration of the partnership.
- (4) The court may not make an order if – 15
- (a) the court is satisfied that the break up is caused wholly or mainly by the misconduct of P, or
  - (b) it has been agreed that no part of the premium should be returned.
- (5) “Joining premium” means a premium in respect of – 20
- (a) becoming a partner when the partnership is formed, or
  - (b) becoming a partner after its formation.
- (6) “Fixed term partnership” means a partnership where the partnership agreement provides that the partnership is to end on the expiry of a specified period.
- 53 Order for benefit of former partner** 25
- (1) The court may make an order under this section if –
- (a) an application is made to it by a former partner, or other person interested in the winding up, who claims that the partnership business or affairs are being conducted, or wound up, in a way that is prejudicial to his interests, and 30
  - (b) it is satisfied that it is just and equitable to make the order.
- (2) The order may make such provision as the court thinks fit for giving relief in respect of the claim and may, in particular –
- (a) require accounts to be drawn up to establish the former partner’s rights under the default rules in section 32 (realisation of former partner’s share other than on winding up) or any substitute provisions in the partnership agreement; 35
  - (b) require interim payments to be made to the former partner in respect of such rights;
  - (c) require security to be provided in respect of such rights; 40
  - (d) break up the partnership;
  - (e) if the partnership has already broken up, give directions as to the way in which it is to be wound up.

## EXPLANATORY NOTES

### **Clause 52**

148. Historically, prospective partners have on occasion paid other prospective partners, or (in the case of a partnership which already exists) the existing partners, money when they entered into partnership. Such amounts are known as “premiums”. This clause reproduces the effect of the existing law in the 1890 Act (section 40). See the report, paragraphs 13.21 - 13.22.

### **Clause 53**

149. The default position under the draft Bill is that a former partner’s share in the partnership is converted into a debt (clause 32) and he is indemnified by the partnership and remaining partners against any payments thereafter made in respect of partnership obligations (clause 34). However, it may be that a former partner feels unhappy at his treatment. For example, he may be aggrieved that the continuing partners are delaying in calculating his entitlement or in paying him out, that the sum which he is offered is inadequate or that the partnership may not pay up on his indemnity. In such circumstances, this clause gives him a right to apply to court for relief. The clause also gives this right to a person interested in the winding up (as defined in clause 50(5)). Subsection (3) provides that an application for an order under this section may include an application for an order appointing a partnership liquidator or provisional liquidator. The court may make a wide range of orders to give relief, including those in subsections (2) (4) and (5). See the report, paragraphs 8.40 - 8.48.

- (3) An application for an order under this section may include an application for an order under section 50 or 51.
- (4) An order under this section breaking up a partnership –
  - (a) must specify the date on which the partnership breaks up,
  - (b) may be combined with an order under section 50 or 51 (whether or not such an order was applied for in accordance with subsection (3)), and 5
  - (c) may include such directions as the court thinks fit for giving effect to the order.
- (5) Subsections (2)(e) and (4)(c) authorise, in particular, a direction restricting the rights conferred on a specified partner by section 43 or Schedule 4. 10

### PART 3

#### LIMITED PARTNERSHIPS

##### *Introduction*

#### **54 Limited and general partners**

- (1) A person does not become a limited partner in a limited partnership until registered as such. 15
- (2) A person does not cease to be a limited partner in a limited partnership until he is registered as no longer being a limited partner in the partnership.
- (3) But subsection (2) does not apply if the person ceases to be a partner –
  - (a) on his death or (if not an individual) dissolution, or
  - (b) on the dissolution of the partnership. 20
- (4) A general partner is a person who –
  - (a) is a partner in a limited partnership, but
  - (b) is not a limited partner.

##### *Limited partners and limited liability* 25

#### **55 Restricted role of limited partner**

- (1) A limited partner must not take part in the management of the partnership business or affairs.
- (2) Nothing in subsection (1) prevents a limited partner from doing anything which is a permitted activity under Schedule 6. 30
- (3) The Secretary of State may by order amend Schedule 6 (by adding, modifying or omitting an activity).

#### **56 Limited liability of limited partner**

- (1) Subject to subsection (3) and section 57, a limited partner is not personally liable for any partnership obligation incurred while he is a limited partner. 35

# EXPLANATORY NOTES

## LIMITED PARTNERSHIPS

### ***Introduction***

#### **Clause 54**

150. The effect of subsections (1) and (2) is that whether an individual is a limited partner is determined by whether that person is registered as a limited partner or not. Subsection (3) introduces an exception to this rule, in relation to ceasing to be a limited partner involuntarily. The purpose of clause 54 is to provide maximum certainty to limited partners about when their status as a limited partner begins and ends. However, once persons are registered as limited partners they can be certain that they have limited liability unless they take part in management or withdraw their capital contribution (clauses 55 and 56). See the report, paragraphs 15.42 - 15.43.
151. Whether a person is a *general* partner in a limited partnership will not be determined by the register. This will depend upon whether that person is carrying on business together with another person in partnership (clause 1 and Schedule 1) and, if any, the relevant terms of the partnership agreement (about how general partners join the partnership). See the report, paragraphs 15.44 and 16.3 - 16.4.

### ***Limited partners and limited liability***

#### **Clause 55**

152. Subsection (1) is the equivalent of the prohibition on taking part in management in section 6(1) of the 1907 Act. See the report, paragraphs 16.20 - 16.21. Subsection (2) introduces a list of 'safe' activities (listed in Schedule 6) that limited partners will be able to undertake without taking part in management. It is intended that the limited partner be excluded from day-to-day decisions and activities related to the partnership business and affairs. But a limited partner may take part in certain strategic decisions. Schedule 6 is not an exclusive list. It is there to provide the limited partner with greater certainty about the strategic decisions that a limited partner may want to be involved in. See the report, paragraphs 17.3 - 17.17.

#### **Clause 56**

153. The effect of subsection (1) is that a limited partner has no secondary liability unless he withdraws any part of his capital contribution. See the report, paragraphs 17.22 - 17.23(1) and 17.26 - 17.33. Subsection (2) is equivalent to the prohibition in section 4(3) of the 1907 Act on the limited partner withdrawing any part of their capital contribution. A limited partner is not required by the Bill to make a capital contribution (clause 13), see the report, paragraphs 17.34 - 17.36.

- (2) While a person remains a limited partner, he is not entitled either directly or indirectly to draw out or receive back the whole or part of any relevant capital contribution made by him to the partnership.
- (3) If he does so –
- (a) he is personally liable under section 23(1) (subject to section 23(2)) for any partnership obligation incurred while he is a limited partner, but 5
  - (b) his total personal liability under section 23(1) cannot exceed the amount drawn out or received back.
- (4) “Relevant capital contribution” means a capital contribution consisting of either or both of – 10
- (a) a sum or sums of money, and
  - (b) property which has an agreed capital value.
- 57 Limited partner who has unlimited liability**
- If a limited partner fails to comply with section 55, he is personally liable under section 23(1) (subject to section 23(2)) for – 15
- (a) any partnership obligation incurred as a result of the non-compliance, and
  - (b) any other partnership obligation incurred during the period of non-compliance.
- Other modifications of Part 2 for limited partnerships* 20
- 58 General application of Act to limited partnerships**
- Subject to sections 59 to 61 and any other provision to the contrary, this Act applies in relation to limited partnerships as it applies in relation to general partnerships.
- 59 Rights and duties of the partners etc.** 25
- (1) A limited partner is not subject to the duties in –
- (a) section 9(2)(a) and (c) (keeping partners informed and accounting for profits of a competing business), and
  - (b) section 15 (keeping accounting and partnership records etc.).
- (2) Section 16 (partnership bound by acts of partners carrying on business in usual way) does not apply in relation to a limited partner. 30
- (3) Subsections (4) to (7) contain default rules for a limited partnership.
- (4) Differences about ordinary matters connected with the partnership business or affairs may be decided by –
- (a) the general partner, or 35
  - (b) if there is more than one general partner, a majority of them.
- (5) But differences about other matters connected with the partnership business or affairs must be decided by –
- (a) the general partner, or
  - (b) if there is more than one general partner, all of them. 40

## EXPLANATORY NOTES

### **Clause 57**

154. Clause 57 describes the personal liability that arises where a limited partner takes part in management. See the report, paragraphs 17.21 and 17.23(2).

### ***Other modifications of Part 2 for limited partnerships***

### **Clause 59**

155. Limited partners are subject to the overarching duty of good faith in clause 9(1). However, the content of the duty will be narrower in scope than that applicable to general partners, in order to reflect the limited partner's more restricted role. As with the existing common law duty, the exact content will depend on the context in which it arises. See the report, paragraph 18.11.
156. Under subsection (1)(b), limited partners are not subject to the duties imposed by clause 15. But limited partners may still take advantage of the duty that the general partners are under to keep records and to make them available on request to any partner. Thus, a limited partner may inspect the partnership records upon request under clause 15. This replicates the right of limited partners to inspect the books contained in section 6(1) of the 1907 Act. See the report, paragraphs 18.8 - 18.12.
157. As with the 1907 Act a limited partner will have no inherent authority to carry on the partnership business, see the report, paragraphs 16.22 - 16.23. Under subsection (2) a partnership will be able expressly to grant a limited partner authority to bind the partnership (see subsection (6)). However, it will be up to the limited partner to ensure that by exercising that authority he does not take part in management and thereby lose the limitation on his liability.
158. As to subsections (4) and (5), see the report, paragraphs 16.15 - 16.16 and 16.19(1) and (2).

- (6) The question whether a limited partner should be given authority to act on behalf of the partnership is not an ordinary matter.
- (7) The partnership agreement cannot be varied under subsection (4) or (5) (see section 4).

**60 Changes in partners** 5

- (1) It is a default rule for a limited partnership that a person may become a partner only with the agreement of –
  - (a) the general partner,
  - (b) if there is more than one general partner, all of them, or
  - (c) if there are no general partners, all the limited partners. 10
- (2) A limited partner may not be expelled from the partnership under section 31 (power to expel partner against whom charging order is made or whose share is arrested in execution).
- (3) Nothing in section 36 (position of assignees etc. of partner’s share) prevents a person to whom a partner has assigned the whole of his share absolutely from becoming a partner in place of the assignor if – 15
  - (a) the general partner agrees to the substitution or, if there is more than one general partner, all of them agree to it, or
  - (b) the substitution is made in accordance with the partnership agreement.

**61 Break up and winding up of limited partnership** 20

- (1) It is a default rule for a limited partnership that the references to “the partners” in section 38(3) (default rule about break up of partnership) do not include the limited partners (unless there are no general partners).
- (2) It is a default rule for a limited partnership that the responsibility for winding up the partnership under section 43 is that of the general partner or general partners, unless – 25
  - (a) the court orders otherwise, or
  - (b) there are no general partners.
- (3) Section 50 and Schedule 4 (winding up by liquidator) and section 51 and Schedule 5 (provisional liquidator) apply in relation to a limited partnership with the following modifications. 30
- (4) The references to “the partners” in paragraphs 3(1)(a), 4(b) and 8(2)(a) of Schedule 4 and paragraph 3(1)(a) of Schedule 5 (matters requiring approval of partners) do not include the limited partners unless – 35
  - (a) the partnership agreement provides otherwise, or
  - (b) the partnership has no general partners.
- (5) The references to “each partner” and to “each person interested in the winding up” in paragraphs 10(3) and 11(3) of Schedule 4 (partners entitled to attend meetings) do not include the limited partners or former limited partners (or personal representatives of, or insolvency practitioners for, former limited partners) unless – 40
  - (a) the partnership agreement provides otherwise, or
  - (b) the partnership has no general partners.

## EXPLANATORY NOTES

159. As to subsection (7), see the report, paragraphs 18.3 - 18.4 and 18.7.

### Clause 60

160. The default rule in subsection (1) generally replicates the effect of section 6(5)(d) of the 1907 Act but modernises it by making the rule clearer, and also provides for a situation where a limited partnership has no general partners. See the report, paragraphs 18.5 - 18.6, 16.16 and 16.19(4). Subsection (2) adapts section 6(5)(c) of the 1907 Act to the regime where the option is expulsion rather than dissolution of the partnership. See the report, paragraphs 18.19 - 18.20. The effect of subsection (3) is that a partner who assigns his share in a limited partnership absolutely requires only the permission of the general partners and not the permission of all partners as required under clause 36(4)(a). (This does not affect an absolute assignment made in accordance with the partnership agreement - clause 60(3)(b).) See the report, paragraphs 18.16 - 18.18.

### Clause 61

161. Subsection (1) provides that a limited partnership should break up if the general partner decides, or if there is more than one general partner at least half of them decide, or if there are no general partners at least half of the limited partners so decide. See the report, paragraphs 18.21 - 18.22.
162. Under subsection (2) it is the responsibility of the general partner(s) to wind up the partnership once it has broken up. See the report, paragraphs 16.17, 16.19(6), 18.23 and 18.27(1). If there are no general partners the limited partners may not want to wind up the partnership as to do so may risk involving them in the management of the partnership, exposing them to personal liability. In this case the limited partners should apply to the court under clause 50 for the appointment of a liquidator to wind up the partnership. See the report, paragraph 18.24.
163. Subsections (4) and (5) modify the solvent winding up regime to take account of the more limited role played by limited partners. See the report, paragraphs 18.25 - 18.27(2) and (3).
164. Subsections (4) and (5) have a further effect where a limited partner applies for the appointment of a liquidator. Under clause 50 a limited partner can apply for the appointment of a liquidator. The effect of subsection (5) is that the powers of a limited partner after making such an application are dependent upon whether the limited partnership has general partners or not. If the limited partnership has no general partners it is important that the remaining limited partners have the powers of general partners, for example to authorise use of the Part 2 powers in Schedule 4. So where there are no general partners in the partnership limited partners will be able to do all things that general partners could do in the context of the liquidation. However, this is not necessary where the limited partnership already has general partners, as the general partners will be able to make these decisions once a liquidator is appointed.
165. Apart from the exceptions set out in subsections (4) and (5) limited partners will be treated the same as general partners for the purposes of Schedules 4 and 5. A limited partner will be able to make an application to court under Schedule 4, paragraph 14 for example. This is because a limited partner is a 'partner' under paragraph 14(2)(a) and because nothing in clause 62 excludes the application of paragraph 14 to limited partners. See the report, paragraph 18.24.

*Registered office and names***62 Registered office**

A limited partnership must –

- (a) at all times have a registered office in England or Wales, or
- (b) at all times have a registered office in Scotland,  
to which communications may be addressed.

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**63 Name of limited partnership**

- (1) The name of a limited partnership must end with –
  - (a) “limited partnership”, or
  - (b) the abbreviation “lp” or “LP”.

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- (2) But if the registered office of the limited partnership is in Wales, its name must end with –
  - (a) “limited partnership” or “partneriaeth cyfyngedig”, or
  - (b) the abbreviation “lp”, “LP”, “pc” or “PC”.

- (3) A partnership must not be registered by a name –
  - (a) which is the same as a name appearing in the index kept under section 714(1) of the Companies Act 1985 (c. 6),
  - (b) the use of which as the name of the partnership would in the opinion of the Secretary of State constitute an offence, or
  - (c) which in the opinion of the Secretary of State is offensive.

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- (4) Subsection (3)(a) does not apply if the person whose name appears in the index consents in writing to the registration of the partnership by the same name.

- (5) In determining for the purposes of this section whether one name is the same as another there are to be disregarded –

- (a) the definite article as the first word of the name,
- (b) any of the following (or abbreviations of them) at the end of the name –
  - “limited partnership” or “partneriaeth cyfyngedig”,
  - “limited liability partnership” or “partneriaeth atebolrwydd cyfyngedig”,
  - “company” or “cwmni”,
  - “and company” or “a’r cwmni”,
  - “company limited” or “cwmni cyfyngedig”,
  - “and company limited” or “a’r cwmni cyfyngedig”,
  - “limited” or “cyfyngedig”,
  - “unlimited” or “anghyfyngedig”,
  - “public limited company” or “cwmni cyfyngedig cyhoeddus”,
  - “investment company with variable capital” or “cwmni buddsoddi a chyfalaf newidiol”, and
  - “open-ended investment company” or “cwmni buddsoddiant penagored”, and

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30

35

40

- (c) type and case of letters, accents, spaces between letters and punctuation marks,

and “and” and “&” are to be taken as the same.

# EXPLANATORY NOTES

## ***Registered office and names***

### **Clause 62**

166. This is a departure from the existing requirement (1907 Act, section 8) of a principal place of business in the UK at the time of registration. This clause provides that it is sufficient that a limited partnership should have a registered office in England or Wales or in Scotland. See the report, paragraphs 15.30 - 15.34 and 15.38(1).

### **Clause 63**

167. Subsections (1) and (2) introduce a mandatory LP (or PC in Welsh) suffix for all limited partnerships. See the report, paragraphs 15.67-15.71. Subsections (3) - (5) impose certain restrictions on the names that can be registered. These are similar to restrictions included in the Companies Act 1985 (section 26) and the Limited Liability Partnerships Act 2000 (Schedule, paragraph 3(1), paragraph 8). See the report, paragraphs 15.64 - 15.66.

**64 Improper use of “limited partnership” etc.**

- (1) A person other than one of those referred to in subsection (2) commits an offence if he carries on a business under a name or title which includes as the last words –
  - (a) “limited partnership” or “partneriaeth cyfyngedig”, or 5
  - (b) any contraction or imitation of either of those expressions.
- (2) Those persons are –
  - (a) a limited partnership,
  - (b) a partner in a limited partnership,
  - (c) an overseas limited partnership, and 10
  - (d) a partner in an overseas limited partnership.
- (3) A person guilty of an offence under subsection (1) is liable on summary conviction to a fine not exceeding level 3 on the standard scale.
- (4) “Overseas limited partnership” means a partnership –
  - (a) constituted under the law of a country or territory outside Great 15  
Britain, and
  - (b) in which one or more of the partners has limited liability in respect of partnership obligations as a result of registration of the partnership in that country or territory.

**65 Information to be provided on partnership documents** 20

- (1) The name of a limited partnership, and the address of its registered office, must be stated on any partnership document.
- (2) “Partnership document” means –
  - (a) a business letter,
  - (b) a written order for goods or services to be supplied to the partnership, 25
  - (c) an invoice or receipt issued in the course of the partnership business, or
  - (d) a written demand for payment of a debt arising in the course of the partnership business.
- (3) Any general partner who without reasonable excuse fails to ensure that subsection (1) is complied with is guilty of an offence and liable on summary conviction to a fine not exceeding level 3 on the standard scale. 30

*Registration*

**66 Application for registration**

- (1) For a partnership or proposed partnership to be registered as a limited partnership, an application for its registration must have been delivered to the registrar. 35
- (2) The application must –
  - (a) specify the name under which the limited partnership is to be registered and, if section 63(4) applies, contain the written consent referred to there, 40
  - (b) contain the necessary registration details, and
  - (c) be signed by –

# EXPLANATORY NOTES

## **Clause 64**

168. Clause 64 restricts and protects the use of the LP suffix. See the report, paragraphs 15.76 - 15.78. A similar provision exists in the Companies Act 1985 (section 34) and the Limited Liability Partnerships Act 2000 (Schedule, paragraph 7). The effect of the definition in subsection (4) is that if a business vehicle is registered in its home country as a limited partnership or the equivalent to a limited partnership, it will be an 'oversea limited partnership'. This will allow that partnership to use the LP name and suffix when trading in Great Britain. Recognition of an oversea limited partnership for the purposes of allowing use of the LP suffix and name 'limited partnership' does not constitute recognition of its status as a limited partnership for other purposes such as tax treatment.

## **Clause 65**

169. This clause sets out the information to be provided on partnership documents. There is a distinction between limited partnerships that trade under their registered name and those limited partnerships that trade under a different name. If a limited partnership trades under its registered name clause 65 sets out the information that must be provided on 'partnership documents', and defines this term by specifying the documents which must contain this information.
170. If a limited partnership trades under a name that is different to its registered name, in addition to being subject to the draft Bill, it is also subject to the Business Names Act 1985. This will mean that the limited partnership will have to comply with the requirements of clause 65, as well as with the additional requirements of the Business Names Act 1985 that relate to the provision of information. Thus, clause 65 applies to all limited partnerships, whether they trade under their registered name or not.
171. The definition of 'partnership document' in subsection (2) of clause 65 is the same as that contained in the Business Names Act 1985 (section 4(1)(a)). This is to simplify compliance for those limited partnerships that must comply with both the draft Bill and the Business Names Act 1985. See the report, paragraphs 15.69 - 15.70, 15.71(3), 16.17 and 16.19(5).

## ***Registration***

### **Clause 66**

172. A partnership does not become a limited partnership until it is registered as such. Clause 66 sets out the information that must be provided in an application for registration. This clause is similar to section 8 of the 1907 Act. See the report, paragraphs 15.35 - 15.37 and 15.38(2). Limited partners are not required to sign the application for registration. See the report, paragraphs 16.9 and 16.14(1).
173. Under the Financial Services and Markets Act 2000 (FSMA) and article 51 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 only an authorised person may "establish, operate and wind up" a collective investment scheme. Many limited partnerships whose core business is investment constitute collective investment schemes under the FSMA. In most cases the general partner of the limited partnership is not an authorised person. In those cases the partnership appoints an authorised person to operate the partnership. See the report, paragraph 16.12. To accommodate limited partnerships that are being operated by an authorised person we have, in several provisions, provided for a person (other than the general partner) to be able to do things that the general partner is required to do, as long as that person has authority from the partnership, see for example Schedule 7, paragraphs 1(3), 2(3), 3(4), 4(4), 5(2) and 6(1) and Schedule 8, paragraph 1(4).

- 
- (i) the proposed general partner, or
  - (ii) if there is more than one proposed general partner, all of them.
- (3) The application contains the necessary registration details if it states –
- (a) the name and address of the proposed general partner (or, if there is more than one, of all of them); 5
  - (b) the name of each proposed limited partner and the amount of any relevant capital contribution being made by him to the partnership;
  - (c) whether the registered office of the limited partnership is to be in England or Wales, or in Scotland;
  - (d) what is to be the address of the registered office; 10
  - (e) if the application relates to a partnership (rather than a proposed partnership), the date of its formation.
- 67 Registration and registration certificate**
- (1) On receiving an application for the registration of a partnership or proposed partnership as a limited partnership, the registrar must, if satisfied that sections 62, 63 and 66 are complied with – 15
- (a) register it as a limited partnership, and
  - (b) supply it with a registration certificate signed by him.
- (2) The registration certificate must record –
- (a) the name of the limited partnership (as specified in the application for registration), 20
  - (b) the fact of its registration as a limited partnership, and
  - (c) the date of registration.
- (3) If the partnership to which the application relates has not been formed before registration, the partnership is formed when it is registered. 25
- 68 Registration of changes, deregistration and other matters**
- (1) Schedule 7 makes provision about making changes and corrections to the register.
- (2) Schedule 8 makes provision about the deregistration of limited partnerships.
- (3) Schedule 9 makes provision about the administration of the registration system. 30
- 69 Offences of providing false information**
- (1) A person is guilty of an offence if he provides, or knowingly causes or knowingly allows to be provided, in an application under section 66 or paragraph 1 of Schedule 8 information which – 35
- (a) he knows to be false, or
  - (b) he is aware may be false.
- (2) A person is guilty of an offence if he provides, or knowingly causes or knowingly allows to be provided, in a notice to the registrar under Schedule 7 information which – 40
- (a) he knows to be false, or
  - (b) he is aware may be false.

## EXPLANATORY NOTES

174. We have not, however, allowed the authorised person to sign the application for registration under clause 66(2). This is because in most cases there will be no partnership in existence prior to the application for registration under clause 66. Thus, in most cases, there will be no partnership in existence to authorise a person to act on its behalf for the purposes of the FSMA. In order to ensure that this does not lead to the general partner being liable under the FSMA for “establishing” a collective investment scheme we are recommending a consequential amendment to the FSMA to the effect that the act of registering a limited partnership does not constitute “establishing” a collective investment scheme. See the report, paragraph 16.12 (footnote 14).

### **Clause 67**

175. A partnership will become a limited partnership on the date it is added to the register. See the report, paragraphs 15.16 - 15.17 and 15.21. If a pre-existing general partnership has applied to become a limited partnership, the partnership will be a limited partnership from this date. If no partnership existed prior to the application for registration a new limited partnership will be formed on this date. This is achieved by subsection (3). See the report, paragraphs 16.27 - 16.29.

### **Clause 69**

176. The offence of providing false information will apply to any person making an application under clause 66 or paragraph 1 of Schedule 8 or delivering a notice under Schedule 7. This will encompass both general partners as well as authorised persons under the FSMA (see the notes above on clause 66) who are able to make applications or deliver notices on behalf of the partnership. The clause also covers a situation where an authorised person registers false information thinking it is correct, that information having been given to the authorised person by someone in the partnership who knew it was false. In this case the person providing the false information, knowing it was false, would be guilty of the offence. See the report, paragraphs 16.31 - 16.32.

- (3) A person guilty of an offence under subsection (1) is liable—
- (a) on summary conviction, to imprisonment for a term not exceeding 6 months or a fine not exceeding the statutory maximum, or to both, or
  - (b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or to both.
- (4) A person guilty of an offence under subsection (2) is liable on summary conviction to imprisonment for a term not exceeding 6 months or a fine not exceeding level 5 on the standard scale, or to both.

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### *Supplementary*

## **70 Offences by bodies corporate**

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- (1) If an offence under this Part committed by a body corporate is proved—
- (a) to have been committed with the consent or connivance of an officer of the body corporate, or
  - (b) to be attributable to neglect on the part of an officer of the body corporate.
- the officer as well as the body corporate is guilty of the offence and liable to be proceeded against and punished accordingly.
- (2) If the affairs of a body corporate are managed by its members, subsection (1) applies in relation to the acts and defaults of a member in connection with his functions of management as if he were a director of the body.
- (3) “Officer” includes—
- (a) a director, manager or secretary, and
  - (b) a person purporting to act as a director, manager or secretary.

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## **71 Evidence**

- (1) A certificate of the registration of a partnership is conclusive evidence that—
- (a) the requirements of this Part relating to registration, and to matters precedent and incidental to it, have been complied with,
  - (b) the partnership was registered as a limited partnership on the date stated in the certificate, and
  - (c) its partnership name is as specified in the certificate.
- (2) A certificate of a change in the name of a partnership is conclusive evidence that—
- (a) the partnership was registered as having a new name on the date specified in the certificate, and
  - (b) its partnership name is as specified in the certificate.
- (3) A copy of or extract from an original document sent to the registrar under this Part, if signed by the registrar, is in all legal proceedings admissible in evidence as of equal validity with the original document.

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## **72 Interpretation of Part 3**

- (1) In this Part—
- “address”, in relation to a partner in a partnership, means—

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# EXPLANATORY NOTES

## ***Supplementary***

### **Clause 70**

177. It is anticipated under the draft Bill that bodies corporate may be partners. For example, a company may be a partner in a general partnership, and a company is commonly the general partner in a limited partnership. Where a body corporate commits an offence (for example, a body corporate partner) this clause sets out the element of consent or neglect required for an officer of that body corporate to be prosecuted for the offence along with the body corporate itself. See the report, paragraphs 16.33 - 16.34.

### **Clause 71**

178. This clause sets out the status of the certificate of registration. See the report, paragraphs 15.24 -15.25. Sub-paragraph (3) is similar in effect to section 16(2) of the 1907 Act.

### **Clause 72**

179. This clause deals with interpretation. As it is possible that, in the future, individuals will be allowed to submit documents to the registrar electronically, subsection (2) has been included to allow for this. See the report, paragraph 15.56, footnote 38.

- (a) for an individual, his usual residential address,
  - (b) for a company or a limited partnership under this Part, its registered office, and
  - (c) for a partnership which is not a limited partnership under this Part, its principal place of business; 5
- “the Gazette”, in relation to the deregistration of a limited partnership, means –
- (a) if the partnership is registered in Scotland, the Edinburgh Gazette;
  - (b) otherwise, the London Gazette; 10
- “name”, in relation to a partner in a partnership, means –
- (a) for an individual, his forename and surname (or, in the case of a peer or other person usually known by a title, his title instead of or in addition to either or both of his forename and surname), and 15
  - (b) for a corporation or a partnership having legal personality, its corporate or partnership name;
- “the registrar” means –
- (a) if the registered office is, or is to be, in England or Wales, the registrar or other officer performing under the Companies Act 1985 (c. 6) the duty of registration of companies having registered offices in England or Wales, and 20
  - (b) if the registered office is, or is to be, in Scotland, the registrar or other officer performing under that Act the duty of registration of companies having registered offices in Scotland; 25
- “relevant capital contribution” has the meaning given by section 56(4).
- (2) For the purposes of this Part, the signing of a document by a person includes –
- (a) in the case of a document required to be delivered to the registrar, ensuring that it is authenticated in a manner approved by the registrar, and 30
  - (b) in the case of a document required to be signed by the registrar, authenticated by the registrar’s official seal.

#### PART 4

##### SPECIAL LIMITED PARTNERSHIPS

- 73 Special limited partnerships (England and Wales) 35**
- (1) This Part provides for a kind of limited partnership to be known as a special limited partnership.
  - (2) A special limited partnership is not a legal person.
  - (3) This Act applies in relation to a special limited partnership as it applies in relation to a limited partnership but with modifications and additional provisions set out in Schedule 10. 40

# EXPLANATORY NOTES

## **SPECIAL LIMITED PARTNERSHIPS**

### **Clause 73**

180. This clause provides for a type of limited partnership without legal personality called a special limited partnership. It does not apply to Scotland. The special limited partnership is primarily directed at the venture capital investment industry which invests internationally, although there is no restriction on who can use the vehicle. See the report, paragraphs 19.2 - 19.10.

**PART 5**

SUPPLEMENTARY

*Disclosure of information about partners etc.*

**74 Disclosure of names and addresses of partners**

- (1) A person dealing with a partnership is entitled, on request to the partnership or a partner, to be informed of— 5
- (a) the full name of each partner, and
  - (b) an address for service of each partner.
- (2) A person who has a complaint against a partnership connected with dealings he has had with the partnership is entitled, on request to the partnership, a partner or a former partner, to be given such information as the person requested is reasonably able to provide (or to obtain) as to— 10
- (a) the full name of each person who was a partner at the time of the act or omission to which the complaint relates, and
  - (b) an address for service, or the last known address, of each such person. 15
- (3) Rules of court may make provision enabling a person who is considering—
- (a) making a claim against a partnership, or
  - (b) making a claim against a partner or former partner in respect of a partnership obligation,
- to apply to the court, before bringing proceedings in respect of the claim, for an order for the disclosure of the information mentioned in subsection (1) or (2). 20

**75 Business Names Act 1985**

Schedule 11 contains amendments of the Business Names Act 1985 (c. 7).

*Interpretation*

**76 Interpretation**

- (1) In this Act— 25
- “assignment”, in relation to Scotland, means assignation;
  - “business” has the meaning given by section 1(6);
  - “the court” means—
    - (a) in relation to England and Wales, the High Court or a county court and includes, in relation to the High Court, a judge of that court, and 30
    - (b) in relation to Scotland, the Court of Session or the sheriff;  - “default rule” has the meaning given by section 5(1);
  - “enactment” includes any provision of, or of any instrument made under, an Act of the Scottish Parliament, any provision of, or of any instrument made under, Northern Ireland legislation and any provision of subordinate legislation (within the meaning of the Interpretation Act 1978 (c. 30)); 35
  - “losses” includes losses of a capital nature; 40
  - “partnership” has the meaning given by section 1(2);

# EXPLANATORY NOTES

## SUPPLEMENTARY

### *Disclosure of information about partners etc.*

#### **Clause 74**

181. A third party may deal with a partnership without knowing the identity of its partners or their addresses. Unlike a limited company, a partnership is not required to file such information on a publicly accessible register. If a dispute arises, the third party will need to know such information. The Business Names Act 1985 requires partners to reveal some such information to third parties in various circumstances. There are also in England and Wales rules of court which enable litigants to obtain such information. In Scotland also there are procedures to obtain such information. What is lacking in the current law is a legally enforceable civil obligation owed by the partnership, its partners or former partners to persons who are dealing or have dealt with the partnership, to reveal the names of the partners and addresses at which they may be reached. This clause provides such a right. See the report, paragraphs 7.30 - 7.31.

#### **Clause 75**

182. This clause introduces Schedule 11 which contains amendments to the Business Names Act 1985. See the notes to that Schedule for an explanation of these changes.

### *Interpretation*

#### **Clause 76**

183. Subsection (1) defines various expressions used in the draft Bill.

- “partnership agreement” has the meaning given by section 1(1);
- “partnership of defined duration” means a partnership where the partnership agreement provides that the partnership is to end –
- (a) on the expiry of a specified period, or
  - (b) on the accomplishment of a venture that the partnership was formed to undertake;
- “partnership obligation” has the meaning given by section 23(6);
- “partnership property” has the meaning given by section 17(1);
- “person interested in the winding up” has the meaning given by section 50(5);
- “the prescribed rate” means –
- (a) 3% above the base rate, or
  - (b) such other rate of interest as may be prescribed by an order made by the Secretary of State;
- and “the base rate” means the interest rate set by the Bank of England which is used as the basis for other banks’ rates;
- “principal place of business” means, in the case of a partnership with only one place of business, that place;
- “profits” includes profits of a capital nature;
- “property” includes money and all other property, real or personal, heritable or moveable, including things in action and other intangible or incorporeal property;
- “trust property” means –
- (a) in relation to England and Wales, property which is held in the partnership name but to which the partnership is not beneficially entitled, and
  - (b) in relation to Scotland, property held by the partnership in trust;
- “week” means any consecutive period of seven days.
- (2) In this Act any reference to an agreement (or to the terms of an agreement) includes a reference to an agreement (or to terms) established by conduct.
  - (3) In this Act any reference to the time at which a partnership obligation is incurred is to be read in accordance with section 23(7).

*Final provisions*

**77 Regulations and orders etc.**

- (1) Any power to make regulations, orders or rules conferred by this Act is exercisable by statutory instrument.
- (2) Any such instrument, apart from one made under section 78 or 80(2), is subject to annulment in pursuance of a resolution of either House of Parliament.
- (3) No order may be made under section 78 unless a draft of the statutory instrument containing the order (whether or not together with other provisions) has been laid before, and approved by a resolution of, each House of Parliament.

## EXPLANATORY NOTES

184. There are a number of references in the draft Bill to agreement between partners, or prospective partners. For example, clause 1 requires all the prospective partners to agree before a partnership is formed. The effect of subsection (2) of clause 76 is that such agreements need not be a result of a formal vote, or indeed be something which the parties expressly consider at all. Such agreements may instead be inferred from the parties' actions. See the report, paragraphs 4.18 - 4.20.
185. Subsection (3) highlights the generally applicable definition of when a partnership obligation arises in clause 23(7). For the reasons for that definition, see the note on that clause.

### ***Final provisions***

#### **Clause 77**

186. This clause governs the way in which secondary legislation will be made under the draft Bill and the level of Parliamentary scrutiny it will receive.

## 78 Consequential amendments

- (1) The Secretary of State may by order make such amendments or repeals in any other Acts as he thinks necessary or expedient in consequence of, or in connection with, any provision of this Act.
- (2) An order under this section may make different provision for different purposes. 5

## 79 Transitional provisions

- (1) Subject to the following provisions of this section, this Act does not apply to partnerships (“existing partnerships”) which, immediately before the day appointed under section 80(2), were – 10
  - (a) subject to the Partnership Act 1890 (c. 39), or
  - (b) registered under the Limited Partnerships Act 1907 (c. 24).
- (2) The Secretary of State may by order make such transitional provisions and savings as he considers appropriate in connection with the coming into force of this Act or of any provision of an order under section 78. 15
- (3) The order may, in particular, make provision for –
  - (a) this Act (or prescribed provisions of it) to apply (with or without modifications) to existing partnerships (or those within a prescribed class) after the end of the transitional period;
  - (b) an existing partnership (or one within a prescribed class) to elect at any time during the transitional period to be subject to the provisions (or prescribed provisions) of this Act (with or without modifications); 20
  - (c) an existing partnership (or one within a prescribed class) to be treated as not having come to an end as a result of the fact that during the transitional period a person – 25
    - (i) ceases to carry on business with two or more existing partners, or
    - (ii) is admitted to the partnership;
  - (d) any provisions of the 1890 or 1907 Acts to be treated (with or without modifications) as being, after the end of the transitional period or after an election under paragraph (b), default rules in relation to an existing partnership (or one within a prescribed class); 30
  - (e) any existing partnership which has been registered under the 1907 Act (or one within a prescribed class) to be treated as registered as a limited partnership or a special limited partnership under this Act. 35
- (4) “The transitional period” means the period of two years beginning with the day appointed under section 80(2).
- (5) “Prescribed” means prescribed by the order.

## 80 Short title, commencement and extent

- (1) This Act may be cited as the Partnerships Act 2003. 40
- (2) This Act (except sections 78 and 79 and this section) comes into force on such day as the Secretary of State may by order appoint.
- (3) The following provisions extend only to England and Wales –
  - (a) section 8 (incapacity to commit offences),

## EXPLANATORY NOTES

### **Clause 78**

187. The introduction of separate legal personality will require a number of consequential amendments. See the report, paragraph 3.58. This clause enables such amendments to be made without further primary legislation.

### **Clause 79**

188. The draft Bill will apply to all partnerships formed after it comes into force. But what of partnerships and limited partnerships which already exist at that date? This clause enables the Secretary of State to make an order specifying how they are to be treated (subsection (2)). The reason that these provisions will be made by order at a later date and are not contained in their final form in the draft Bill is that there are a number of details which will depend on the circumstances prevailing when the legislation comes into force. For example, the order will vary according to whether a similar piece of legislation has been passed for Northern Ireland.
189. This clause does, however, set out the main features of the transitional provisions which will be finalised in secondary legislation (subsections (3) and (4)). In summary, the draft Bill will apply to all pre-existing partnerships, at the latest, two years after it comes into force. Before then, a partnership will be entitled to renounce the default rules in the draft Bill, and to adopt instead equivalent provisions of the 1890 Act or 1907 Act. The details of any elections required to bring this about will be specified in the secondary legislation. See report, Part XIV.

### **Clause 80**

190. This clause deals with the short title (ie the name by which the draft Bill will be known once it receives Royal Assent), commencement (ie the time at which the provisions of the Bill come into force, which may be later than the time at which it receives Royal Assent) and extent.

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- (b) section 20 (execution of deeds),
  - (c) section 33(3) (agreement discharging former partner’s personal liability not requiring valuable consideration),
  - (d) section 46 (order charging partner’s share),
  - (e) Part 4 (special limited partnerships), 5
  - (f) paragraphs 1 to 3 of Schedule 2 (partner’s secondary liability: limitation), and
  - (g) paragraph 7 of Schedule 4 (winding up by liquidator: disclaimer).
- (4) The following provisions extend only to Scotland –
- (a) section 21 (validity of documents signed by partnerships), 10
  - (b) section 37 (position where partner’s share is arrested in execution),
  - (c) paragraphs 4 to 10 of Schedule 2 (partner’s secondary liability: prescription), and
  - (d) paragraph 8 and Part 4 of Schedule 4 (winding up by liquidator: termination of leases and liquidator’s powers relating to sequestration of partnership’s estate etc.). 15
- (5) Any order under section 78 or 79 may provide for any provision of it to have the same extent as the legislation it affects.
- (6) Otherwise, this Act extends only to Great Britain.



## SCHEDULES

### SCHEDULE 1

Section 1

#### WHETHER PERSONS ARE CARRYING ON BUSINESS TOGETHER

- |   |   |    |
|---|---|----|
| 1 | A person does not carry on a business with another merely because –   |    |
|   | (a) he receives a payment contingent on or varying with the profits of a business,  | 5  |
|   | (b) he is an agent of a person engaged in a business and has a contract for his remuneration by a share of the profits of the business,   |    |
|   | (c) he receives a debt or other liquidated amount (by instalments or otherwise) out of the accruing profits of a business,  | 10 |
|   | (d) he is the beneficiary of the estate of a person who has died and receives by way of annuity a share of profits made in a business in which the deceased was a partner,  |    |
|   | (e) he lends money to a person engaged in or about to engage in a business and under the contract for the loan is to receive a rate of interest varying with the profits of the business or a share of those profits,           | 15 |
|   | (f) he sells the goodwill of a business and receives (by way of annuity or otherwise) a share of the profits of the business in return for the sale.  |    |
| 2 | A person does not carry on a business with another merely because they share an interest in property (whether or not they share profits made by the use of the property).   | 20 |
| 3 | A person does not carry on a business with another merely because they share gross profits (whether or not they have a joint or common interest in any property from which, or from the use of which, the returns are derived). | 25 |

### SCHEDULE 2

Section 25

#### PARTNER'S SECONDARY LIABILITY: LIMITATION AND PRESCRIPTION

##### *Limitation (England and Wales)*

- |   |  |    |
|---|--|----|
| 1 | The Limitation Act 1980 (c. 58) is amended as follows.   |    |
| 2 | After section 10 insert –  | 30 |
|   | <b>“10A Special time limit for secondary liability of partners</b>   |    |
|   | (1) An action to hold a partner personally liable under section 23(1) of the Partnerships Act 2003 for a partnership obligation shall not be brought after – |    |

# EXPLANATORY NOTES

## **Schedule 1**

191. Schedule 1 retains most of the substance of section 2 of the 1890 Act as guidance for determining the existence of a partnership. See the report, paragraphs 4.48 - 4.53 and clause 1(7) of the draft Bill.

## **Schedule 2**

192. Schedule 2 amends the Limitation Act 1980 and the Prescription and Limitation (Scotland) Act 1973 to establish the limitation/prescriptive period within which a third party will be entitled to sue a partner (or former partner). See the report, paragraphs 7.65 - 7.72 and clause 25(3) of the draft Bill.

- (a) the date of the expiration of the period of limitation (if any) applicable under this Act to an action against the partnership in respect of the partnership obligation, or
- (b) if later, the expiration of two years from the date of judgment against the partnership establishing the amount of the partnership obligation. 5
- (2) Subsection (1)(b) applies –
- (a) whether or not there is an appeal against the judgment, and
- (b) whether or not execution of the judgment is stayed.
- (3) Subsection (1) applies to a former partner as it applies to a partner. 10
- (4) This section does not apply in relation to a special limited partnership.”
- 3 In section 9(2), after “10” insert “or 10A”.

*Prescription (Scotland)*

- 4 The Prescription and Limitation (Scotland) Act 1973 (c. 52) is amended as follows. 15
- 5 After section 8A insert –
- “8B Extinction of obligations arising from secondary liability of partners**
- (1) If any obligation of a partner (including a former partner) arising from personal liability under section 23(1) of the Partnerships Act 2003 has subsisted for the period described in subsection (2) – 20
- (a) without any relevant claim having been made in relation to the obligation; and
- (b) without the subsistence of the obligation having been relevantly acknowledged; 25
- then as from the expiration of that period the obligation shall be extinguished.
- (2) The period referred to in subsection (1) is the continuous period –
- (a) beginning with the date on which decree is awarded against the partnership in respect of the partnership obligation from which the partner’s liability arises, and 30
- (b) expiring on whichever of the following dates is the later –
- (i) the date on which any prescriptive period applicable to that partnership obligation would have expired but for the making of the relevant claim in the proceedings in which the decree was awarded against the partnership, or 35
- (ii) the second anniversary of the date referred to in paragraph (a) above.
- (3) In subsection (2), the references to “decree” include an award in arbitral proceedings. 40
- (4) Subsections (4) and (5) of section 6 of this Act apply for the purposes of this section as they apply for the purposes of that section.”



6	In section 9— (a) in subsection (1), for “and 8A” (in both places) substitute “, 8A and 8B”, (b) in subsection (3), for “or 8A” substitute “, 8A or 8B”.	
7	In section 10, in each of subsections (1), (2)(a) and (3), for “and 8A” substitute “, 8A and 8B”.	5
8	In section 13, for “or 8A” substitute “, 8A or 8B”.	
9	In section 14(1)(b), after “8A” insert “or 8B”.	
10	In section 15(1), in the definition of “prescriptive period”, for “or 8A” substitute “, 8A or 8B”.	10

### SCHEDULE 3

Section 47

#### ORDERS UNDER SECTION 47: SUPPLEMENTARY PROVISIONS

##### *Order to specify date of removal or break up*

1	(1) An order under section 47 must specify the date on which— (a) the person ceases to be a partner, or (b) the partnership breaks up. (2) In the case of an order under section 47(1)(b), the date specified may be— (a) the date on which the applicant became a partner, or (b) any later date.	15
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##### *Combination orders*

2	(1) An application for an order under section 47(1)(c) may include an application for an order under section 50 or 51. (2) An order under section 47(1)(c) may be combined with an order under section 50 or 51 whether or not such an order was applied for in accordance with sub-paragraph (1).	20 25
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##### *Directions*

3	(1) The court may by an order under section 47 give such directions as it thinks fit for giving effect to the order, including, in particular— (a) directions as to the rights of a specified partner to realise his share in the partnership, and (b) in the case of an order under section 47(1)(c), a direction restricting the rights conferred on a specified partner by section 43 or Schedule 4 (winding up). (2) If an order under section 47(1)(b) specifies that the applicant ceases to be a partner from a date before the date of the order, the court may by the order give such directions as it thinks just and equitable for putting the applicant and other persons— (a) in the position they would have been in if the partner had in fact ceased to be a partner on that date, or	30 35
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# EXPLANATORY NOTES

## **Schedule 3**

193. Schedule 3 contains further provisions about orders under clause 47 of the draft Bill (orders removing partner or breaking up partnership). See the report, paragraphs 8.128 - 8.129, 8.131(1) - (4) and 8.133 - 8.136 and clause 47(5).

(b) so near that position as the court considers just and equitable.

*Fraud, misrepresentation or non-disclosure*

- 4 (1) Sub-paragraphs (2) and (3) apply, subject to paragraph 3(1), if the ground on which the court makes an order under section 47 is that of fraud, misrepresentation or non-disclosure by a partner (“the partner at fault”). 5
- (2) Each applicant for the order is entitled to be indemnified by the partner at fault in respect of any loss suffered by the applicant which is attributable to the fraud, misrepresentation or non-disclosure.
- (3) If the order is made under section 47(1)(c), each partner not at fault is entitled on a distribution of partnership assets to be paid any amount which the partnership owes to him before any amount is paid to the partner at fault. 10
- (4) Subject to paragraph 3(1)(a) and sub-paragraphs (2) and (3), a partner who ceases to be a partner under an order made under section 47 retains any rights he would otherwise have had to realise his share in the partnership.

*Meaning of “non-disclosure”* 15

- 5 In section 47 and this Schedule “non-disclosure” means breach of a duty of disclosure –
- (a) under section 9(2)(a) or 10, or
- (b) under the default rule in section 15(2)(b) or any substitute provision in the partnership agreement. 20

SCHEDULE 4

Section 50

WINDING UP BY LIQUIDATOR

PART 1

GENERAL

*Effect of liquidator’s appointment* 25

- 1 (1) On the appointment of a liquidator, all the powers of the partners cease, except so far as the liquidator sanctions their continuance.
- (2) Each partner and each person interested in the winding up must cooperate with the liquidator in relation to the winding up.
- (3) In relation to the winding up by the liquidator, the duty imposed by section 9 (overriding duty of good faith) applies not only to a partner but also to a person interested in the winding up. 30

*General duties of liquidator*

- 2 The liquidator must –
- (a) get in and realise the partnership property, 35

# EXPLANATORY NOTES

## **Schedule 4**

194. This Schedule contains various provisions about the operation of a new scheme for the winding up of solvent partnerships. It is designed to make the winding up of solvent partnerships simpler and more efficient than is the case under the current law, where the partners are not able or willing to wind up the partnership business themselves. See Clause 50 and the report, paragraphs 12.26 - 12.30 and 12.45 - 12.48.

## **Part 1**

195. Paragraph 1 provides for the principal effects of the liquidator's appointment. In particular, the effect of sub-paragraph (1) is to put the liquidator in charge. A liquidator will often be appointed in circumstances in which the partners have fallen out. The intention is that the liquidator will come to his own view on the best way to proceed, and partners will be obliged to co-operate (sub-paragraph (2)). Partners who do not accept the liquidator's decisions will have the power to apply to court under paragraph 13. But the court is likely to need very good reasons before interfering with the view reached by the liquidator. See the report, paragraphs 12.61 - 12.66.
196. Paragraph 2 sets out the liquidator's duty to collect, distribute and transfer the partnership's assets. See the report, paragraphs 12.67 - 12.68.

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(b)	pay the debts and discharge the liabilities of the partnership in accordance with the default rule in Step 2 of section 44(3) (whether or not the partnership agreement provides otherwise),	
(c)	distribute any surplus in accordance with the default rules in Steps 3 to 5 of section 44(3) or any substitute provisions in the partnership agreement, and	5
(d)	secure that all trust property is transferred to –	
	(i) the person entitled to the property, or	
	(ii) a trustee for that person.	
<i>General powers of liquidator</i>		10
3	(1) The liquidator may –	
	(a) with the approval of each of the partners, or	
	(b) with the sanction of the court,	
	exercise any of the powers specified in Part 2 of this Schedule.	
	(2) The liquidator may exercise any of the powers specified in Part 3 of this Schedule.	15
<i>Distribution of partnership property to partners etc. in its existing form</i>		
4	The liquidator may –	
	(a) if so permitted by the partnership agreement,	
	(b) with the approval of each of the partners, or	20
	(c) with the sanction of the court,	
	sell or transfer, according to its estimated value, to a partner or a person interested in the winding up any particular partnership property in its existing form.	
<i>Contracts entered into by liquidator</i>		25
5	(1) A contract entered into by the liquidator in the performance of his functions is to be taken to be entered into by him on behalf of the partnership, unless the contract provides that he should be personally liable on it.	
	(2) If the liquidator assumes personal liability under the contract, he is entitled to an indemnity out of partnership property in respect of that liability.	30
	(3) This paragraph does not –	
	(a) limit any right to indemnity which the liquidator would have apart from it,	
	(b) limit his liability on contracts entered into in breach of this Schedule or an order of the court, or	35
	(c) confer a right to indemnity in respect of any liability under paragraph (b).	
<i>Court’s power to vest property in liquidator</i>		
6	(1) On the application of the liquidator, the court may by order direct that all or any part of the partnership property is to vest in the liquidator by his official name.	40

## EXPLANATORY NOTES

197. Paragraph 3 divides the liquidator's powers into those he may exercise with the approval of the partners (or with the sanction of the court) and other powers which he may exercise without any such approval (or sanction). The former are set out in Part 2 of Schedule 4 and the latter in Part 3 of Schedule 4. The powers in Part 3 are wide. This is to enable the liquidator to fulfil his role of resolving partnership conflicts during a winding up. Partners do continue to have unlimited liability for the debts of the partnership, so they are given some protection in relation to the exercise of powers in Part 2, which the liquidator can normally only exercise with the partners' agreement. Note, however, that if partners unreasonably refuse to approve a particular proposal, the liquidator may ask the court to sanction it, notwithstanding the opposition of some or all the partners. See the report, paragraphs 12.71 - 12.76 and 12.78(1).
198. Paragraph 4 enables the partnership liquidator, in certain circumstances, to distribute the partnership property in its existing form (*in specie*) rather than realising the property and distributing the proceeds. See the report, paragraphs 12.77 and 12.78(2).
199. Paragraph 5 establishes, as a general rule, that a partnership liquidator is not personally liable on a contract which he enters into in performing his functions. Where he does assume personal liability, he is entitled to an indemnity out of partnership property. See the report, paragraphs 12.69 - 12.70.
200. While it should not be necessary, as a general rule, to vest partnership property in the liquidator, there may be circumstances where the partnership liquidator might find it useful to take title to all or part of the partnership property. Paragraph 6 allows him to apply to the court for such an order. See the report, paragraphs 12.62 and 12.66(4).

- (2) If the court makes such an order, the property to which the order relates vests accordingly.
- (3) The liquidator may, after giving such indemnity (if any) as the court may direct, bring or defend in his official name any action or other legal proceeding – 5
- (a) which relates to that property, or
  - (b) which it is necessary to bring or defend for the purpose of effectually winding up the partnership and recovering partnership property.

*Disclaimer (England and Wales only)*

- 7 (1) This paragraph applies to a partnership which is being wound up in England and Wales. 10
- (2) The Secretary of State may by regulations make provision conferring on the liquidator power to disclaim onerous property.
- (3) The regulations may, in particular, make provision – 15
- (a) as to what constitutes onerous property,
  - (b) about the procedure for disclaiming property,
  - (c) as to the effect of the disclaimer (with respect to the partnership and to persons affected by the operation of the disclaimer), and
  - (d) conferring on the court powers in relation to property which is disclaimed. 20

*Termination of leases (Scotland)*

- 8 (1) This paragraph applies to a partnership which is being wound up in Scotland.
- (2) Where either of the conditions specified in sub-paragraph (3) is satisfied in relation to an interest of the partnership as tenant under a lease, the liquidator may – 25
- (a) with the approval of each of the partners, or
  - (b) with the sanction of the court,
- terminate the lease so far as relating to that interest by giving notice in writing to the landlord. 30
- (3) The conditions are –
- (a) that, at any time, the liquidator –
    - (i) is satisfied that a provision in the lease or a rule of law prevents the disposal of the interest by the liquidator, and
    - (ii) so informs the landlord, and 35
  - (b) that the interest is not disposed of within the period of one year from the date of the liquidator's appointment.
- (4) The period of notice terminating the interest is to be –
- (a) in the case of an agricultural lease – 40
    - (i) a period of not less than one year and not more than two years ending with such term of Whitsunday or Martinmas as may be specified in the notice, or
    - (ii) such period as may be agreed between the liquidator and the landlord,

## **EXPLANATORY NOTES**

201. It is appropriate that a partnership liquidator should be able to terminate a long-term contract which otherwise would prevent him completing the winding up of the partnership's affairs. Paragraph 7 applies to England and Wales only and gives power to create subordinate legislation to provide for the disclaimer of onerous property. See the report, paragraphs 12.79, 12.82 and 12.83(1).
202. Paragraph 8 applies to Scotland (which does not have a regime for disclaimer of onerous property) and gives the partnership liquidator power to terminate a lease in such circumstances. A termination would not affect the right of any party to claim compensation or damages from the partnership in respect of the termination. See the report, paragraphs 12.80 - 12.81 and 12.83(2).

- (b) in the case of any other lease, a period of 6 months or such shorter period of notice applying to the termination of the lease by virtue of any other enactment.
- (5) This paragraph –
- (a) has effect despite any provision in the lease, or any rule of law, which would otherwise prevent or restrict termination of the lease by the liquidator, and 5
- (b) does not affect any claim by a person for compensation or damages in respect of the termination under this paragraph of the lease (or any rights under it). 10
- (6) A claim for such compensation or damages is to be treated as a claim against the partnership and not against the liquidator personally.
- (7) “Agricultural lease” means –
- (a) a lease of a holding within the meaning of the Small Landholders (Scotland) Acts 1886 to 1931, 15
- (b) a lease of a croft within the meaning of section 3(1) of the Crofters (Scotland) Act 1993 (c. 44), or
- (c) a lease the tenancy under which is –
- (i) a 1991 tenancy,
- (ii) a short limited duration tenancy, or 20
- (iii) a limited duration tenancy,
- within the meaning of the Agricultural Holdings (Scotland) Act 2003 (asp 11).
- (8) “Lease” includes a sub-lease.
- Effect of partnership’s insolvency* 25
- 9 (1) This paragraph applies if –
- (a) the partnership is unable to pay its debts, and
- (b) there is no reasonable prospect of its becoming able to pay its debts.
- (2) For this purpose, a partnership is to be taken to be unable to pay its debts if –
- (a) it is unable to pay its debts as they fall due, or 30
- (b) the value of its assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.
- (3) The liquidator must –
- (a) apply to the court for a winding-up order to be made against the partnership under a provision of the Insolvency Act 1986 (c. 45) (as applied by an order under section 420 of that Act (insolvent partnerships)), or 35
- (b) petition the court for sequestration of the estate of the partnership under the Bankruptcy (Scotland) Act 1985 (c. 66).
- (4) But sub-paragraph (3) does not apply if the liquidator has reasonable grounds for believing that the court does not have jurisdiction – 40
- (a) to make a winding-up order against the partnership under a provision of the 1986 Act (as applied), or
- (b) in respect of the sequestration of the estate of the partnership under the 1985 Act. 45

## **EXPLANATORY NOTES**

203. In the course of a winding up, the partnership liquidator may discover that the partnership, which was believed to be solvent, is in fact insolvent or likely to become so. Paragraph 9 provides that, if the partnership liquidator is satisfied that there are not sufficient assets to meet the firm's liabilities or that the firm is unable to pay its debts as they fall due, he is under a duty to apply to the court to initiate insolvency proceedings (sub-paragraph 3). The liquidator must give the court full financial details of the partnership, as specified in sub-paragraph (7). Sub-paragraphs (4) and (5) are to cater for cases in England and Wales where the current time limit on the presentation of applications to wind up partnerships might have expired. See the report, paragraphs 12.89 - 12.94.

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- (5) If sub-paragraph (4) applies, the liquidator must apply to the court for directions and such order as it thinks fit.
- (6) An application (or petition) under sub-paragraph (3) or (5) must be made (or presented) by the liquidator not later than one month after the day on which this paragraph starts to apply. 5
- (7) The application (or petition) must contain a statement as to the partnership business and affairs, including –
- (a) particulars of the partnership’s assets, debts and liabilities,
  - (b) a summary of the liquidator’s receipts and payments,
  - (c) the names and addresses of the partnership’s creditors, 10
  - (d) the securities held by them respectively, and
  - (e) the dates when the securities were respectively given.
- (8) If the liquidator fails without reasonable excuse to comply with this paragraph –
- (a) he is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale, and 15
  - (b) he is liable for any resulting loss suffered by a partner, a person interested in the winding up, or a creditor of the partnership.

*Annual accounts*

- 10 (1) If the winding up by the liquidator will continue for more than one year, he must prepare a full and true account of – 20
- (a) his acts and dealings, and
  - (b) the conduct of the winding up, during the year.
- (2) He must summon a partnership meeting for the purpose of – 25
- (a) laying the account before the meeting, and
  - (b) giving an explanation of it.
- (3) The persons entitled to attend the meeting are –
- (a) each partner, and
  - (b) each person interested in the winding up. 30
- (4) The meeting must be held –
- (a) at the end of the first year from the date of his appointment, and of each succeeding year, or
  - (b) at the first convenient date within 3 months from the end of the year.
- (5) If the liquidator fails to comply with this paragraph, he is guilty of an offence and liable on summary conviction to a fine not exceeding level 3 on the standard scale. 35

*Final accounts*

- 11 (1) When the liquidator has, to the best of his knowledge and belief, complied with paragraph 2, he must prepare a full and true account of the conduct of the winding up showing, in particular – 40
- (a) a summary of his receipts and payments, and
  - (b) how the partnership property and trust property has been disposed of.

## **EXPLANATORY NOTES**

204. Where the winding up continues for more than a year, paragraph 10 provides that the partnership liquidator is under a duty to hold a meeting of the partners and others interested in the winding up at which he must give an accurate account of his acts and dealings and the conduct of the winding up. See the report, paragraphs 12.84 and 12.86(1), (2) and (4).
205. Where the partnership liquidator has fully wound up the partnership's business, paragraph 11 provides that he must produce a final account and summon a meeting of the partners and others interested in the winding up to consider it. Those attending the meeting may vote against his release (under paragraph 16). Sub-paragraph (6) provides a default rule that a resolution against a partnership liquidator's release may be decided by a majority of those attending the meeting. See the report, paragraphs 12.84 and 12.86(3) and (4).

- 
- (2) He must then summon a partnership meeting for the purpose of –  
    (a) laying the account before the meeting, and  
    (b) giving an explanation of it.
- (3) The persons entitled to attend the meeting are –  
    (a) each partner, and 5  
    (b) each person interested in the winding up.
- (4) The liquidator must allow the person or persons attending the meeting an opportunity to vote against his release under paragraph 16.
- (5) But sub-paragraph (4) does not apply if –  
    (a) the partnership agreement provides for a quorum for the meeting, 10  
        and  
    (b) the quorum is not present.
- (6) It is a default rule that a resolution against the liquidator’s release may be decided upon by a majority of the persons attending the meeting.
- (7) The liquidator ceases to hold office at the time the meeting finishes (or, if no one attends the meeting, was due to finish). 15
- (8) If the liquidator fails to comply with this paragraph, he is guilty of an offence and liable on summary conviction to a fine not exceeding level 3 on the standard scale.

*Power of court to order an account* 20

- 12 If during the course of the winding up of the partnership by the liquidator –  
    (a) a partner, or  
    (b) a person interested in the winding up,  
is not satisfied with the way in which the winding up is being conducted, he may apply to the court to order an account to be taken of the partnership business and affairs. 25

*Reference of questions to court*

- 13 (1) An application may be made to the court to determine any question arising in the winding up of the partnership.
- (2) The application may be made by – 30  
    (a) the liquidator,  
    (b) a partner,  
    (c) a person interested in the winding up,  
    (d) a creditor of the partnership, or  
    (e) if not a creditor of the partnership, a person who ceased to be a partner before the break up of the partnership. 35
- (3) If the court is satisfied that the determination of the question will be just and beneficial, it may –  
    (a) accede wholly or partially to the application on such terms and conditions as it thinks fit, or 40  
    (b) make such other order as it thinks fit.

## **EXPLANATORY NOTES**

206. Paragraph 12 gives a right to partners or others interested in the winding up, where they are dissatisfied with the conduct of the winding up, to apply to the court to order an account to be taken of the partnership's affairs. See the report, paragraphs 12.85 and 12.86(5).
207. During the winding up questions may arise which need to be determined by the court. Paragraph 13 gives interested parties a right to apply to the court to determine such questions. The court has power to make appropriate orders. A liquidator might apply to court under this provision, for example, if he was unsure of the effect of the rules in the partnership agreement governing the distribution of surplus assets to the partners. Similarly, a partner who believed that the liquidator was misunderstanding such a rule might apply to the court to have the issue resolved. On the other hand, as noted in relation to paragraph 1 of the notes to this Schedule, it is unlikely that a partner would persuade a court to interfere with an exercise of the liquidator's discretion. See the report, paragraphs 12.87 and 12.88.

*Resignation of liquidator*

- 14 (1) The liquidator may at any time resign as liquidator by giving notice of his intention to do so.
- (2) The notice must include a full and true account of the conduct of the winding up showing, in particular – 5
- (a) a summary of his receipts and payments, and
  - (b) how any partnership property or trust property has been disposed of.
- (3) The notice must be given to – 10
- (a) the court,
  - (b) each partner,
  - (c) each person interested in the winding up, and
  - (d) if the liquidator was appointed on the application of a creditor of the partnership, the creditor.
- (4) The resignation notice takes effect – 15
- (a) at the end of the period of 8 weeks starting with the day on which it is given, or
  - (b) if earlier, at the time from which the liquidator's release has effect under paragraph 16(2).

*Appointment or removal of liquidator by court* 20

- 15 (1) If for any reason there is no liquidator acting, the court may appoint a liquidator.
- (2) The court may, on cause shown, remove a liquidator and appoint another.

*Release of liquidator*

- 16 (1) If the liquidator complies with paragraph 11 and either – 25
- (a) no one attends the meeting summoned under paragraph 11(2),
  - (b) the person or persons attending the meeting do not resolve against his release under paragraph 11(4), or
  - (c) no vote against his release takes place by virtue of paragraph 11(5),
- he is released with effect from the time at which he ceases to hold office. 30
- (2) The court may, on application, order that –
- (a) the liquidator, or
  - (b) a person who has ceased to be the liquidator,
- should be released with effect from a time specified in the order.
- (3) The application may be made by – 35
- (a) the person to whom the application relates, or
  - (b) if he has died, his personal representative.
- (4) A liquidator who is released is, with effect from the time specified in subparagraph (1) or (2), discharged from all liability to partners, former partners and the partnership – 40
- (a) in respect of acts or omissions of his in the winding up, and
  - (b) otherwise in relation to his conduct as liquidator.

## EXPLANATORY NOTES

208. Paragraph 14 provides that the liquidator may resign at any time by giving notice. He must include an account of the conduct of the winding up in his notice. See the report, paragraphs 12.97 and 12.99(1).
209. Paragraph 15(1) provides for the situation where a partnership liquidator ceases to act (for example, by resigning under paragraph 14) and it is necessary to appoint a replacement. The court is given the power to appoint a replacement partnership liquidator. Paragraph 15(2) provides that, where a partnership liquidator is guilty of misconduct or there is other sufficient reason to justify his replacement, the court may remove him and appoint a replacement. See the report paragraphs 12.95 and 12.96.
210. Paragraph 16 deals with the release and discharge of a partnership liquidator on completion of the winding up. In the first instance, the partnership liquidator should be able to obtain release and discharge from the partnership by summoning a meeting of the partners to consider his application (see paragraph 11). As the fallback, the partnership liquidator should be entitled to apply to the court to obtain release and discharge.
211. The effect of the discharge is to release the partnership liquidator from liability to the partnership, partners, former partners and the estates of former partners (sub-paragraph (4)). That release will not apply if the liquidator has obtained his release by fraud or deliberate concealment of wrongdoing (as the liquidator would not in those circumstances have complied with paragraph 11 and in particular the requirement to prepare a “full and true account of the conduct of the winding up”). The discharge has no effect in relation to third party claims against the partnership liquidator. See the report, paragraphs 12.97 - 12.98 and 12.99(2) and (3).

- (5) In sub-paragraph (4) “liquidator” includes a person who has ceased to be the liquidator.

*Expenses of winding up*

- 17 All expenses properly incurred in the winding up, including the remuneration of the liquidator or any provisional liquidator appointed under section 51, are payable out of the partnership’s assets in priority to all other claims. 5

*Rules*

- 18 (1) The Secretary of State may make rules for the purpose of giving effect to this Schedule. 10  
(2) The rules may, in particular, make provision as to the remuneration payable to the liquidator.

PART 2

POWERS OF LIQUIDATOR EXERCISABLE WITH APPROVAL OR SANCTION

- 19 Power to make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim (present or future, certain or contingent, ascertained or sounding only in damages) against the partnership, or whereby the partnership may be rendered liable. 15
- 20 Power to compromise, on such terms as may be agreed – 20  
(a) all debts and liabilities capable of resulting in debts, and all claims (present or future, certain or contingent, ascertained or sounding only in damages) subsisting or supposed to subsist between the partnership and a partner, former partner or other debtor or person apprehending liability to the partnership, and 25  
(b) all questions in any way relating to or affecting the assets or the winding up of the partnership,  
and take any security for the discharge of any such debt, liability or claim and give a complete discharge in respect of it.
- 21 Power to carry on the partnership business so far as may be necessary for the beneficial winding up of the partnership. 30

PART 3

POWERS OF LIQUIDATOR EXERCISABLE WITHOUT APPROVAL OR SANCTION

- 22 Power to bring or defend any action or other legal proceeding in the name and on behalf of the partnership. 35
- 23 Power to sell any partnership property by public auction or private contract with power –  
(a) to transfer the whole of it, or  
(b) to sell it in parcels.  
This is subject to paragraph 4 (distribution of property to partners etc. in existing form). 40

## EXPLANATORY NOTES

212. Paragraph 17 gives the partnership liquidator priority in respect of all expenses properly incurred in the winding up, including his remuneration. See the report, paragraphs 12.100 - 12.101.
213. As there may be matters relating to the solvent winding up of partnerships which would be more appropriately dealt with in subordinate legislation than in the draft Bill, paragraph 18 provides for a rule-making power. See the report, paragraphs 12.105 - 12.106.

### ***Part 2***

214. Paragraphs 19 - 21 set out the powers of the partnership liquidator which require approval or sanction. See paragraph 3(1) of Schedule 4 and the report, paragraphs 12.75 - 12.76 and 12.78(1).

### ***Part 3***

215. Paragraphs 22 - 28 set out the powers which the partnership liquidator may exercise without approval or sanction. See paragraph 3(2) of Schedule 4 and the report, paragraphs 12.71 - 12.73 and 12.74(2).

- |    |  |    |
|----|--|----|
| 24 | Power to do all acts and execute, in the name and on behalf of the partnership, all deeds, receipts and other documents.   |    |
| 25 | Power to prove, rank and claim in the bankruptcy, insolvency or sequestration of any partner, former partner or other debtor of the partnership for any balance against his estate, and to receive dividends in the bankruptcy, insolvency or sequestration in respect of that balance, as a separate debt due from the bankrupt or insolvent, and rateably with the other separate creditors. | 5  |
| 26 | Power to borrow any money required on the security of the partnership's assets.  | 10 |
| 27 | Power to appoint an agent to do any business which it would be unreasonable for the liquidator to have to do himself.  |    |
| 28 | Power to do all such other things as may be necessary for winding up the partnership and distributing its property.  |    |

PART 4 15

LIQUIDATOR'S POWERS IN RELATION TO SEQUESTRATION OF ESTATES OF PARTNERS AND PARTNERSHIP (SCOTLAND)

- |    |  |    |
|----|--|----|
| 29 | The Bankruptcy (Scotland) Act 1985 (c. 66) is amended as follows.  |    |
| 30 | (1) Section 5 (sequestration of the estate of living or deceased debtor) is amended as follows.  | 20 |
|    | (2) In subsection (2) –  |    |
|    | (a) the word “or” before paragraph (c) is repealed, and  |    |
|    | (b) after that paragraph, there is inserted “; or  |    |
|    | (d) where the debtor is a partner, a liquidator appointed under section 50 of the Partnerships Act 2003 in respect of the partnership, but only if the conditions in subsection (2D) below are satisfied.” | 25 |
|    | (3) After subsection (2C), there is inserted –   |    |
|    | “(2D) The conditions mentioned in paragraph (d) of subsection (2) above are that –   | 30 |
|    | (a) the partnership is a qualified creditor, and   |    |
|    | (b) the liquidator referred to in that paragraph is presenting or has presented a petition for sequestration of the estate of the partnership.”  |    |
| 31 | (1) Section 6 (sequestration of other estates) is amended as follows.  | 35 |
|    | (2) In subsection (4) –  |    |
|    | (a) the word “or” before paragraph (b) is repealed, and  |    |
|    | (b) after that paragraph, there is inserted “; or  |    |
|    | (c) a liquidator appointed under section 50 of the Partnerships Act 2003 in respect of the partnership, if paragraph 9 of Schedule 4 to that Act applies.”   | 40 |
|    | (3) In subsection (5), after “(4)(b)” there is inserted “or (c)”.  |    |

# EXPLANATORY NOTES

## ***Part 4***

216. Paragraphs 29 - 31 apply to Scotland only and contain amendments to the Bankruptcy (Scotland) Act 1985 to permit the partnership liquidator to present a petition for sequestration of the partnership's estate and of the estate of any insolvent partner under sections 5 and 6 of the 1985 Act. See the report, paragraphs 12.93 and 12.94(5). (For the position in England and Wales see the report, paragraphs 3.54 - 3.56 and 12.92.)

SCHEDULE 5

Section 51

FUNCTIONS OF PROVISIONAL LIQUIDATOR

*Effect of provisional liquidator's appointment*

- 1 (1) On the appointment of a provisional liquidator, all the powers of the partners are suspended, except so far as the provisional liquidator sanctions their continuance, until the determination of the application under section 50. 5
- (2) Each partner and each person interested in the winding up must cooperate with the provisional liquidator in relation to the performance of his functions. 10
- (3) In relation to the performance of those functions, the duty imposed by section 9 (overriding duty of good faith) applies not only to a partner but also to a person interested in the winding up.

*General duty of provisional liquidator*

- 2 (1) The provisional liquidator must secure the preservation of – 15
  - (a) partnership property, and
  - (b) trust property,until the application under section 50 has been determined.
- (2) But the provisional liquidator must not begin to wind up the partnership.

*General powers of provisional liquidator*

- 3 (1) The provisional liquidator may – 20
  - (a) with the approval of each of the partners, or
  - (b) with the sanction of the court,exercise any of the powers specified in Part 2 or 3 of Schedule 4.
- (2) For this purpose, the power specified in paragraph 21 of that Schedule is limited to power to carry on the partnership business so far as may be necessary for the preservation of partnership property or trust property. 25

*Contracts entered into by provisional liquidator*

- 4 (1) A contract entered into by the provisional liquidator in the performance of his functions is to be taken to be entered into by him on behalf of the partnership, unless the contract provides that he should be personally liable on it. 30
- (2) If the provisional liquidator assumes personal liability under the contract, he is entitled to an indemnity out of partnership property in respect of that liability. 35
- (3) This paragraph does not –
  - (a) limit any right to indemnity which the provisional liquidator would have apart from it,
  - (b) limit his liability on contracts entered into in breach of this Schedule or an order of the court, or 40

# EXPLANATORY NOTES

## Schedule 5

217. A provisional liquidator may be appointed under clause 51 of the draft Bill. Schedule 5 contains provisions concerning the functions of the provisional liquidator. As to the purpose of appointing a provisional liquidator see the note below on paragraph 2 of this Schedule.
218. Paragraph 1 sets out the principal effects of the provisional liquidator's appointment. See the report, paragraphs 12.61, 12.63 - 12.65 and 12.66(2), (5) and (6).
219. Paragraph 2 sets out the general duty of the provisional liquidator. The purpose of the appointment of a provisional liquidator is to preserve partnership property and property which the partnership holds on trust for others pending the determination of an application to appoint a partnership liquidator. See the report, paragraphs 12.54 and 12.56(2).
220. Paragraph 3 provides that the provisional liquidator may, with the approval of the partners or with the sanction of the court, exercise any of the powers of a partnership liquidator specified in Part 2 or Part 3 of Schedule 4. This is in contrast with a partnership liquidator who requires approval or sanction in relation to Part 2 powers only. A provisional liquidator is subject to a further limitation (to which a partnership liquidator is not) in that the power to carry on the partnership business (Schedule 4, paragraph 21) is limited to the power to carry on the business so far as may be necessary for the preservation of partnership property or trust property. See the report, paragraphs 12.54 and 12.56(3).
221. As in the case of the partnership liquidator, paragraph 4 provides that, in relation to the provisional liquidator, the general rule is that he should not be personally liable on a contract which he enters into in the performance of his functions. If he does assume personal liability under a contract, he is entitled to an indemnity. See the report, paragraphs 12.69 and 12.70.

- (c) confer a right to indemnity in respect of any liability under paragraph (b).

*Resignation of provisional liquidator*

- 5 (1) The provisional liquidator may at any time resign as provisional liquidator by giving notice of his intention to do so. 5
- (2) The notice must include a full and true statement of his acts and dealings as provisional liquidator.
- (3) The notice must be given to – 10
- (a) the court,
  - (b) each partner,
  - (c) each person interested in the winding up, and
  - (d) if the provisional liquidator was appointed on the application of a creditor of the partnership, the creditor.
- (4) The resignation notice takes effect – 15
- (a) at the end of the period of 8 weeks starting with the day on which it is given, or
  - (b) if earlier, at the time from which the provisional liquidator's release has effect under paragraph 8(1).

*Appointment or removal of provisional liquidator by court*

- 6 (1) If for any reason there is no provisional liquidator acting, the court may appoint a provisional liquidator. 20
- (2) The court may, on cause shown, remove a provisional liquidator and appoint another.

*Ceasing to hold office on determination of section 50 application*

- 7 The provisional liquidator ceases to hold office on the determination of the application under section 50. 25

*Release of provisional liquidator*

- 8 (1) The court may, on application, order that – 30
- (a) the provisional liquidator, or
  - (b) a person who has ceased to be the provisional liquidator, should be released with effect from a time specified in the order.
- (2) The application may be made by –
- (a) the person to whom the application relates, or
  - (b) if he has died, his personal representative.
- (3) A provisional liquidator (or a person who has ceased to be the provisional liquidator) who is released is, with effect from the time specified in subparagraph (1), discharged from all liability to partners, former partners and the partnership – 35
- (a) in respect of acts or omissions of his in the performance of his functions, and 40
  - (b) otherwise in relation to his conduct as provisional liquidator.

## **EXPLANATORY NOTES**

222. Paragraph 5 provides that a provisional liquidator should be able to resign in the same way as a partnership liquidator. See the report, paragraphs 12.102 - 12.104(1).
223. Paragraph 6 provides that the court can appoint a provisional liquidator if there happens to be no provisional liquidator acting and also that the court may, on cause shown, remove a provisional liquidator and appoint another. Again this mirrors the provision in relation to a partnership liquidator. See the report, paragraphs 12.103 and 12.104(3).
224. As the provisional liquidator holds office on an interim basis only, paragraph 7 provides that he ceases to hold office on the determination of the application under clause 50 for the appointment of a partnership liquidator. See the report, paragraphs 12.103 and 12.104(2).
225. Paragraph 8 provides that the provisional liquidator should be entitled to release if the court grants such an application. On his release the provisional liquidator is discharged from liability to the partnership, partners, former partners and the estates of former partners. As is the case in relation to liquidators, the release will not apply if he has obtained his release by fraud or deliberate concealment of wrongdoing; and the discharge has no effect in relation to third party claims against him. See the report, paragraphs 12.103 and 12.104(4) and (5).

Rules

- 9 (1) The Secretary of State may make rules for the purpose of giving effect to this Schedule.
- (2) The rules may, in particular, make provision as to the remuneration payable to the provisional liquidator.

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SCHEDULE 6

Section 55

PERMITTED ACTIVITIES FOR LIMITED PARTNERS

Each of the following is a permitted activity –

*Strategic decisions*

- 1 Taking part in a decision about the variation of the partnership agreement. 10
- 2 Taking part in a decision about whether to approve, or veto, a class of investment by the limited partnership.  
Note that this is subject to section 59(4) and (5) (default rules about decision-making).
- 3 Taking part in a decision about whether the general nature of the partnership business should change.
- 4 Taking part in a decision about whether to dispose of the partnership business or to acquire another business.  
Note that this is subject to section 59(4) and (5) (default rules about decision-making). 15
- 5 Taking part in a decision about whether a person should become or cease to be a partner.  
Note that this is subject to section 60(1) (default rule about admission of new partners).
- 6 Taking part in a decision about whether the partnership should end.  
Note that this is subject to section 61(1) (default rule about break up of limited partnership).
- 7 Taking part in a decision about how the partnership should be wound up. 20  
Note that this is subject to section 61(2), (4) and (5) (default rules about winding up of limited partnership).

*Enforcement of rights*

- 8 Enforcing his rights under the partnership agreement (unless those rights are to carry out management functions).

## EXPLANATORY NOTES

226. As is the case in relation to the partnership liquidator, there are matters relating to the provisional liquidator which would be more appropriately dealt with in subordinate legislation than in the draft Bill. Paragraph 9 provides a rule-making power. See the report, paragraphs 12.105 and 12.106.

### **Schedule 6**

227. Schedule 6 sets out a list of activities that a limited partner may undertake without risking taking part in management (which would mean losing limited liability). See the report, paragraphs 17.3-17.17. All the activities on the list either relate to the governance or strategic direction of the partnership, or involve the limited partner in the partnership in a capacity which is different from them acting as partner, for example paragraphs 10 and 11. The list is not exhaustive. There will be other non-listed activities that are clearly not taking part in management that the limited partner will be able to undertake safely.
228. A decision to vary the partnership agreement will normally involve the agreement of all of the partners. Taking part in such a decision is a permitted activity under paragraph 1. Paragraph 2 would allow a limited partner to take part in a decision about broad classes of investment, such as a decision not to invest in certain types of industry on ethical grounds. It would not permit taking part in day-to-day decisions to invest in particular companies.
229. A decision about whether the partnership business should change goes to the fundamental contract between the partners and as such is a strategic decision about the nature of the joint venture. As a default rule limited partners may take part in a decision about whether the nature of the partnership business should be changed (clause 59(7)). Given this, it is included in Schedule 6 as paragraph 3.
230. Paragraph 4 is directed at, among other things, decisions about whether the partnership should merge or consolidate with another partnership. Paragraph 5 may also be relevant in this situation, depending upon how the merger is achieved. For example, if two limited partnerships decide to merge, this may be achieved by the partners in one of the firms becoming partners in the second firm. Decisions prior to the merger within the individual partnerships about whether this should occur would be included within paragraph 5.

*Approving accounts of limited partnership*

- 9 Approving the accounts of the limited partnership.

*Contract work*

- 10 Being engaged under a contract by the limited partnership or by a general partner in the limited partnership (unless the contract is to carry out management functions).

*Directorships etc.*

- 11 Acting in his capacity as a director or employee of, or a shareholder in, a corporate general partner.

*Conflicts of interest between limited and general partners*

- 12 Taking part in a decision which involves an actual or potential conflict of interest between a limited partner (or limited partners) and a general partner (or general partners).

*Consultation and advice*

- 13 Discussing the prospects of the partnership business.
- 14 Consulting or advising a general partner, or the general partners, about the activities of the limited partnership or about its accounts (including doing so as a member of an advisory committee of the limited partnership).

## SCHEDULE 7

Section 68(1)

## REGISTRATION OF CHANGES AND CORRECTIONS

*Change of partnership name*

- 1 (1) For the name of a limited partnership to be changed, notice of the proposed change must have been delivered to the registrar. 5
- (2) The notice must –
- (a) specify the existing name of the limited partnership,
  - (b) specify the proposed name of the limited partnership, and
  - (c) if subsection (4) of section 63 applies, contain the written consent referred to there. 10
- (3) The notice must be signed by –
- (a) the general partner or, if there is more than one general partner, all of them, or
  - (b) a person (other than a general partner) who has authority to give the notice on behalf of the partnership. 15
- (4) On receiving the notice the registrar must, if satisfied that section 63 is complied with –
- (a) alter the register to record the change of name, and

## EXPLANATORY NOTES

231. Paragraph 11 will allow a limited partner to do things that would otherwise constitute management, as long as they are genuinely done in a different capacity, for example as director of a general partner that is a company. See the report, paragraph 17.16.
232. Under section 6(1) of the 1907 Act the limited partner may inspect the books of the firm, examine the prospects of the partnership business and advise “with the partners thereon”. Paragraphs 9, 13 and 14 cover these aspects of the limited partner’s role (and see also clause 59(1)(b) and the note above on this clause).

### **Schedule 7**

233. Schedule 7 provides for the detailed workings of the registration system. The general partners are responsible for registration requirements, and keeping the register up to date. This means that limited partners are generally not required to sign notices under Schedule 7 (the only exception being paragraph 4(5)). It is doubtful that limited partners would want to be involved in these matters. In addition, requiring limited partners to sign these notices would not be consistent with the prohibition on limited partners taking part in management.
234. The concern that might arise where the limited partners do not sign the notices is what the consequences are if the general partner makes a mistake in the registration of a limited partner. If a general partner makes a mistake in the registration of a limited partner and the would-be limited partner is exposed to liability as a result, this can be rectified by the court by an application under clause 47. For example, the general partner may wrongly register a new limited partner as a general partner, rather than as a limited partner. As we expect the register under the new Act to be on-line it will be a simple matter for a limited partner to check his status on the register to see if and when he has been registered as a limited partner. When a limited partner becomes aware of the mistake in registration he can apply for an order under clause 47. The court has wide powers to give directions under Schedule 3, paragraph 3. The court may make an order removing him from the partnership, backdated to the date he was registered. There is also a power to put the applicant and other third parties in the position they would have been in had the partner ceased to be a partner on the date of the court order. Of course, if the period of mistaken registration is not significant, the would-be limited partner may be content to have himself re-registered as a limited partner without any application to the court.
235. Most notices in Schedule 7 may be signed by a person with authority to sign on behalf of the partnership. This will encompass ‘authorised persons’ under the Financial Services and Markets Act 2000 (see discussion of the FSMA in the notes above on clause 66).
236. Paragraph 1 allows for the procedure by which a limited partnership can change its registered name. See the report, paragraphs 15.40-15.41. The name of the partnership is one of the main ways that third parties will use to search the register. It is important, therefore, that the name is not altered in law until the change in name is registered. Paragraph 2 provides similarly for a change in the partnership’s registered office. See the report, paragraphs 15.52 – 15.53.

- (b) supply the partnership with a certificate signed by him of the change of name.
- (5) The certificate must record –
  - (a) the change of name, and
  - (b) the date on which the change was registered. 5
- (6) The change of name has effect from the date on which it was registered.
- (7) The change of name does not –
  - (a) affect any rights or duties of the limited partnership, or
  - (b) render defective any legal proceedings by or against it, and any legal proceedings that might have been continued or commenced by or against it in its former name may be continued or commenced by or against it in its new name. 10

*Change of registered office*

- 2 (1) For the registered office of a limited partnership to be changed –
  - (a) within England and Wales, or 15
  - (b) within Scotland,notice of the proposed change must have been delivered to the registrar.
- (2) The notice must specify –
  - (a) the existing registered office of the limited partnership, and
  - (b) the proposed registered office of the limited partnership. 20
- (3) The notice must be signed by –
  - (a) a general partner, or
  - (b) a person (other than a general partner) who has authority to give the notice on behalf of the partnership.
- (4) On receiving the notice the registrar must alter the register to record the change of registered office. 25
- (5) The change has effect from the date on which it was registered.

*Registration of new limited partners*

- 3 (1) For a person to become a limited partner in an existing limited partnership, notice that he is a proposed limited partner must have been delivered to the registrar. 30
- (2) The notice must specify –
  - (a) the name of the limited partnership,
  - (b) the name of the proposed limited partner, and
  - (c) the amount of any relevant capital contribution being made by him to the partnership. 35
- (3) If the proposed limited partner is a general partner in the limited partnership, the notice must state that fact.
- (4) The notice must be signed by –
  - (a) a general partner, or 40
  - (b) a person (other than a general partner) who has authority to give the notice on behalf of the partnership.

## **EXPLANATORY NOTES**

237. The purpose of paragraphs 3 and 4 is to give greater clarity to limited partners about their status. Before an individual is registered as a limited partner there is a chance they will be treated as a general partner, if they participate in the partnership. It is of prime importance that limited partners have certainty about when their limited status begins and ends. This enables them to participate in the limited partnership with confidence. See the report, paragraphs 15.42 - 15.43 and 16.14(4). Paragraph 3 requires the name of the limited partner to be registered and the amount of their capital contribution, if any (compare section 8(d), (f) and (g) and section 9(1)(d), (f) and (g) of the 1907 Act).

- (5) But if sub-paragraph (3) applies, the notice may not be signed by the proposed limited partner.
- (6) On receiving a notice under this paragraph, the registrar must –
- (a) register the proposed limited partner as a limited partner in the partnership, and 5
  - (b) if sub-paragraph (3) applies, ensure that the register is altered to record the fact that the partner has ceased to be a general partner in the partnership.
- (7) The proposed limited partner becomes a limited partner on the date recorded in the register as the date of his registration. 10

*Registration of persons ceasing to be limited partners*

- 4 (1) For a person to cease to be a limited partner in a limited partnership, otherwise than –
- (a) on his death or (if not an individual) dissolution, or
  - (b) on the dissolution of the partnership, 15
- notice that he is to cease to be a limited partner must have been delivered to the registrar.
- (2) The notice must specify –
- (a) the name of the limited partnership, and
  - (b) the name of the person who is to cease to be a limited partner. 20
- (3) If the person to whom the notice relates is to become a general partner in the limited partnership, the notice must state that fact.
- (4) The notice must be signed by –
- (a) a general partner, or
  - (b) a person (other than a general partner) who has authority to give the notice on behalf of the partnership. 25
- (5) But if –
- (a) sub-paragraph (3) applies, and
  - (b) the partnership does not have one or more general partners,
- the notice must be signed by the person to whom the notice relates. 30
- (6) On receiving a notice under this paragraph, the registrar must –
- (a) register the person as no longer being a limited partner in the partnership, and
  - (b) if sub-paragraph (3) applies, ensure that the register is altered to reflect the fact that the person has become a general partner in the partnership. 35
- (7) The person ceases to be a limited partner on the date recorded in the register as the date on which he is no longer a limited partner in the partnership.

*Registration of other changes relating to limited partnerships*

- 5 (1) If during the continuance of a limited partnership any of the events described in the Table occurs, a notice specifying the nature of the event must be delivered to the registrar within 28 days. 40

## EXPLANATORY NOTES

238. Paragraph 4(7) provides the parallel certainty about when a person ceases to be a limited partner. In all cases where this is voluntary the person ceases to be a partner only once the change is registered. Where the person ceases to be a limited partner involuntarily, (upon death, or dissolution where the partner is a body corporate), the change is effective immediately and the change must be registered within 28 days of the death or dissolution (paragraph 5(1) item 3). See the report, paragraphs 15.46 - 15.47 and 15.49(2).
239. As with other changes to registered particulars it is the general partner (or authorised person; see the notes above on clause 66) who is responsible for signing the notice that an individual has ceased to be a limited partner. However, paragraph 4 also provides for a situation where a limited partnership may not have any general partners and a limited partner wants to become a general partner. See the report, paragraphs 16.11 and 16.14(4).
240. In paragraph 5 a uniform 28 days has been provided for notification of all changes (See the report, paragraph 15.50). We think that a uniform period makes compliance easier, especially for smaller partnerships. There is no detriment to the third party from a 28 day notice period as in most cases the changes to be notified are incidental, such as address changes or the change in the capital contribution. Where a person becomes a general partner their personal liability as a partner is not dependent upon registration. They will be fully liable from the moment they become a general partner, whether registered or not.

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<i>nature of change</i>		
1	A person becomes a general partner.	
2	A person ceases to be a general partner.	
3	A person ceases to be a limited partner on his death or (if not an individual) dissolution.	5
4	The name of an existing general or limited partner changes.	
5	The address of an existing general partner changes.	
6	There is a change in the amount of the relevant capital contribution of a limited partner.	

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(2)	The notice must be signed by –	10
	(a) a general partner, or	
	(b) a person (other than a general partner) who has authority to give the notice on behalf of the partnership.	
(3)	Where it is proposed that a person who is a limited partner should become a general partner, item 1 of the Table does not apply (and paragraph 4 does).	15
(4)	Where it is proposed that a person who is a general partner should become a limited partner, item 2 of the Table does not apply (and paragraph 3 does).	
(5)	A person who has ceased to be a general partner in a limited partnership may, at any time during the continuance of the limited partnership, deliver to the registrar a notice –	20
	(a) signed by him, and	
	(b) specifying that he has ceased to be a general partner in the partnership.	
(6)	On receiving a notice under this paragraph, the registrar must ensure that the register is altered so far as necessary to record the specified change.	25
(7)	Any general partner who without reasonable excuse fails to ensure that subparagraph (1) is complied with is guilty of an offence and liable on summary conviction to a fine not exceeding –	
	(a) £1000 for the first day on which the failure occurs, and	
	(b) £100 for each day during which the failure continues.	30

*Registration of corrections*

6	(1) The registrar may at any time register a correction to the register, on the application of –	
	(a) a general partner, or	
	(b) a person (other than a general partner) who has authority to make the application on behalf of the partnership.	35
(2)	“Correction” means an alteration in the register which needs to be made because of an error having occurred in incorporating into the register the information supplied to the registrar.	
(3)	If the correction relates to information contained in –	40

## **EXPLANATORY NOTES**

241. Paragraph 5(5) protects former general partners from being dependent on the current general partner(s) to de-register them, once they have ceased being a general partner. It allows the person with the greatest interest in being de-registered to take care of de-registration.

- (a) the certificate of the registration of the partnership, or
  - (b) a certificate of a change in the name of the partnership,
- the registrar must supply the partnership with a revised certificate.

## SCHEDULE 8

Section 68(2)

## DEREGISTRATION

5

*Power to deregister on application by partners*

- 1 (1) The registrar may deregister a limited partnership if –
- (a) an application has been delivered to the registrar for its deregistration, and
  - (b) the requirements relating to a deregistration warning are complied with (as to which, see paragraph 4). 10
- (2) No application may be made under this paragraph unless –
- (a) all the persons who are partners at the time of the application agree, or
  - (b) if at the time of the application the partnership has been dissolved, all the persons who were partners immediately before dissolution agree. 15
- (3) The application must –
- (a) confirm that each of the persons whose agreement is required under sub-paragraph (2)(a) or (b) has agreed to make the application, 20
  - (b) state who those persons are, and
  - (c) confirm whether they are the persons named on the register as partners and, if not, explain why not.
- (4) The application must be signed by –
- (a) the general partner or, if there is more than one general partner, all of them, or 25
  - (b) a person (other than a general partner) who has authority to make the application on behalf of the partnership.
- (5) But if there are no general partners, the application must be signed by all of the persons whose agreement is required under sub-paragraph (2)(a) or (b). 30
- (6) Paragraphs 4 and 5 apply in relation to deregistration of a limited partnership which has been dissolved as if the references to a limited partnership were references to a dissolved limited partnership.

*Power to deregister on inquiry by registrar*

- 2 (1) The registrar may deregister a limited partnership if – 35
- (a) there are reasonable grounds for believing that one of the grounds for doing so exists,
  - (b) the registrar has made the necessary preliminary inquiries (as to which, see paragraph 3), and
  - (c) the requirements relating to a deregistration warning are complied with (as to which, see paragraph 4). 40

# EXPLANATORY NOTES

## **Schedule 8**

242. One of the flaws of the 1907 Act was that it did not provide for the de-registration of limited partnerships. Schedule 8 provides a de-registration process. See the report, paragraphs 15.79 - 15.81 and 15.83. There are two ways that a de-registration may be initiated. The partners in a limited partnership may apply to the registrar to be de-registered. This is covered by paragraph 1. The registrar also has a power to de-register a limited partnership without having received an application from the partnership (paragraph 2). Both methods of de-registration contain safeguards to ensure that a limited partnership is not mistakenly de-registered. A limited partnership that is de-registered becomes a general partnership unless it has already been dissolved (paragraph 5).

- (2) The grounds for deregistering a limited partnership are that –
  - (a) the limited partnership has been dissolved;
  - (b) the limited partnership does not have –
    - (i) one or more general partners, and
    - (ii) one or more limited partners;
  - (c) the limited partnership does not have a registered office as required by section 62;
  - (d) if the limited partnership was formed under section 67(3), the partners have not started to carry on a business together with the object of making a profit.
- (3) But the registrar may not deregister a limited partnership on the ground that it does not have one or more general partners at a time when –
  - (a) an application has been made under section 50 for the appointment of a liquidator for the partnership and the application has not been determined, or
  - (b) a liquidator has been appointed under section 50 and he has not ceased to hold office without being replaced.
- (4) The registrar may not deregister a limited partnership on the ground in subparagraph (2)(d) before the end of two years starting with the day on which the partnership was formed.
- (5) Paragraphs 3 to 5 apply in relation to deregistration on the ground in subparagraph (2)(a) as if the references to a limited partnership were references to a dissolved limited partnership.

*Preliminary inquiries*

- 3 (1) The registrar makes the necessary preliminary inquiries if –
  - (a) he has sent two letters of inquiry to the registered office of the limited partnership in accordance with sub-paragraphs (2) to (5), and
  - (b) within the time limit for replying to the second letter, no one has shown why he should not deregister the partnership.
- (2) Each of the letters must –
  - (a) state that the registrar believes that one or more of the grounds for deregistering the partnership exists,
  - (b) specify the ground or grounds, and
  - (c) invite any person named on the register as a partner, within the time limit for replying to the letter, to show why the partnership should not be deregistered.
- (3) The second letter must be sent –
  - (a) at the end of two weeks from the time limit for replying to the first letter (or as soon as possible thereafter), and
  - (b) by registered post or recorded delivery.
- (4) The time limit for replying to each letter is one month from the date of the letter.
- (5) If there are reasonable grounds for believing that the partnership does not have a registered office, the letters of inquiry must instead be sent –
  - (a) in the case of each person named on the register as a general partner, to his address as specified in the register, and

## **EXPLANATORY NOTES**

243. Paragraph 3 sets out the details of the preliminary inquiries process. This is a safeguard which requires the registrar to write to the partnership informing them that they are to be de-registered. The partners can reply showing why the partnership should not be de-registered. It is only relevant to a registrar initiated de-registration.

- (b) in the case of each person named on the register as a limited partner, to his address if known to the registrar.

#### *Deregistration warning*

- 4 (1) The requirements relating to a deregistration warning are that—
- (a) at least 3 months before the registrar deregisters the partnership, a deregistration warning has been published in the Gazette, and 5
- (b) in that 3 month period, no one has shown why he should not deregister it.
- (2) The deregistration warning must—
- (a) specify the name under which the limited partnership is registered, 10
- (b) state that the registrar may exercise his power under this Act to deregister it, and
- (c) invite any person to show why he should not do so.

#### *Deregistration*

- 5 (1) If the registrar deregisters a limited partnership, he must publish notice of the fact in the Gazette, specifying the date on which the deregistration occurred. 15
- (2) The deregistration has effect on the date specified in the notice.
- (3) On deregistration—
- (a) the limited partnership becomes a general partnership, and 20
- (b) each general or limited partner in the limited partnership becomes a partner in the general partnership.
- (4) But sub-paragraph (3) does not apply if the limited partnership had been dissolved before the deregistration.
- (5) The deregistration does not affect the personal liability of any partner for partnership obligations incurred while the partnership was registered as a limited partnership. 25

#### *Order where limited partnership should not have been deregistered*

- 6 (1) This paragraph applies if—
- (a) a limited partnership has been deregistered (whether under paragraph 1 or paragraph 2), 30
- (b) after the deregistration, the partnership continued to exist as a general partnership, and
- (c) the partnership was subsequently registered again as a limited partnership under section 67. 35
- (2) On an application by the partnership or any partner, the court may make an order under this paragraph if it considers that—
- (a) the condition in sub-paragraph (3) or (4) is satisfied, and
- (b) it is just and equitable to do so.
- (3) In the case of deregistration under paragraph 1, the condition is that the application for deregistration was made in contravention of paragraph 1(2). 40
- (4) In the case of deregistration under paragraph 2, the condition is that either—

## EXPLANATORY NOTES

244. Paragraph 4 sets out the de-registration warning process. This is a safeguard which requires the registrar to publish the intended de-registration in the Gazette and provide 3 months for anyone to show why the partnership should not be de-registered. The registrar must go through this process each time a limited partnership is being de-registered, whether it is partner initiated or initiated by the registrar.
245. The reason that the de-registration warning is necessary where the partners themselves have applied to be de-registered is that a general partner or authorised person may apply for de-registration in the mistaken belief that all of the partners have agreed (paragraph 1(2)). De-registration has the potential to expose the limited partners to unlimited liability. The publication of this warning in the Gazette gives any limited partners in the partnership the opportunity to object to the de-registration application if this is appropriate.
246. Paragraph 2 provides the power for the registrar to de-register a limited partnership if he has reasonable grounds for believing that the limited partnership either has been dissolved or does not satisfy one of the requirements of being a limited partnership, for example the limited partnership does not have at least 1 general partner. The registrar must also publish the de-registration warning (paragraph 4). In addition, and prior to this, the registrar must make the preliminary inquiries set out in paragraph 3 to find out whether it is appropriate to de-register the partnership.
247. There are also two sets of circumstances where a limited partnership satisfies one of the grounds for de-registration but, despite this, it is inappropriate that the partnership be de-registered. These are provided for in paragraph 2(3) and (4). Sub-paragraph (3) relates to a situation where a limited partnership has no general partners and is being wound up by a liquidator, or an application has been made for a liquidator to be appointed. Without sub-paragraph (3) the partnership would be susceptible to being de-registered because the partnership does not have 1 or more general partners (paragraph 2(2)(b)(i)). However, if the partnership was de-registered while being wound up by the liquidator the limited partners would be exposed to personal liability during the winding up. The effect would be the same if the partnership was de-registered while awaiting the appointment of a liquidator. As the winding up is a finite process there is no detriment to allowing the limited partnership to stay on the register during the course of the liquidator's appointment. This protects the limited partners until the partnership has been dissolved. It will then be able to be de-registered, either under paragraph 1 by application of the former partners, or under paragraph 2 by the registrar on the ground that the limited partnership has been dissolved.
248. Where a general partnership registers to become a limited partnership it is usual that a partnership business is in operation prior to registration. This usually means that all elements of a partnership are present, including the element of carrying on business with a view to making a profit. Where there is no partnership in existence prior to registration as a limited partnership, under clause 67(3) a new partnership is formed on this date. It is expected that the new limited partnership will then begin to trade, thereby fulfilling all the elements of a partnership, by carrying on business with the object of making a profit. If the limited partnership did not begin to carry on business it would not truly be a partnership, despite it being registered as a limited partnership. Thus, it is appropriate that a limited partnership be de-registered if the partners have not started to carry on a business together with the object of making a profit (Schedule 8, paragraph 2(2)(d)). However, sub-paragraph (4) has been included to provide, for newly registered limited partnerships, a period of 2 years when paragraph 2(2)(d) does not apply.
249. A 2-year period has been provided in sub-paragraph (4) to make provision for limited partnerships that are registered to be sold as 'off the shelf' limited partnerships. It has also been included to accommodate the usual practice of establishing limited partnerships for investment purposes. In many cases the limited partnership is registered before investors are sought and it is appropriate to allow a reasonable period before the partners in the limited partnership start to carry on business. If this provision were not included the limited partnership would be at danger of being de-registered during this establishment period under paragraph 2(2)(d) of this Schedule.

- (a) none of the grounds for deregistration in paragraph 2(2) applied in relation to the partnership, or
  - (b) the partnership was deregistered in contravention of paragraph 2(3) or (4).
- (5) The order may make such provision as the court thinks fit for putting the limited partnership and other persons – 5
- (a) in the position they would have been in if the limited partnership had not been deregistered, or
  - (b) so near that position as the court considers just and equitable.
- (6) An application under this paragraph must be made before the end of 3 years starting with the day on which the notice of deregistration was published under paragraph 5. 10

## SCHEDULE 9

Section 68(3)

### ADMINISTRATION OF THE REGISTRATION SYSTEM

#### *Delivery of documents* 15

- 1 (1) For the purposes of this Part, “deliver”, in relation to a document required to be delivered to the registrar, includes sending the document in a form and by a means approved by him.
- (2) Sub-paragraph (3) applies if, under an order made under section 69 of the Deregulation and Contracting Out Act 1994 (c. 40), a person is authorised to accept delivery of any class of documents which under this Part are required to be delivered to the registrar. 20
- (3) If –
- (a) the registrar directs that documents of that class are to be delivered to a specified address of the authorised person, and 25
  - (b) the direction is printed and made available to the public (with or without payment),
- any document of that class which is delivered to an address other than the specified address is to be treated for the purposes of this Part as if it had not been delivered. 30

#### *Registration of information about limited partnerships*

- 2 (1) The information contained in a document delivered to the registrar under this Part may be registered and kept by him in any form he thinks fit, provided it is possible to inspect the information and to produce a copy of it in legible form. 35
- (2) Originals of documents sent under this Part to the registrar in legible form must be kept by him for 10 years, after which they may be destroyed.

#### *Inspection of registers etc.*

- 3 (1) Any person may inspect information kept by the registrar for the purposes of this Part and may require – 40

## EXPLANATORY NOTES

250. Paragraph 6 is designed for the situation where a limited partnership is de-registered mistakenly. See the report, paragraphs 15.82 - 15.83. In this case the limited partnership should register again under clause 67. However, this still leaves a period between the mistaken de-registration and the re-registration of the partnership. During this interim period the partnership will be a general partnership and all partners will be general partners with unlimited liability for that period. Where certain conditions are fulfilled a limited partnership can, under paragraph 6, apply to the court for an order dealing with the interim period. This order can put the limited partnership and other persons (including limited partners and third persons) in the position they would have been in had the partnership not been de-registered, if it is just and equitable to do so (paragraph 6(5)(b)). For example, this would allow a limited partner's liability that arises during the interim period to be limited by court order.
251. The conditions for obtaining a court order under paragraph 6 depend upon whether the mistaken de-registration was a partner-initiated de-registration or one initiated by the registrar. If it was initiated by the partners it must be the case that the agreement of all the partners to the de-registration was not actually present. If it is a de-registration initiated by the registrar the conditions are (a) that the ground that the registrar relied upon in paragraph 2(2) did not actually exist at the time (for example, that the limited partnership had not been dissolved), or (b) that the registrar did not take into account the fact that one of the exceptions in paragraph 2(3) or (4) applied to the limited partnership. In addition, the court will only make an order if it considers that it is just and equitable to do so (paragraph 6(2)(b)).

### **Schedule 9**

252. Paragraph 1(1) has been provided to allow for the possibility of electronic filing and/or delivery of documents to the registrar. See the report, paragraphs 15.56 - 15.57.
253. Paragraph 2(1) will allow the development of an on-line register, similar to the register of companies that is searchable online. Sub-paragraph (2) is the equivalent to section 707A(2) of the Companies Act 1985. See the report, paragraphs 15.58 - 15.59.
254. Paragraph 3 recreates, in modern form, the effect of section 16 of the Limited Partnerships Act 1907. See the report, paragraphs 15.60 - 15.61.

- (a) a copy, in such form as the registrar considers appropriate, of information kept in the register, or
  - (b) a certified copy of, or extract from, the original of any document.
- (2) Any person may require a certificate, signed by the registrar, of—
- (a) the registration of a partnership as a limited partnership, or 5
  - (b) the registration of a change in the name of a limited partnership.

*Regulations*

- 4 (1) The Secretary of State may by regulations make provision in connection with the registration of limited partnerships under this Act.
- (2) The regulations may, in particular— 10
- (a) impose fees (to be paid into the Consolidated Fund) in respect of—
    - (i) the registration of a limited partnership or of information relating to a limited partnership,
    - (ii) the inspection of any register, documents or information relating to limited partnerships, or 15
    - (iii) the provision of any certificate relating to a limited partnership or of an extract or copy of any document;
  - (b) make provision for the performance by the assistant registrar and other officers of acts which this Part requires to be done by the registrar; 20
  - (c) make provision in connection with the supply or obtaining of Welsh or English translations of documents delivered to the registrar which relate to limited partnerships whose registered office is (or is to be) in Wales.

## SCHEDULE 10

Section 73 25

## SPECIAL LIMITED PARTNERSHIPS

*Introduction*

- 1 The following are the modifications and additional provisions that apply in relation to a special limited partnership.
- 2 Except in paragraph 3, references to a partnership are to a special limited partnership. 30

*Meaning of partnership agreement and partnership*

- 3 (1) This paragraph applies instead of section 1.
- (2) A partnership agreement is an agreement between two or more persons for carrying on a business together with the object of making a profit. 35
- (3) For the purposes of this Act, “partnership” is the relation which subsists between persons carrying on a business together under a partnership agreement.
- (4) For the purposes of this Act, persons who have entered into partnership with one another are called collectively “a partnership”. 40

## EXPLANATORY NOTES

255. By allowing fees to be set by regulations, paragraph 4 corrects a flaw in the 1907 Act, which set the level of fees in the primary Act. This has meant that the level of fees has become outdated and has not provided funds to modernise the register. See the report, paragraphs 15.62 - 15.63(1).

### **Schedule 10**

256. The special limited partnership has been provided specifically for use as an investment vehicle. See the report, paragraphs 19.2 - 19.10. It is available only under the law of England and Wales as it preserves the aggregate approach of that law. Users of special limited partnerships are likely to have sophisticated partnership agreements. See the report, paragraph 19.12. For this reason Schedule 10 generally disapplies most of the default rules in the Bill. It also alters the application of the Bill where it is inappropriate for a partnership without legal personality.
257. A special limited partnership operates similarly to a limited partnership under the 1907 Act. It is formed in accordance with the aggregate approach to partnership rather than as an entity as created by Part 3 of the Bill. See paragraph 3(3), and see the report, paragraph 19.14. There are other modifications necessary to clause 1 to accommodate this form of partnership and these are effected by paragraph 3.

- (5) A partnership is not a special limited partnership unless it is registered as such under paragraph 26.
- (6) In this Act “business” includes every trade, profession and occupation.
- (7) Schedule 1 provides examples of circumstances which do not by themselves establish that persons are carrying on a business together. 5

*The carrying on of the partnership business*

- 4 (1) This paragraph applies instead of section 6.
- (2) The partners carry on the partnership business.
- (3) The partners are agents of each other for the purpose of the partnership business. 10
- (4) It is a default rule that a change in the nature of the partnership business (whether or not it involves a change in the partnership agreement) requires the agreement of all the partners.

*Capacity*

- 5 Sections 7 (capacity of partnership) and 8 (incapacity to commit offences (England and Wales)) do not apply. 15

*Remuneration, expenses and personal liabilities*

- 6 (1) Section 12 applies but with the following modifications.
- (2) In subsection (4), omit “the partnership or”.
- (3) Omit subsections (5) and (6). 20
- (4) In subsection (7), for “other amount” substitute “amount”.
- (5) Omit subsection (8).

*Partnership property*

- 7 (1) This paragraph applies instead of sections 17 (partnership property), 18 (rules for identifying partnership property) and 19 (land acquired out of partnership profits). 25
- (2) In this Act, “partnership property” means all property –
  - (a) acquired on behalf of the partnership, or
  - (b) contributed to the partnership as capital.
- (3) Partnership property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement. 30

*Execution of documents*

- 8 Section 20 (execution of deeds (England and Wales)) does not apply.

*Secondary liability of partners*

- 9 (1) Section 23 (unlimited liability of partners) applies but with the following modifications. 35

## **EXPLANATORY NOTES**

258. As with an English limited partnership under the 1907 Act, the partners are agents of each other. This is the effect of paragraph 4(3). See the report, paragraph 19.15.
259. Paragraph 6 alters the application of clause 12 to take account of the fact that there are no partnership obligations that are distinct from the obligations of the individual partners themselves.
260. Paragraph 7 defines “partnership property” and is based on section 20 of the Partnership Act 1890.
261. Under paragraph 8 the execution of deeds binding special limited partnerships will continue to be governed by existing law. That is, subject to a few minor exceptions that apply in particular circumstances, a deed will have to be executed by all the partners, or in the presence of all the partners and by their direction, in order to bind the partnership [See Lindley & Banks paragraphs 12 - 67, 12 - 178].

(2) In subsection (1), after “personally liable” insert “jointly and severally with the other partners”.

(3) Omit subsections (3) to (5).

- 10 The following provisions do not apply –
- (a) section 24 (secondary nature of partner’s liability), and 5
  - (b) subsections (1), (2) and (4) of section 25 (partner’s secondary liability: supplementary).

*Non-partners who are liable by holding out*

- 11 (1) Section 26 applies but with the following modifications.
- (2) In subsection (4), for “Sections 23(2) to (5), 24 and 25 apply” substitute “Section 23(2) applies”. 10
- (3) In subsection (6), omit “the partnership or”.

*Changes in partners*

- 12 (1) The following provisions do not apply –
- (a) section 27 (admission of new partners), 15
  - (b) section 28 (how persons cease to be partners),
  - (c) section 29 (ceasing to be partner on ground of insolvency),
  - (d) section 30 (power to resign),
  - (e) section 31 (power to expel partner),
  - (f) section 32 (realisation of former partner’s share (other than on winding up)), and 20
  - (g) section 34 (former partners: indemnity and contribution, and return of property).
- (2) Section 33 (liability of former partner for obligations incurred while a partner) applies but with the substitution for subsection (2) of – 25
- “(2) Section 23(2) applies to a former partner as it applies to a partner.”

*Break up of partnership*

- 13 (1) This paragraph applies instead of section 38 (events which break up a partnership).
- (2) Subject to any agreement between the partners, a partnership breaks up if – 30
- (a) in the case of a partnership of defined duration –
    - (i) the specified period expires, or
    - (ii) the venture is accomplished;
  - (b) in the case of any other partnership, a general partner gives notice to the other partners of his intention to break up the partnership. 35
- (3) Subject to any agreement between the partners, a partnership breaks up if a partner dies or (if not an individual) is dissolved.
- (4) A partnership breaks up if an order under section 47(1)(c), 49 or 53(2)(d) (order breaking up partnership) has effect in relation to it.
- 14 The following provisions do not apply – 40
- (a) subsection (2) of section 39 (effects of break up), and

## **EXPLANATORY NOTES**

262. Under paragraph 12 the provisions in the Bill relating to the admission of partners and in relation to persons ceasing to be partners are inapplicable to a special limited partnership. Many of these provisions are inapplicable to a special limited partnership as there is no entity that exists outside the individual partners considered together. Thus, when an individual partner leaves the partnership, the partnership breaks up. Under the 1890 and 1907 Acts this was called a 'technical dissolution' (dissolution under those Acts being called 'break up' under the draft Bill). A new partnership may form immediately afterwards, consisting of all the partners in the old partnership, except the departed partner. However, in accordance with existing English law, this will be a new partnership. See the report, paragraphs 19.18 - 19.20.
263. Paragraph 13(2)(b) replicates the existing law that, as a default rule, notice to terminate a partnership cannot be given by a limited partner (1907 Act, s 6(5)(e)).

(b) section 40 (restriction on ceasing to be a partner on or after break up).

*Protection for property acquired after break up*

15 Section 42 does not apply.

*Distribution of partnership’s assets on winding up*

16 (1) Section 44 applies but with the following modifications. 5  
(2) In subsection (1)(b), omit “before its dissolution”.  
(3) Omit subsections (4), (5)(a) and (6).

*Dissolution*

17 Section 45 does not apply.

*Court’s powers in relation to partnerships* 10

18 (1) Section 47 (order breaking up partnership) applies but with the following modifications.  
(2) Subsections (1)(a) and (b) and (3) do not apply.  
(3) Subsection (2) applies only for the purposes of subsection (4)(a).  
19 (1) Schedule 3 (orders under section 47: supplementary provisions) applies but 15  
with the following modifications.  
(2) Omit paragraph 1(1)(a) and (2).  
(3) In paragraph 3–  
(a) in sub-paragraph (1)(b), omit “in the case of an order under section 20  
47(1)(c),” and  
(b) omit sub-paragraph (2).  
(4) In paragraph 4(3), omit “If the order is made under section 47(1)(c),”.

20 (1) Section 48 (section 47: interim orders) applies but with the following modifications.  
(2) In subsection (1)(a), for “section 47(1)(a) for the removal of a partner (“P”) 25  
from a partnership” substitute “section 47(1)(c) for the break up of a  
partnership on the ground that one or more of the grounds in section 47(2)(a)  
to (e) applies in relation to a partner (“P”)”.  
(3) In subsection (2), for “section 47(1)(a)” substitute “section 47(1)(c)”.

*Limited and general partners* 30

21 Subsection (3)(b) of section 54 does not apply.

*Default rules about changes in partners in limited partnership*

22 Subsections (1) and (2) of section 60 do not apply.

*Default rule about break up of limited partnership*

23 Subsection (1) of section 61 does not apply. 35

## EXPLANATORY NOTES

264. Paragraph 17 is necessary because under the draft Bill a special limited partnership will not dissolve. Dissolution under the draft Bill refers to the point at which the partnership entity ceases to exist. A special limited partnership is not an entity. If the partners wish the partnership to cease it will break up. This is all that needs to occur to end the 'partnership' as the partnership is defined as the relation between the partners. The authority of the individual partners continues for the limited purpose of winding up the affairs of the former partnership and dealing with the property (clause 43). See the report, paragraphs 19.18 - 19.20.
265. Paragraph 18 also reflects the fact that a partner leaving a special limited partnership effects a break up of that partnership (see the notes above on Schedule 10, paragraph 12). Therefore, there is no difference between an order that a partner leave the partnership and an order breaking up the partnership, as an order that a partner leave the partnership would cause a 'technical' break up. For this reason clause 47(1)(a) and (b) has been disapplied in relation to a special limited partnership.
266. In paragraph 19 similar changes are made to Schedule 3 to make it applicable to special limited partnerships. For example, as in paragraph 18 of Schedule 10, Schedule 3, paragraph 1(1)(a) has been disapplied because the date at which a person ceases to be a partner under paragraph 1(1)(a) will be the same as the date on which the partnership breaks up under paragraph 1(1)(b).
267. Paragraph 20 also makes changes that are necessary because the removal of a partner from a special limited partnership is equivalent to a break up of that partnership (see notes to paragraph 12).
268. Paragraph 21 is necessary because the concept of dissolution is not applicable to special limited partnerships (see the notes above on Schedule 10, paragraph 17).
269. As with paragraph 12, paragraphs 22 and 23 disapply default rules. This is because the Bill does not, for the most part, provide a system of default rules for special limited partnerships. See the report, paragraph 19.12.

*Registered office of limited partnership*

- 24 Section 62 applies but with the omission of paragraph (b) and the word “or” before it.

*Application for registration of special limited partnership*

- 25 (1) Section 66 applies but with the following modifications. 5  
 (2) In subsection (1) –  
 (a) omit “partnership or”, and  
 (b) for “limited partnership” substitute “special limited partnership”.  
 (3) In subsection (2)(a), for “limited partnership” substitute “special limited partnership”. 10  
 (4) In subsection (3), omit paragraphs (c) and (e).

*Registration of special limited partnership and registration certificate*

- 26 (1) This paragraph applies instead of section 67.  
 (2) On receiving an application for the registration of a proposed partnership as a special limited partnership, the registrar must, if satisfied that sections 62, 63 and 66 are complied with – 15  
 (a) register it as a special limited partnership, and  
 (b) supply it with a registration certificate signed by him.  
 (3) The registration certificate must record –  
 (a) the name of the partnership (as specified in the application for registration), 20  
 (b) the fact of its registration as a special limited partnership, and  
 (c) the date of registration.  
 (4) The partnership is formed when it is registered.  
 (5) There is no need to re-register a partnership merely because of a change in the partners. 25

*Registration of changes and corrections*

- 27 (1) Schedule 7 applies but with the following modifications.  
 (2) In paragraph 2(1), omit paragraph (b) and the word “or” before it.  
 (3) Omit paragraph 4(1)(b). 30

*Deregistration*

- 28 (1) Schedule 8 applies but with the following modifications.  
 (2) In paragraph 1 –  
 (a) omit sub-paragraph (2)(b),  
 (b) in sub-paragraphs (3)(a) and (5), omit “or (b)”, and 35  
 (c) omit sub-paragraph (6).  
 (3) In paragraph 2 –  
 (a) omit sub-paragraph (2)(a),

## EXPLANATORY NOTES

270. Paragraph 24 is necessary because special limited partnerships are governed by the law of England and Wales, thus the registered office must be in England or Wales. See clause 80(3)(e) of the draft Bill.
271. Paragraph 25 modifies clause 66 of the draft Bill to provide a process by which people can apply to register a special limited partnership. See the report, paragraph 19.21. Clause 66(3)(e) has been disapplied because it will not be possible for a pre-existing entity partnership to register as a special limited partnership. A special limited partnership is formed by registration and cannot have any existence outside the register. A mechanism to allow pre-existing English or Welsh limited partnerships to register as special limited partnerships will be provided by transitional provisions. However, this option will only be available during the 2-year transitional period.
272. Paragraph 26(4) is the equivalent rule to clause 67(3) but adapted for special limited partnerships. A special limited partnership will not have been able to begin trading prior to registration. This is because there is no provision in the Bill for a non-entity general partnership. Because a limited partnership becomes a limited partnership upon registration, the only way a limited partnership can begin trading prior to registration is as a general partnership. This paragraph clarifies that registration is sufficient to constitute carrying on business, given that prior to registration the partnership had not begun to carry on business. This means that all the elements of a partnership are present post-registration. (Even during the transitional period, a limited partnership under the 1907 Act which becomes a special limited partnership will not have begun trading *as a special limited partnership under the new Bill* prior to registration, see the report, part XIV, XIX.)
273. As is noted above, paragraph 26(4) (or its equivalent for limited partnerships, clause 67(3)) necessitates Schedule 8, paragraph 2(2)(d) (to allow for de-registration of limited partnerships that never begin trading). Schedule 8, paragraph 2(2)(d) is itself modified by Schedule 8, paragraph 2(4) (which provides an exception for newly registered limited partnerships). It should be noted that Schedule 8, paragraph 2(4) also applies to special limited partnerships. (See the notes above on Schedule 8, paragraph 2, and particularly sub-paragraph (4).) This means that special limited partnerships also get the benefit of the two-year period before they are susceptible to being de-registered on the grounds of not having started to carry on a business with the object of making a profit.
274. Although a partner leaving or joining the firm causes a break up, it is not practicable to require a special limited partnership to fully re-register as a new partnership each time there is a change in the partners. In the 1907 Act this appeared to be the implication of section 9(1)(d), which allowed the change in partners to be registered, rather than requiring the 'new' partnership to re-register anew. This effect has been clarified in paragraph 26(5). See the report, paragraph 19.21.
275. Paragraph 27(2) has been included because the special limited partnerships part of the Bill is only applicable to England and Wales (see clause 80(3)(e) of the draft Bill). Paragraphs 27(3) and 28 have been included to take account of the fact that the concept of dissolution is not applicable to special limited partnerships (see the notes above on Schedule 10, paragraph 17).

- (b) in sub-paragraph (2)(d), for “section 67(3)” substitute “paragraph 26(4) of Schedule 10”, and
- (c) omit sub-paragraph (5).
- (4) For paragraph 5(3) and (4) substitute –
  - “(3) On deregistration – 5
    - (a) if it has not already done so, the limited partnership breaks up, and
    - (b) each general or limited partner becomes a partner with unlimited liability.”
- (5) In paragraph 6(1)(c), for “section 67” substitute “paragraph 26 of Schedule 10”. 10

*Evidence*

- 29 Section 71 applies but with the substitution, in subsection (1)(b), of “special limited partnership” for “limited partnership”.

*Interpretation of Part 3* 15

- 30 (1) Section 72 applies but with the following modifications.
- (2) In subsection (1), in the definition of “the Gazette” –
  - (a) omit paragraph (a), and
  - (b) in paragraph (b), omit “otherwise,”.
- (3) In subsection (1), in the definition of “the registrar” – 20
  - (a) in paragraph (a), omit “if the registered office is, or is to be, in England or Wales,”, and
  - (b) omit paragraph (b) and the word “and” before it.

*Interpretation*

- 31 (1) Section 76 applies but with the following modifications to subsection (1). 25
- (2) In the definition of “business”, for “section 1(6)” substitute “paragraph 3(6) of Schedule 10”.
- (3) In the definition of “partnership”, for “section 1(2)” substitute “paragraph 3(3) of Schedule 10”.
- (4) After the definition of “partnership” insert – 30
  - ““a partnership” has the meaning given by paragraph 3(4) of Schedule 10;”.
- (5) In the definition of “partnership agreement”, for “section 1(1)” substitute “paragraph 3(2) of Schedule 10”.
- (6) In the definition of “partnership property”, for “section 17(1)” substitute 35
  - “paragraph 7(2) of Schedule 10”.
- (7) For the definition of “trust property”, substitute –
  - ““trust property” means property which, in the course of the partnership business, is held by one or more partners in trust for a third person;”. 40

## **EXPLANATORY NOTES**

276. Paragraph 28(4) makes provision for the status of a de-registered special limited partnership. Under paragraph 28(4) de-registration triggers break up. This means that the partnership is ended. However, the authority of the partners may continue for the limited purpose of winding up the partnership's affairs and distributing any partnership property (clause 43(2)).
277. As to paragraph 29, see paragraph 15.24 of the report regarding the status of the certificate of registration. This is equally applicable to special limited partnerships.
278. Paragraph 30 is needed because the special limited partnerships part of the Bill is only applicable to England and Wales (see clause 80(3)(e) of the draft Bill).
279. The purpose of paragraph 31 is to alter references in the definition provision (clause 76) by substituting the relevant provision in Schedule 10. It also alters the definition of "trust property" to fit the aggregate status of the special limited partnership.

## SCHEDULE 11

Section 75

## AMENDMENTS OF THE BUSINESS NAMES ACT 1985

- 1 The Business Names Act 1985 (c. 7) is amended as follows.
- 2 (1) Section 1(1) (persons subject to this Act) is amended as follows.
- (2) In paragraph (a), after “partnership” insert “(other than a limited partnership)”.
- (3) After paragraph (a), insert –
- “(aa) in the case of a limited partnership, does not consist of its registered name, without any addition other than one so permitted;”.
- 3 In section 2 (prohibition of use of certain business names) for subsection (4) substitute –
- “(4) If a partnership which is a legal person contravenes subsection (1), each of the partners (or, in the case of a limited partnership, each of the general partners) is guilty of an offence.
- (5) If any other person contravenes subsection (1), that person is guilty of an offence.”
- 4 (1) Section 4 (disclosure required of persons using business names) is amended as follows.
- (2) In subsection (1)(a) –
- (a) in sub-paragraph (i), after “partnership” insert “(other than a limited partnership)”, and
- (b) after sub-paragraph (i), insert –
- “(ia) in the case of a limited partnership, its registered name and the name of each general partner,”.
- (3) In subsection (3), after “business” (in both places) insert “(or, in the case of a limited partnership, its registered office)”.
- (4) For subsection (6) substitute –
- “(6) If a partnership which is a legal person contravenes subsection (1) or (2), each of the partners (or in the case of a limited partnership, each of the general partners) who without reasonable excuse procured or permitted the contravention is guilty of an offence.
- (6A) If any other person contravenes subsection (1) or (2), that person is guilty of an offence.”
- (5) In subsection (7), after “partner” insert “(or, in the case of a limited partnership, any general partner)”.
- 5 (1) Section 7 (offences) is amended as follows.
- (2) In subsection (3), after “4(6)” insert “or (6A)”.
- (3) In subsection (4), after “4(6)” insert “, (6A)”.
- 6 (1) Section 8 (interpretation) is amended as follows.
- (2) In subsection (1), after the definition of “lawful business name” insert –
- ““limited partnership” includes a foreign limited partnership;”.

# EXPLANATORY NOTES

## Schedule 11

280. The Business Names Act 1985 (BNA) imposes additional requirements upon businesses that wish to trade in Great Britain under a name that is not their usual name. For a company or LLP the usual name is the registered corporate name. Thus, a company will fall within the scope of the BNA if it trades under a name other than its registered name. A partnership will fall under the BNA if the partnership name is not made up of all the surnames (or corporate names where there are corporate partners) of the partners.
281. The amendments in Schedule 11 alter the way that partnerships become subject to the BNA. Limited and general partnerships will now be treated slightly differently from each other under the BNA, due mostly to the fact that limited partnerships have a registered name. The Schedule also clarifies who is the subject of the BNA (see paragraph 6(3) and notes below).
282. A limited partnership becomes registered under a registered name. This may or may not be made up of the surnames and/or corporate names of the partners. All limited partnerships are required under clause 65 to include their registered name on all partnership documents. It is appropriate that a limited partnership only becomes subject to the BNA when it is trading in Great Britain under a name that is not its registered name. This is the effect of paragraphs 1 and 2. See the report, paragraphs 13.23 - 13.24 and 15.72 - 15.75.
283. Paragraph 3 alters the offence provisions of section 2 of the BNA so that where an entity partnership (a general or limited partnership) contravenes section 1 of the Act it is the partners that are guilty of the offence. There is a further modification for limited partnerships where paragraph 3 makes the general partners guilty of the offence and not the limited partners. Partners in a special limited partnership would fall within the new section 2(5) of the BNA. See clause 8 of the draft Bill.
284. Paragraphs 4(1) and (2) alter section 4 of the BNA to take account of the fact that a limited partnership has a registered name: limited partnerships are required to include their registered name on the documents listed in the BNA (section 4(1)(a)) rather than the names of all the partners.
285. Paragraph 4(3) replaces 'principal place of business' with 'registered office' for limited partnerships. See the report, paragraphs 15.30-15.34.
286. Paragraphs 4(4) and 4(5) alter the offence provisions similarly to paragraph 3. See note above.
287. Section 8 of the BNA currently states that "partnership" includes a foreign partnership. Paragraph 6 includes the equivalent provision for a limited partnership.

(3) After subsection (2) insert –

“(3) In the case of a partnership which is a legal person, the person to whom this Act applies is to be taken to be the partnership (and not the partners).”

## **EXPLANATORY NOTES**

288. Paragraph 6(3) is there to clarify that where a partnership has legal personality it is the partnership to which the BNA applies and not the partners. Under section 1 of the BNA, the Act applies to “any person who has a place of business in Great Britain and who carries on business in Great Britain under a name...”. Ambiguity could arise because under clause 6(1) of the Bill it is the partners that carry on the partnership business. While it is the partners that carry on the partnership business, it makes more sense for the BNA to apply to the partnership rather than the partners. For example, if the written approval under section 2 of the Act were granted to the partners and not to the partnership, each new partner joining the partnership would need to apply for the relevant written approval individually.

# **APPENDIX B**

## **PARTNERSHIP ACT 1890**

### **PARTNERSHIP ACT 1890**

(53 & 54 VICT C. 39)

#### ARRANGEMENT OF SECTIONS

##### *Nature of Partnership*

1. Definition of partnership
2. Rules for determining existence of partnership
3. Postponement of rights of person lending or selling in consideration of share of profits in case of insolvency
4. Meaning of firm

##### *Relations of Partners to persons dealing with them*

5. Power of partner to bind the firm
6. Partners bound by acts on behalf of firm
7. Partner using credit of firm for private purposes
8. Effect of notice that firm will not be bound by acts of partner
9. Liability of partners
10. Liability of the firm for wrongs
11. Misapplication of money or property received for or in custody of the firm
12. Liability for wrongs joint and several
13. Improper employment of trust-property for partnership purposes
14. Persons liable by "holding out"
15. Admissions and representations of partners
16. Notice to acting partner to be notice to the firm
17. Liabilities of incoming and outgoing partners
18. Revocation of continuing guaranty by change in firm

##### *Relations of Partners to one another*

19. Variation by consent of terms of partnership
20. Partnership property
21. Property bought with partnership money
22. Conversion into personal estate of land held as partnership property
23. Procedure against partnership property for a partner's separate judgment debt
24. Rules as to interests and duties of partners subject to special agreement
25. Expulsion of partner
26. Retirement from partnership at will
27. Where partnership for term is continued over, continuance on old terms presumed
28. Duty of partners to render accounts, etc.
29. Accountability of partners for private profits
30. Duty of partner not to compete with firm
31. Rights of assignee of share in partnership

##### *Dissolution of Partnership, and its consequences*

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An Act to declare and amend the Law of Partnership  
[August 14, 1890]

*Nature of Partnership*

**Definition of partnership**

1. — (1) Partnership is the relation which subsists between persons carrying on a business in common with a view of profit.

(2) But the relation between members of any company or association which is —

(a) Registered as a Company under the Companies Act 1862, or any other Act of Parliament for the time being in force and relating to the registration of joint stock companies; or

(b) Formed or incorporated by or in pursuance of any other Act of Parliament or letters patent, or Royal Charter:

[(c) ...]<sup>1</sup>

is not a partnership within the meaning of this Act.

**Rules for determining existence of partnership**

2. In determining whether a partnership does or does not exist, regard shall be had to the following rules:

- (1) Joint tenancy, tenancy in common, joint property, common property, or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof.

<sup>1</sup> Repealed by the Statute Law (Repeals) Act 1998 s 1(1) and Sched 1, Part X.

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

**Postponement of rights of person lending or selling in consideration of share of profits in case of insolvency**

3. In the event of any person to whom money has been advanced by way of loan upon such a contract as is mentioned in the last foregoing section, or of any buyer of a goodwill in consideration of a share of the profits of the business, being adjudged a bankrupt, entering into an arrangement to pay his creditors less than [100p]<sup>2</sup> in the pound, or dying in insolvent circumstances, the lender of the loan shall not be entitled to recover anything in respect of his loan, and the seller of the

<sup>2</sup> Substituted by the Decimal Currency Act 1969, s 10(1).

goodwill shall not be entitled to recover anything in respect of the share of profits contracted for, until the claims of the other creditors of the borrower or buyer for valuable consideration in money or money's worth have been satisfied.

### **Meaning of firm**

4. — (1) Persons who have entered into partnership with one another are for the purposes of this Act called collectively a firm, and the name under which their business is carried on is called the firm-name.

(2) In Scotland a firm is a legal person distinct from the partners of whom it is composed, but an individual partner may be charged on a decree or diligence directed against the firm, and on payment of the debts is entitled to relief *pro rata* from the firm and its other members.

#### *Relations of Partners to persons dealing with them*

### **Power of partner to bind the firm**

5. Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom he is dealing either knows that he has no authority, or does not know or believe him to be a partner.

### **Partners bound by acts on behalf of firm**

6. An act or instrument relating to the business of the firm and done or executed in the firm-name, or in any other manner showing an intention to bind the firm, by any person thereto authorised, whether a partner or not, is binding on the firm and all the partners.

Provided that this section shall not affect any general rule of law relating to the execution of deeds or negotiable instruments.

### **Partner using credit of firm for private purposes**

7. Where one partner pledges the credit of the firm for a purpose apparently not connected with the firm's ordinary course of business, the firm is not bound, unless he is in fact specially authorised by the other partners; but this section does not affect any personal liability incurred by an individual partner.

### **Effect of notice that firm will not be bound by acts of partner**

8. If it has been agreed between the partners that any restriction shall be placed on the power of any one or more of them to bind the firm, no act done in contravention of the agreement is binding on the firm with respect to persons having notice of the agreement.

### **Liability of partners**

9. Every partner in a firm is liable jointly with the other partners, and in Scotland severally also, for all debts and obligations of the firm incurred while he is a partner; and after his death his estate is also severally liable in a due course of

administration for such debts and obligations, so far as they remain unsatisfied, but subject in England or Ireland to the prior payment of his separate debts.

### **Liability of the firm for wrongs**

10. Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm, or with the authority of his co-partners, loss or injury is caused to any person not being a partner in the firm, or any penalty is incurred, the firm is liable therefor to the same extent as the partner so acting or omitting to act.

### **Misapplication of money or property received for or in custody of the firm**

11. In the following cases; namely—

- (a) Where one partner acting within the scope of his apparent authority receives the money or property of a third person and misapplies it; and
- (b) Where a firm in the course of its business receives money or property of a third person, and the money or property so received is misapplied by one or more of the partners while it is in the custody of the firm;

the firm is liable to make good the loss.

### **Liability for wrongs joint and several**

12. Every partner is liable jointly with his co-partners and also severally for everything for which the firm while he is a partner therein becomes liable under either of the two last preceding sections.

### **Improper employment of trust-property for partnership purposes**

13. If a partner, being a trustee, improperly employs trust-property in the business or on the account of the partnership, no other partner is liable for the trust-property to the persons beneficially interested therein:

Provided as follows:—

- (1) This section shall not affect any liability incurred by any partner by reason of his having notice of a breach of trust; and
- (2) Nothing in this section shall prevent trust money from being followed and recovered from the firm if still in its possession or under its control.

### **Persons liable by “holding out”**

14. — (1) Every one who by words spoken or written or by conduct represents himself, or who knowingly suffers himself to be represented, as a partner in a particular firm, is liable as a partner to any one who has on the faith of any such representation given credit to the firm, whether the representation has or has not been made or communicated to the person so giving credit by or with the knowledge of the apparent partner making the representation or suffering it to be made.

(2) Provided that where after a partner's death the partnership business is continued in the old firm-name, the continued use of that name or of the

deceased partner's name as part thereof shall not of itself make his executors or administrators estate or effects liable for any partnership debts contracted after his death.

### **Admissions and representations of partners**

15. An admission or representation made by any partner concerning the partnership affairs, and in the ordinary course of its business, is evidence against the firm.

### **Notice to acting partner to be notice to the firm**

16. Notice to any partner who habitually acts in the partnership business of any matter relating to partnership affairs operates as notice to the firm, except in the case of a fraud on the firm committed by or with the consent of that partner.

### **Liabilities of incoming and outgoing partners**

17. — (1) A person who is admitted as a partner into an existing firm does not thereby become liable to the creditors of the firm for anything done before he became a partner.

(2) A partner who retires from a firm does not thereby cease to be liable for partnership debts or obligations incurred before his retirement.

(3) A retiring partner may be discharged from any existing liabilities, by an agreement to that effect between himself and the members of the firm as newly constituted and the creditors, and this agreement may be either express or inferred as a fact from the course of dealing between the creditors and the firm as newly constituted.

### **Revocation of continuing guaranty by change in firm**

18. A continuing guaranty or cautionary obligation given either to a firm or to a third person in respect of the transactions of a firm is, in the absence of agreement to the contrary, revoked as to future transactions by any change in the constitution of the firm to which, or of the firm in respect of the transactions of which, the guaranty or obligation was given.

#### *Relations of Partners to one another*

### **Variation by consent of terms of partnership**

19. The mutual rights and duties of partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either express or inferred from a course of dealing.

### **Partnership property**

20. — (1) All property and rights and interests in property originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm, or for the purposes and in the course of the partnership business, are called in this Act partnership property, and must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

(2) Provided that the legal estate or interest in any land, or in Scotland the title to and interest in any heritable estate, which belongs to the partnership shall devolve according to the nature and tenure thereof, and the general rules of law thereto applicable, but in trust, so far as necessary, for the persons beneficially interested in the land under this section.

(3) Where co-owners of an estate or interest in any land, or in Scotland of any heritable estate, not being itself partnership property, are partners as to profits made by the use of that land or estate, and purchase other land or estate out of the profits to be used in like manner, the land or estate so purchased belongs to them, in the absence of an agreement to the contrary, not as partners, but as co-owners for the same respective estates and interests as are held by them in the land or estate first mentioned at the date of the purchase.

### **Property bought with partnership money**

21. Unless the contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm.

### **Conversion into personal estate of land held as partnership property**

[22. *Where land or any heritable interest therein has become partnership property, it shall, unless the contrary intention appears, be treated as between the partners (including the representatives of a deceased partner), and also as between the heirs of a deceased partner and his executors or administrators, as personal or moveable and not real or heritable estate.*]<sup>3</sup>

### **Procedure against partnership property for a partner's separate judgment debt**

23. — (1) [...] <sup>4</sup> A writ of execution shall not issue against any partnership property except on a judgment debt against the firm.

(2) The High Court, or a judge thereof, [...], <sup>5</sup> or a county court, may, on the application by summons of any judgment creditor of a partner, make an order charging that partner's interest in the partnership property and profits with payment of the amount of the judgment debt and interest thereon, and may by the same or a subsequent order appoint a receiver of that partner's share of profits (whether already declared or accruing), and of any other money which may be coming to him in respect of the partnership, and direct all accounts and inquiries, and give all other orders and directions which might have been directed or given if the charge had been made in favour of the judgment creditor by the partner, or which the circumstances of the case may require.

(3) The other partner or partners shall be at liberty at any time to redeem the interest charged, or in case of a sale being directed, to purchase the same.

<sup>3</sup> Repealed by the Trusts of Land and Appointment of Trustees Act 1996, s 25(2) and Sched 4 as regards England and Wales. See s 25(4) and (5) for savings. Section 22 is still in force in Scotland.

<sup>4</sup> Repealed by the Statute Law Revision Act 1908, s 1 and Schedule.

<sup>5</sup> Repealed by the Courts Act 1971, s 56(4) and Sched 11, Part II.

[(4) ...]<sup>6</sup>

(5) This section shall not apply to Scotland.

**Rules as to interests and duties of partners subject to special agreement**

24. The interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined, subject to any agreement express or implied between the partners, by the following rules:

- (1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm.
- (2) The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—
  - (a) In the ordinary and proper conduct of the business of the firm; or,
  - (b) In or about anything necessarily done for the preservation of the business or property of the firm.
- (3) A partner making, for the purpose of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of five per cent. per annum from the date of the payment or advance.
- (4) A partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him.
- (5) Every partner may take part in the management of the partnership business.
- (6) No partner shall be entitled to remuneration for acting in the partnership business.
- (7) No person may be introduced as a partner without the consent of all existing partners.
- (8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners.
- (9) The partnership books are to be kept at the place of business of the partnership (or the principal place, if there is more than one), and every partner may, when he thinks fit, have access to and inspect and copy any of them.

**Expulsion of partner**

25. No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.

<sup>6</sup> Repealed by the Statute Law (Repeals) Act 1998, s 1(1) and Sched 1, Part X.

### **Retirement from partnership at will**

26. — (1) Where no fixed term has been agreed upon for the duration of the partnership, any partner may determine the partnership at any time on giving notice of his intention so to do to all the other partners.

(2) Where the partnership has originally been constituted by deed, a notice in writing, signed by the partner giving it, shall be sufficient for this purpose.

### **Where partnership for term is continued over, continuance on old terms presumed**

27. — (1) Where a partnership entered into for a fixed term is continued after the term has expired, and without any express new agreement, the rights and duties of the partners remain the same as they were at the expiration of the term, so far as is consistent with the incidents of a partnership at will.

(2) A continuance of the business by the partners or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is presumed to be a continuance of the partnership.

### **Duty of partners to render accounts, etc**

28. Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.

### **Accountability of partners for private profits**

29. — (1) Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership, or from any use by him of the partnership property name or business connexion.

(2) This section applies also to transactions undertaken after a partnership has been dissolved by the death of a partner, and before the affairs thereof have been completely wound up, either by any surviving partner or by the representatives of the deceased partner.

### **Duty of partner not to compete with firm**

30. If a partner, without the consent of the other partners, carries on any business of the same nature as and competing with that of the firm, he must account for and pay over to the firm all profits made by him in that business.

### **Rights of assignee of share in partnership**

31. — (1) An assignment by any partner of his share in the partnership, either absolute or by way of mortgage or redeemable charge, does not, as against the other partners, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs, or to require any accounts of the partnership transactions, or to inspect the partnership books, but entitles the assignee only to receive the share of profits to which the assigning partner would otherwise be entitled, and the assignee must accept the account of profits agreed to by the partners.

(2) In case of a dissolution of the partnership, whether as respects all the partners or as respects the assigning partner, the assignee is entitled to receive the share of the partnership assets to which the assigning partner is entitled as between himself and the other partners, and, for the purpose of ascertaining that share, to an account as from the date of the dissolution.

*Dissolution of Partnership, and its consequences*

**Dissolution by expiration or notice**

32. Subject to any agreement between the partners, a partnership is dissolved—

- (a) If entered into for a fixed term, by the expiration of that term:
- (b) If entered into for a single adventure or undertaking, by the termination of that adventure or undertaking:
- (c) If entered into for an undefined time, by any partner giving notice to the other or others of his intention to dissolve the partnership.

In the last-mentioned case the partnership is dissolved as from the date mentioned in the notice as the date of dissolution, or, if no date is so mentioned, as from the date of the communication of the notice.

**Dissolution by bankruptcy, death, or charge**

33. — (1) Subject to any agreement between the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.

(2) A partnership may, at the option of the other partners, be dissolved if any partner suffers his share of the partnership property to be charged under this Act for his separate debt.

**Dissolution by illegality of partnership**

34. A partnership is in every case dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership.

**Dissolution by the Court**

35. On application by a partner the Court may decree a dissolution of the partnership in any of the following cases:

- [(a) *When a partner is found lunatic by inquisition, or in Scotland by cognition, or is shown to the satisfaction of the Court to be of permanently unsound mind, in either of which cases the application may be made as well on behalf of that partner by his committee or next friend or person having title to intervene as by any other partner.*]<sup>7</sup>
- (b) When a partner, other than the partner suing, becomes in any other way permanently incapable of performing his part of the partnership contract:

<sup>7</sup> Repealed as regards England and Wales by the Mental Health Act 1959, s 149(2) and Sched 8. It is still in force in Scotland.

- (c) When a partner, other than the partner suing, has been guilty of such conduct as, in the opinion of the Court, regard being had to the nature of the business, is calculated to prejudicially affect the carrying on of the business:
- (d) When a partner, other than the partner suing, wilfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable for the other partner or partners to carry on the business in partnership with him:
- (e) When the business of the partnership can only be carried on at a loss:
- (f) Whenever in any case circumstances have arisen which, in the opinion of the Court, render it just and equitable that the partnership be dissolved.

### **Rights of persons dealing with firm against apparent members of firm**

36. — (1) Where a person deals with a firm after a change in its constitution he is entitled to treat all apparent members of the old firm as still being members of the firm until he has notice of the change.

(2) An advertisement in the London Gazette as to a firm whose principal place of business is in England or Wales, in the Edinburgh Gazette as to a firm whose principal place of business is in Scotland, and in the [Dublin Gazette]<sup>8</sup> as to a firm whose principal place of business is in Ireland, shall be notice as to persons who had not dealings with the firm before the date of the dissolution or change so advertised.

(3) The estate of a partner who dies, or who becomes bankrupt, or of a partner who, not having been known to the person dealing with the firm to be a partner, retires from the firm, is not liable for partnership debts contracted after the date of the death, bankruptcy, or retirement respectively.

### **Right of partners to notify dissolution**

37. On the dissolution of a partnership or retirement of a partner any partner may publicly notify the same, and may require the other partner or partners to concur for that purpose in all necessary or proper acts, if any, which cannot be done without his or their concurrence.

### **Continuing authority of partners for purposes of winding up**

38. After the dissolution of a partnership the authority of each partner to bind the firm, and the other rights and obligations of the partners, continue notwithstanding the dissolution so far as may be necessary to wind up the affairs of the partnership, and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise.

Provided that the firm is in no case bound by the acts of a partner who has become bankrupt; but this proviso does not affect the liability of any person who

<sup>8</sup> This should be construed as 'Belfast Gazette' pursuant to the General Adaptation of Enactments (Northern Ireland) Order 1921, SR & O 1921 No 1804, Art 7(a).

has after the bankruptcy represented himself or knowingly suffered himself to be represented as a partner of the bankrupt.

### **Rights of partners as to application of partnership property**

39. On the dissolution of a partnership every partner is entitled, as against the other partners in the firm, and all persons claiming through them in respect of their interests as partners, to have the property of the partnership applied in payment of the debts and liabilities of the firm, and to have the surplus assets after such payment applied in payment of what may be due to the partners respectively after deducting what may be due from them as partners to the firm; and for that purpose any partner or his representatives may on the termination of the partnership apply to the Court to wind up the business and affairs of the firm.

### **Apportionment of premium where partnership prematurely dissolved**

40. Where one partner has paid a premium to another on entering into a partnership for a fixed term, and the partnership is dissolved before the expiration of that term otherwise than by the death of a partner, the Court may order the repayment of the premium, or of such part thereof as it thinks just, having regard to the terms of the partnership contract and to the length of time during which the partnership has continued; unless

- (a) the dissolution is, in the judgment of the Court, wholly or chiefly due to the misconduct of the partner who paid the premium, or
- (b) the partnership has been dissolved by an agreement containing no provision for a return of any part of the premium.

### **Rights where partnership dissolved for fraud or misrepresentation**

41. Where a partnership contract is rescinded on the ground of the fraud or misrepresentation of one of the parties thereto, the party entitled to rescind is, without prejudice to any other right, entitled—

- (a) to a lien on, or right of retention of, the surplus of the partnership assets, after satisfying the partnership liabilities, for any sum of money paid by him for the purchase of a share in the partnership and for any capital contributed by him, and is
- (b) to stand in the place of the creditors of the firm for any payments made by him in respect of the partnership liabilities, and
- (c) to be indemnified by the person guilty of the fraud or making the representation against all the debts and liabilities of the firm.

### **Right of outgoing partner in certain cases to share profits made after dissolution**

42. — (1) Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of any agreement to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since the dissolution as the Court may find to be attributable to the use of his share of the

partnership assets, or to interest at the rate of five per cent. per annum on the amount of his share of the partnership assets.

(2) Provided that where by the partnership contract an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of the profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.

### **Retiring or deceased partner's share to be a debt**

43. Subject to any agreement between the partners, the amount due from surviving or continuing partners to an outgoing partner or the representatives of a deceased partner in respect of the outgoing or deceased partner's share is a debt accruing at the date of the dissolution or death.

### **Rule for distribution of assets on final settlement of accounts**

44. In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:

- (a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits:
- (b) The assets of the firm including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:
  1. In paying the debts and liabilities of the firm to persons who are not partners therein:
  2. In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital:
  3. In paying to each partner rateably what is due from the firm to him in respect of capital:
  4. The ultimate, residue, if any, shall be divided among the partners in the proportion in which profits are divisible.

### *1 Supplemental*

#### **Definitions of "court" and "business"**

45. In this Act, unless the contrary intention appears,—

The expression "court" includes every court and judge having jurisdiction in the case:

The expression "business" includes every trade, occupation, or profession.

### **Saving for rules of equity and common law**

46. The rules of equity and of common law applicable to partnership shall continue in force except so far as they are inconsistent with the express provisions of this Act.

### **Provision as to bankruptcy in Scotland**

47. — (1) In the application of this Act to Scotland the bankruptcy of a firm or of an individual shall mean sequestration under the Bankruptcy (Scotland) Acts, and also in the case of an individual the issue against him of a decree of *cessio bonorum*.

(2) Nothing in this Act shall alter the rules of the law of Scotland relating to the bankruptcy of a firm or of the individual partners thereof.

48. [...]

49. [...]<sup>9</sup>

### **Short title**

50. This Act may be cited as the Partnership Act 1890.

### SCHEDULE

[...]<sup>10</sup>

<sup>9</sup> Sections 48 and 49 were repealed by the Statute Law Revision Act 1908, s 1 and Schedule.

<sup>10</sup> Repealed by the Statute Law Revision Act 1908, s 1 and Schedule.

# **APPENDIX C**

## **LIMITED PARTNERSHIPS ACT 1907**

### ARRANGEMENT OF SECTIONS

1. Short title
2. ...
3. Interpretation of terms
4. Definition and constitution of limited partnership
5. Registration of limited partnership required
6. Modifications of general law in case of limited partnerships
7. Law as to private partnerships to apply where not excluded by this Act
8. Manner and particulars of registration
9. Registration of changes in partnerships
10. Advertisement in Gazette of statement of general partner becoming a limited partner and of assignment of share of limited partner
11. ...
12. ...
13. Registrar to file statement and issue certificate of registration
14. Register and index to be kept
15. Registrar of joint stock companies to be registrar under Act
16. Inspection of statements registered
17. Power to Board of Trade to make rules

# Limited Partnerships Act 1907

## 1907 CHAPTER 24

An Act to establish Limited Partnerships. [28th August 1907]

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:

### Short title

**1** This Act may be cited for all purposes as the Limited Partnerships Act 1907.

**2** ...

### Interpretation of terms

**3** In the construction of this Act the following words and expressions shall have the meanings respectively assigned to them in this section, unless there be something in the subject or context repugnant to such construction:-

“Firm,” “firm name,” and “business” have the same meanings as in the Partnership Act 1890:

“General partner” shall mean any partner who is not a limited partner as defined by this Act.

### Definition and constitution of limited partnership

**4** - (1) . . . Limited partnerships may be formed in the manner and subject to the conditions by this Act provided.

(2) A limited partnership shall not consist . . . of more than twenty persons, and must consist of one or more persons called general partners, who shall be liable for all debts and obligations of the firm, and one or more persons to be called limited partners, who shall at the time of entering into such partnership contribute thereto a sum or sums as capital or property valued at a stated amount, and who shall not be liable for the debts or obligations of the firm beyond the amount so contributed.

(3) A limited partner shall not during the continuance of the partnership, either directly or indirectly, draw out or receive back any part of his contribution, and if he does so draw out or receive back any such part shall be liable for the debts and obligations of the firm up to the amount so drawn out or received back.

(4) A body corporate may be a limited partner.

### Registration of limited partnership required

**5** Every limited partnership must be registered as such in accordance with the provisions of this Act, or in default thereof it shall be deemed to be a general partnership, and every limited partner shall be deemed to be a general partner.

### **Modifications of general law in case of limited partnerships**

**6** - (1) A limited partner shall not take part in the management of the partnership business, and shall not have power to bind the firm:

Provided that a limited partner may by himself or his agent at any time inspect the books of the firm and examine into the state and prospects of the partnership business, and may advise with the partners thereon.

If a limited partner takes part in the management of the partnership business he shall be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general partner.

(2) A limited partnership shall not be dissolved by the death or bankruptcy of a limited partner, and the lunacy of a limited partner shall not be a ground for dissolution of the partnership by the court unless the lunatic's share cannot be otherwise ascertained and realised.

(3) In the event of the dissolution of a limited partnership its affairs shall be wound up by the general partners unless the court otherwise orders.

(4) . . .

(5) Subject to any agreement expressed or implied between the partners-

- (a) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the general partners;
- (b) A limited partner may, with the consent of the general partners, assign his share in the partnership, and upon such an assignment the assignee shall become a limited partner with all the rights of the assignor;
- (c) The other partners shall not be entitled to dissolve the partnership by reason of any limited partner suffering his share to be charged for his separate debt;
- (d) A person may be introduced as a partner without the consent of the existing limited partners;
- (e) A limited partner shall not be entitled to dissolve the partnership by notice.

### **Law as to private partnerships to apply where not excluded by this Act**

**7** Subject to the provisions of this Act, the Partnership Act 1890, and the rules of equity and of common law applicable to partnerships, except so far as they are inconsistent with the express provisions of the last-mentioned Act, shall apply to limited partnerships.

### **Manner and particulars of registration**

**8** The registration of a limited partnership shall be effected by sending by post or delivering to the registrar at the register office in that part of the United Kingdom in which the principal place of business of the limited partnership is situated or proposed to be situated a statement signed by the partners containing the following particulars:-

- (a) The firm name;
- (b) The general nature of the business;
- (c) The principal place of business;
- (d) The full name of each of the partners;
- (e) The term, if any, for which the partnership is entered into, and the date of its commencement;

- (f) A statement that the partnership is limited, and the description of every limited partner as such;
- (g) The sum contributed by each limited partner, and whether paid in cash or how otherwise.

### **Registration of changes in partnerships**

**9** - (1) If during the continuance of a limited partnership any change is made or occurs in-

- (a) the firm name,
- (b) the general nature of the business,
- (c) the principal place of business,
- (d) the partners or the name of any partner,
- (e) the term of character of the partnership,
- (f) the sum contributed by any limited partner,
- (g) the liability of any partner by reason of his becoming a limited instead of a general partner or a general instead of a limited partner,

a statement, signed by the firm, specifying the nature of the change, shall within seven days be sent by post or delivered to the registrar at the register office in that part of the United Kingdom in which the partnership is registered.

(2) If default is made in compliance with the requirements of this section each of the general partners shall, on conviction under the Magistrates' Courts Act 1952, be liable to a fine not exceeding one pound for each day during which the default continues.

### **Advertisement in Gazette of statement of general partner becoming a limited partner and of assignment of share of limited partner**

**10** - (1) Notice of any arrangement or transaction under which any person will cease to be a general partner in any firm, and will become a limited partner in that firm, or under which the share of a limited partner in a firm will be assigned to any person, shall be forthwith advertised in the Gazette, and until notice of the arrangement or transaction is so advertised the arrangement or transaction shall, for the purposes of this Act, be deemed to be of no effect.

(2) For the purposes of this section, the expression "the Gazette" means-

In the case of a limited partnership registered in England, the London Gazette;  
In the case of a limited partnership registered in Scotland, the Edinburgh Gazette;  
In the case of a limited partnership registered in Ireland, the Belfast Gazette.

**11** . . .

**12** . . .

### **Registrar to file statement and issue certificate of registration**

**13** On receiving any statement made in pursuance of this Act the registrar shall cause the same to be filed, and he shall send by post to the firm from whom such statement shall have been received a certificate of the registration thereof.

### **Register and index to be kept**

**14** At each of the register offices herein-after referred to the registrar shall keep,

in proper books to be provided for the purpose, a register and an index of all the limited partnerships registered as aforesaid, and of all the statements registered in relation to such partnerships.

**Registrar of joint stock companies to be registrar under Act**

**15** The registrar of joint stock companies shall be the registrar of limited partnerships, and the several offices for the registration of joint stock companies in London, Edinburgh, and [ Belfast ] shall be the offices for the registration of limited partnerships carrying on business within those parts of the United Kingdom in which they are respectively situated.

**Inspection of statements registered**

**16** - (1) Any person may inspect the statements filed by the registrar in the register offices aforesaid, and there shall be paid for such inspection such fees as may be appointed by the Board of Trade, not exceeding [5p] for each inspection; and any person may require a certificate of the registration of any limited partnership, or a copy of or extract from any registered statement, to be certified by the registrar, and there shall be paid for such certificate of registration, certified copy, or extract such fees as the Board of Trade may appoint, not exceeding [10p] for the certificate of registration, and not exceeding [2p] for each folio of seventy-two words, or in Scotland for each sheet of two hundred words.

(2) A certificate of registration, or a copy of or extract from any statement registered under this Act, if duly certified to be a true copy under the hand of the registrar or one of the assistant registrars (whom it shall not be necessary to prove to be the registrar or assistant registrar) shall, in all legal proceedings, civil or criminal, and in all cases whatsoever be received in evidence.

**Power to Board of Trade to make rules**

**17** The Board of Trade may make rules (but as to fees with the concurrence of the Treasury) concerning any of the following matters:-

- (a) The fees to be paid to the registrar under this Act, so that they do not exceed in the case of the original registration of a limited partnership the sum of two pounds, and in any other case the sum of [25p];
- (b) The duties or additional duties to be performed by the registrar for the purposes of this Act;
- (c) The performance by assistant registrars and other officers of acts by this Act required to be done by the registrar;
- (d) The forms to be used for the purposes of this Act;
- (e) Generally the conduct and regulation of registration under this Act and any matters incidental thereto.

# **APPENDIX D<sup>1</sup>**

## **EXTRACTS FROM CONSULTATION PAPER ON REFORM OF THE INSOLVENT PARTNERSHIPS ORDER 1994 (ENGLAND AND WALES)**

### **The Background**

- (1) Prior to 1986, insolvent partnerships were generally dealt with under the Bankruptcy Act 1914, although it was possible to wind up a firm with eight or more partners as an unregistered company. That dichotomy is preserved in the present statutory regime.
- (2) Insolvent partnerships are presently dealt with under a hybrid of primary and secondary legislation. Other secondary legislation (such as the Insolvency Regulations 1994) is applied with “necessary modifications” which are not specified.
- (3) The Insolvent Partnerships Order 1994 (“IPO”) offers a number of routes to an insolvent winding up of a partnership, applying the Insolvency Act 1986 (“the Act”) with specific modifications set out in the schedules to that Statutory Instrument. It also introduced aspects of the “rescue culture” to partnerships, creating the possibility of a Partnership Voluntary Arrangement (“PVA”) and Partnership Administration Order (“PAO”).
- (4) The partnership regime follows the corporate insolvency regime, so that at present a proposal for a PVA does not give rise to a moratorium, reducing its efficacy unless coupled with a petition for a PAO. Under the Insolvency Act 2000, a Company Voluntary Arrangement (“CVA”) proposal would trigger a moratorium, and it is anticipated that if/when those sections of the 2000 Act are brought into force, there will also be secondary legislation to apply the like provisions to insolvent partnerships. In many cases, partners are advised to apply for “interlocking” Individual Voluntary Arrangements (“IVA”) (which do give rise to moratoria<sup>2</sup>). This is not practical in the case of larger partnerships.
- (5) The IPO also implemented a recommendation of the Cork Report in 1986 reversing the common law rule that postponed joint estate creditors behind the creditors of the individual separate estates of the partners. Where there are joint petitions against the firm and members, priorities of

<sup>1</sup> See Part III, para 3.56 above.

<sup>2</sup> NB: when the changes in the Insolvency Act 2000 are brought into effect, it will also be possible to have an IVA without a moratorium.

debts and expenses are now contained in modified sections 175 and 328 of the 1986 Act.<sup>3</sup> In general:

- (a) the expenses of the joint estate are met from the joint estate, and the expenses of each separate estate are met from that separate estate, but if there is a shortfall on the joint estate, it is apportioned and met by the separate estates, and vice versa;
  - (b) once the expenses have been met, the joint estate debts are met from the joint estate, in the statutory order of priorities;
  - (c) if there is a shortfall, the liquidator brings that down as a claim against each separate estate, ranking alongside the separate estate creditors;
  - (d) claims of partners against each other are postponed behind the claims of their creditors, except in the case of fraud or a wholly-independent debt.
- (6) Thus, although it remains possible for a creditor to bring proceedings (including insolvency proceedings) against an individual partner for a partnership debt,<sup>4</sup> in practice the IPO regime appears to anticipate that joint estate claims will be processed through the joint estate. Creditors who have to bring their claim through the separate estate of an insolvent partner will be disadvantaged, because the claim from that estate is postponed behind other creditors. This is frequently the position of landlords who have granted a lease to only four partners<sup>5</sup> and failed to take separate covenants from the others.
- (7) The solvency of a partnership is determined by the balance sheet of the joint estate, and does not take into account the ability of individual solvent partners to meet partnership debts.<sup>6</sup>

### **The Principal Criticisms and Proposals for Reform**

- (8) It should be possible to achieve a moratorium by proposing a PVA.
- (9) It should be possible to wind up an insolvent partnership voluntarily. As in the case of a voluntary liquidation of a company, this should be triggered where it is not possible for a statutory declaration of solvency to be made.<sup>7</sup>
- (10) Those entitled to petition for a partnership to be wound up compulsorily should include:

<sup>3</sup> See for example Sched 4 IPO.

<sup>4</sup> Cf *Schooler v Commissioners of Customs & Excise* [1995] 2 BCLC 610 CA.

<sup>5</sup> This is the maximum permitted under s 34(2) of the Law of Property Act 1925.

<sup>6</sup> *Re H S Smith and Sons* The Times Law Reports 6 January 1999.

<sup>7</sup> Cf s 89 of the 1986 Act.

- (a) a creditor;
  - (b) an office-holder of the partnership;
  - (c) an office-holder of an insolvent member;
  - (d) a partner in his capacity as a creditor, or by a “just and equitable petition”.
- (11) The procedure for winding up a partnership compulsorily should be simplified. Every insolvent partnership should be dealt with on a “corporate” model.
- (12) Where a partner is bankrupted and the Court is satisfied that the partnership is unable to pay its debts as they fall due, the Court (on a petition, or of its own motion) should be able to make a winding-up order, following which the liquidation should proceed on a corporate model as above.
- (13) The IPO regime should be simplified to reflect the above.
- (14) It would be preferable if the regime governing insolvent partnerships were the subject of primary legislation.

#### **The Position of Joint Estate Creditors**

- (15) Although the present regime appears to contemplate that joint estate creditors will prove in the joint estate, and the liquidator of the partnership will bring any shortfall down to rank for proof in the separate estates, creditors at present still have the right to prove either against the insolvent partnership estate or at the level of the individual estates of the partners. This increases complexity and cost.
- (16) It would simplify the process if joint estate creditors are required to prove *only* against the joint estate where the partnership itself is being wound up. The liquidator would then prove for any shortfall against the separate estates, ranking for dividend along with the creditors of those estates if the partner in question is insolvent. Partners would still be fully liable for partnership liabilities, but the mechanism for distribution would be clearer. This would accord with the economic realities. However, it would involve a substantive change to the rights of individual creditors, which might be controversial.

# **APPENDIX E**

## **PERSONS AND ORGANISATIONS WHO COMMENTED ON CONSULTATION PAPER NO 159 – PARTNERSHIP LAW**

*Consultation took place in 2000 and closed on 12 January 2001. The description of consultees is the name at the time of submission.*

### **Judges**

Association of District Judges

Lord Justice Gibson

The Right Honourable The Lord Millett

Sir Donald Rattee

### **Barristers and barristers' organisations**

Roderick I'Anson Banks

Chancery Bar Association (CBA)

Law Reform Committee, General Council of the Bar

Terence Mowschenson QC

### **Solicitors and solicitors' organisations**

Association of Women Solicitors

Keith Baker (Croft Baker & Co, Solicitors & Notaries)

Bournemouth & District Incorporated Law Society

City of Westminster Law Society & Holborn Law Society

Richard Coleman (and Simon James)<sup>1</sup> (Clifford Chance)

David C Cooke (Pinsent Curtis)

Devon and Exeter Incorporated Law Society

Peter Farthing (Clyde & Co)

George Ide, Phillips Solicitors

John Avery Jones (Speechly Bircham)

The Law Society

Alan Magnus (D J Freeman)

Newcastle Upon Tyne Law Society (Non-Contentious Sub-Committee)

Nick Openshaw (Openshaws)

Osborne Clarke OWA

<sup>1</sup> Simon James prepared a response of the litigation issues. Otherwise the response was that of Richard Coleman.

David Pollacchi (Lass Salt Garvin)

The Surrey Law Society

Worcestershire Law Society

**Academic Lawyers**

Elsbeth Deards

Professor D DeMott

Professor Dr J M M Maeijer<sup>2</sup>

Professor G K Morse

Professor L S Sealy

Dr Michael Twomey

Peter Walton

Professor P R H Webb

**Accountants and accountants' organisations**

Association of Chartered Certified Accountants (ACCA)

Angela Hennessey

Institute of Chartered Accountants in England & Wales (ICAEW)

**Professional Representative Bodies (other than those already covered)**

Architecture and Surveying Institute

Association of Consulting Actuaries

Chartered Institute of Patent Agents

Construction Industry Council

The General Practitioners' Committee of the British Medical Association (BMA)

Institute of Chartered Secretaries & Administrators (ICSA)

The Royal Institution of Chartered Surveyors

**Organisations for Business and Industry**

Country Land and Business Association

Institute of Directors

Manchester Chamber of Commerce and Industry

Portsmouth & South East Hampshire Chamber of Commerce and Industry

Tenant Farmers Association

**Financial Organisations and Companies**

British Bankers' Association

Finance & Leasing Association

<sup>2</sup> Confidential.

Griffiths & Armour Insurance Brokers  
3i Group plc  
Lloyds TSB  
National Westminster Bank / Royal Bank of Scotland

**Government Departments and Royal Offices**

Companies House  
H M Customs & Excise (Debt Management Team)  
H M Customs & Excise (Taxable Persons Team)  
W J Furber (Farrer & Co), The Solicitor to the Duchy of Cornwall  
Inland Revenue  
The Insolvency Service  
H M Land Registry  
Lord Chancellor's Department

**Others**

Association of Partnership Practitioners (APP)  
Law Reform Advisory Committee for Northern Ireland (NILRAC)  
National Association of Estate Agents

**RESPONDENTS IN SCOTLAND**

Blackadders, Solicitors  
Centre for Research into Law Reform, University of Glasgow  
The City Law Partnership  
The Committee of Scottish Clearing Bankers  
R Craig Connal, QC  
Faculty of Advocates  
David Guild, Advocate  
Professor George L Gretton  
The Institute of Chartered Accountants of Scotland  
The Law Society of Scotland  
J & H Mitchell, Solicitors  
Noble & Company Limited  
The Partnership Law Advisory Group  
Registers of Scotland  
The Royal Faculty of Procurators in Glasgow  
The Royal Incorporation of Architects in Scotland  
The Scottish Chambers of Commerce  
The Sheriffs' Association

# **APPENDIX F**

## **PERSONS AND ORGANISATIONS WHO COMMENTED ON CONSULTATION PAPER NO 161 – LIMITED PARTNERSHIPS ACT 1907**

*Consultation took place in 2001 and closed on 11 January 2002. The description of consultees is the name at the time of submission.*

### **RESPONDENTS IN ENGLAND AND WALES**

#### **Judges**

The Association of District Judges

#### **Barristers and barristers' organisations**

Roderick I'Anson Banks

Chancery Bar Association (CBA)

Commercial Bar Association

David Goldberg QC (Gray's Inn Chambers)

Law Reform Committee, General Council of the Bar

#### **Solicitors and solicitors' organisations**

Berwin Leighton Paisner

Richard Coleman (Clifford Chance)

Roger Cohen (Berwin Leighton Paisner)

Eversheds

Neill C Gibson (Stephenson Harwood)

KLegal Solicitors

The Law Society

Alan M Magnus (D J Freeman)

Nabarro Nathanson

Melville Rodrigues (Rowe & Maw)

#### **Academic Lawyers**

Elsbeth Deards

Professor G K Morse

Dr Michael Twomey

#### **Financial Organisations and Companies**

Chris Brown (Igloo Regeneration)

Richard McBride (Barclays Bank PLC)

**Accountants**

Robert Kaufeler (PricewaterhouseCoopers)

KPMG Tax

**Professional Representative Bodies (other than those already covered)**

Association of Chartered Certified Accountants (ACCA)

Royal Institute of Chartered Surveyors

**Organisations for Business and Industry (Other than Venture Capital)**

British Property Federation

**Venture Capital Industry**

3i Group plc

**Government Departments and Offices**

Companies House

Inland Revenue

Law Reform Advisory Committee for Northern Ireland

**Others**

Association of Partnership Practitioners and British Venture Capital Association  
(joint response)

**RESPONDENTS IN SCOTLAND**

Centre for Research into Law Reform, University of Glasgow

The Committee of Scottish Clearing Bankers

Faculty of Advocates

David Guild, Advocate

Jim Henderson (Companies House)

The Law Society of Scotland

J & H Mitchell, Solicitors

Noble & Company Limited

Donald Rennie, W.S.

Scottish Landowners' Federation

Thorntons WS, Solicitors