

**The Law Commission**

**Consultation Paper No 159**

**The Scottish Law Commission**

**Discussion Paper No 111**

# **PARTNERSHIP LAW**

**A Joint Consultation Paper**

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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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This joint consultation paper, completed on 31 July 2000, is circulated for comment and criticism only. It does not represent the final views of the two Law Commissions.

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## THE LAW COMMISSION

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## PARTNERSHIP

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## ABBREVIATIONS

### Bell

Bell, *Commentaries on the Law of Scotland* (7th ed 1870).

### Clark

Clark, *A Treatise of the Law of Partnership and Joint Stock Companies According to the Law of Scotland*, Volume 1 (1st ed 1866).

### Lindley & Banks

*Lindley & Banks on Partnership* (17th ed 1995).

### Miller

Miller, *The Law of Partnership in Scotland* (2nd ed 1994).

### Morse

G. Morse, *Partnership Law* (3rd ed 1995).

### Stair Memorial Encyclopaedia

*The Laws of Scotland: Stair Memorial Encyclopaedia* (1987- ).

### Underhill

*Underhill's Principles of the Law Partnership* (12th ed 1986).

# **PART I**

## **INTRODUCTION**

### **The terms of reference**

1.1 On 24 November 1997 the Minister of State at the Department of Trade and Industry requested the Law Commission and the Scottish Law Commission to undertake jointly a review of partnership law. The terms of reference were:

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.<sup>1</sup>

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

1.2 There are many different types of partnership, ranging from informal associations between two persons engaged in a short-term profit-making enterprise without any express partnership agreement, through small family partnerships to major professional or business partnerships with many members, an elaborate partnership agreement and a management structure as sophisticated as that of most companies.

1.3 The work carried on by partnerships encompasses the full spectrum of business and industry. Well known as a vehicle for professionals, they are also prominent in the retail trade, and in the construction, manufacturing, agricultural and tourist industries.

1.4 The impact of partnerships on the economy is significant. There are in fact almost as many partnerships in the United Kingdom as there are trading companies.<sup>2</sup> The business carried on by these partnerships is also significant. Their combined turnover is more than that of sole traders, who outnumber partnerships by more than three to one.<sup>3</sup> Nor are they restricted to micro businesses: 852,000 of the 2.77 million persons employed by partnerships are in firms with at least ten employees.<sup>4</sup>

1.5 The vast differences in the size and nature of partnerships illustrate the flexibility of partnership as a business entity and, therefore, its continuing relevance in the marketplace.

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<sup>1</sup> This paper reviews the Partnership Act 1890. We plan to publish a further paper reviewing the Limited Partnerships Act 1907.

<sup>2</sup> At the start of 1998, there were 684,645 partnerships and 738,325 trading companies (private and public): see the DTI, Small and Medium Enterprise (SME) Statistics for the UK 1998 (August 1999), Table 23.

<sup>3</sup> The combined turnover for partnerships in 1997 was £151,213 million (*ex VAT*). The combined turnover for 2,234,915 sole traders was £140,270 million (*ex VAT*). See the Small and Medium Enterprise (SME) Statistics for the UK 1997 (July 1998), Table 23.

<sup>4</sup> See the Small and Medium Enterprise (SME) Statistics for the UK 1998 (August 1999), Table 23. The actual proportion is higher than this as the 190 firms which employed more than 200 people are not included.

1.6 The absence of detailed rules governing the setting up and running of the partnership gives partners the freedom to stipulate the management structure of a firm and the terms upon which they associate in business. The partnership also has the advantage of giving a large degree of privacy in financial matters.

1.7 Alongside these advantages is the disadvantage that in entering into a partnership, the partner is taking on unlimited liability for the debts which the partnership may incur. In addition, some may consider that it is a disadvantage that a partnership, unlike a company, is not able to grant a floating charge.

### **Need for business vehicle other than company**

1.8 It is important that there should be a range of legal vehicles available to meet the needs of businesses at all levels.<sup>5</sup> A company has many advantages, including a clear structure which separates ownership from management, a highly developed legal framework and limited liability for shareholders. However, the existence of the structure requires rules for the protection of shareholders and the existence of limited liability requires rules designed to protect creditors and other third parties. The result is that company law is complex and incorporation as a company involves incurring many obligations which a small firm may see as excessively bureaucratic and burdensome.

1.9 Incorporation of a business as a company gives the benefit of limited liability. But recent empirical research by Andrew Hicks and Judith Freedman suggests that many businesses have been incorporated for reasons other than to obtain limited liability.<sup>6</sup>

1.10 Hicks found that limited liability was a reason for incorporation for 61% of his respondents while Freedman and Godwin's research<sup>7</sup> found the figure to be 66%. In Hicks' study only half of the 61% thought that the objective of limited liability was more than fairly important. When asked about incorporating a new business today, only 40% said limited liability would be relevant.

1.11 This research suggests that there is a significant proportion of companies for whom limited liability is not as critical as one might have thought. In any event limited liability is often only partially achieved. In Freedman and Godwin's research, 54% of respondents said that directors currently provided personal guarantees, principally to banks.<sup>8</sup> This amounts to a major inroad into limited liability as the bank is likely to be the company's major creditor. Where limited liability is not required, or is not practically available, there is scope for owner managed businesses to use a less regulated structure.

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<sup>5</sup> Modern Company Law For a Competitive Economy, The Strategic Framework, A Consultation Document from the Company Law Review Steering Group, February, 1999, DTI/Pub 3955/6k/2/99/NP. URN 99/654 para 1.12.

<sup>6</sup> See Alternative Company Structures for Small Business, Chartered Association of Certified Accountants (ACCA), Research Report 42, by Andrew Hicks, Robert Drury and Jeff Smallcombe, 1995; Judith Freedman, "Small Businesses and the Corporate Form: Burden or Privilege" (1994) MLR 555.

<sup>7</sup> J Freedman and M Godwin, "Incorporating the Micro Business: Perceptions and Misperceptions" published in A Hughes and D Storey, *Finance and the Small Firm* (1st ed 1994) pp 232-281.

<sup>8</sup> Hicks' research was that 54% had borrowings from a bank and of these 63% had given personal guarantees.

1.12 It is clearly important that small businesses should have available to them a business structure which is less formal, less regulated and less cumbersome than the existing form of company. Although there have been suggestions for the introduction of new, simpler forms of companies with limited,<sup>9</sup> or even unlimited, liability for members,<sup>10</sup> so far no such suggestion has borne fruit. Even if a new simpler form of company were to be introduced, it seems likely that there would be a need for ordinary partnerships to continue to be available at the least formal, least regulated end of the scale of business associations.<sup>11</sup>

### **The Limited Liability Partnership**

1.13 The Limited Liability Partnerships Act 2000 creates a new form of business entity with limited liability. The Act is a response to pressure from large professional firms, which are concerned about the unlimited liability of partners for very large legal claims, particularly for professional negligence. In large partnerships one partner may have no opportunity to assist another partner to avoid such claims. Partners may not know each other and one partner may have no knowledge of another partner's specialism. The result which is proposed is an entity giving limited liability to the partners other than the negligent partner. The Limited Liability Partnership ("LLP") will have much of the organisational flexibility of existing partnerships. It will be taxed as a partnership.

1.14 In return for limited liability, the LLP will be required to comply with many of the provisions of Part VII of the Companies Act 1985 concerning the preparation, audit and publication of accounts. This is in sharp contrast to the privacy enjoyed by existing partnerships in relation to their financial affairs. Provisions of the Companies Act in relation, among other things, to the creation and registration of charges, the delivery of annual returns and the investigation of companies and their affairs will be adapted to the LLP. So will provisions of the Insolvency Act 1986 in relation to voluntary arrangements, administration orders and winding up.

1.15 The option of creating an LLP will not be confined to the regulated professions, as was initially proposed, but other businesses may choose to trade through the LLP structure. It is likely that most small and medium sized partnerships will not opt to become LLPs. Many large firms also may choose not to do so in order to preserve privacy in relation to their financial affairs. The creation of the LLP does not affect the need to modernise and reform the general law of partnership.

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<sup>9</sup> See the Report by Professor Gower on *A New Form of Incorporation for Small Firms* (1981) Cmnd 8171. We understand that there was no overwhelming support for this proposal.

<sup>10</sup> See *Alternative Company Structures for Small Business*, Chartered Association of Certified Accountants, Research Report 42, by Andrew Hicks, Robert Drury and Jeff Smallcombe, 1995; and Andrew Hicks, "Corporate Form: Questioning the Unsung Hero" [1997] JBL 306.

<sup>11</sup> See *Modern Company Law For a Competitive Economy, The Strategic Framework*, n 5 above, para 5.2.10: "We recognise that for some small businesses the Companies Act form, however improved, may be unduly burdensome as compared to the partnership approach and an improved partnership form may be particularly beneficial in that context."

## **The need for reform**

1.16 The core rules of partnership law are to be found mainly in the Partnership Act 1890.<sup>12</sup> Although the 1890 Act has been regarded as a reasonably successful example of codification of a branch of the common law, and has operated almost without amendment for over a hundred years, it contains a number of conceptual flaws that we examine later.<sup>13</sup>

1.17 A large number of the rules contained in the 1890 Act can be overridden by agreement between the partners.<sup>14</sup> These rules form a default code. We would emphasise that we do not intend to alter this situation. Our proposals are primarily concerned with a revised set of default rules out of which partners can contract. A workable default code is important: 52% of the partnerships surveyed by the Forum of Private Business in November 1991 did not have a written partnership agreement. 57% of those surveyed on behalf of the Association of Chartered Certified Accountants in 1995 did not have a formal agreement.<sup>15</sup> This means that for a large number of partnerships, usually small businesses, the statutory rules are the sole basis upon which their affairs are regulated. In addition, where firms do have a partnership agreement, it often focuses on regulation of the internal partnership affairs and may not deal with other important matters covered by the 1890 Act.

1.18 While attention has recently been focused on the review of company law,<sup>16</sup> it is no less important that the rules which govern partnerships and which protect third parties who transact with them, are clear and address sufficiently the needs and current practices of today's market.

## **Preliminary consultations**

1.19 In 1994 a feasibility study was carried out for the Department of Trade and Industry by the Law Commission, in consultation with the Scottish Law Commission, to try to ascertain the extent to which reform of company law would be useful to small businesses.<sup>17</sup> In the comments obtained by the Commissions for the purposes of this study the law of partnership was often mentioned. One of the conclusions reached by the Commissions in the light of the comments received was that a reform of partnership law might be of benefit to small businesses. The DTI published the feasibility study as a Consultation Paper.<sup>18</sup> Respondents to it supported the need for reform of the law of partnership. There was support for a review of partnership law right across the business, legal and academic communities.

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<sup>12</sup> See Appendix A.

<sup>13</sup> See the discussion of the existing law in Part 2 and the main criticisms of the existing law and our provisional proposals in Part 3.

<sup>14</sup> There are a number of rules in the 1890 Act which cannot be contracted out of and, where this is the case, it will be made clear throughout the paper.

<sup>15</sup> Alternative Company Structures for Small Business, Association of Chartered Certified Accountants, Research Report 42, by Andrew Hicks, Robert Drury and Jeff Smallcombe, 1995.

<sup>16</sup> The Review of Company Law by the Department of Trade and Industry (begun 1998).

<sup>17</sup> *Company Law Review: The Law Applicable to Private Companies* URN 94/529.

<sup>18</sup> *Company Law Review: The Law Applicable to Private Companies* URN 94/529.

1.20 The two Commissions have carried out further preliminary informal consultations since receiving this reference. The purpose of these preliminary consultations was to try to identify the main areas of current concern to practitioners. We are grateful to all who assisted us.<sup>19</sup>

### **Acknowledgements**

1.21 We have been greatly assisted in the project by our consultant, Mr R. C. I'Anson Banks. As both a leading practitioner in partnership law and the current editor of the most authoritative English textbook, *Lindley & Banks on Partnership*,<sup>20</sup> his advice has been invaluable. However, the views expressed in this Consultation Paper are those of the Commissions alone. We gratefully acknowledge the assistance of Gabriel Moss QC and David Marks of 3/4 South Square on charges and rights in security granted over partnership assets. We also gratefully acknowledge the work of Emile Woolf and Peter Holgate of Kingston Smith in producing Appendix C.

1.22 We also gratefully acknowledge the assistance of Mr W. Holligan, a Scottish solicitor with considerable experience in partnership matters, who prepared a paper for the purposes of the Scottish Law Commission's preliminary consultations. The Scottish Law Commission has also held preliminary meetings with Professor Gretton of Edinburgh University, Mr I. Stubbs of Maclay Murray Spens, and Mr B. Thomson of Noble & Co Limited, to whom we are grateful for their assistance.

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<sup>19</sup> See Appendix D.

<sup>20</sup> *Lindley & Banks* was first published in 1860.

# **PART II**

## **THE ESSENTIAL FEATURES OF PARTNERSHIP LAW**

### **Introduction**

2.1 This Part seeks to explain the basic structure of partnership law and to identify its principal elements.<sup>1</sup> Most of these are explored in greater depth later in this Paper. The Partnership Act 1890 forms the basis of partnership law in the United Kingdom. This was a codifying statute designed to “declare and amend the law of partnership”.<sup>2</sup> The Act provides that the common law rules remain in force except in so far as they are inconsistent with the express provisions of the Act.<sup>3</sup> In setting out the basic features of partnership law in this Part we therefore refer both to sections of the Act and to the surviving common law.

### **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>4</sup>

a contract for the purpose of carrying on a commercial business - that is a business bringing profit in some shape or another between the partners.

A partnership relationship can arise only by mutual consent, which may be express or inferred from parties’ conduct. No new partner can be introduced without the consent of all the partners.<sup>5</sup>

### **Partnership and legal personality**

#### ***English Law***

2.3 English law does not recognise the partnership (or firm) as 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 partners. The firm name is a mere expression, not a legal entity.<sup>6</sup>

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<sup>1</sup> For more detailed discussion of the law of partnership the reader is referred to the following textbooks: *Lindley & Banks on Partnership* (17th ed 1995); Geoffrey Morse, *Partnership law* (4th ed 1998); Prime & Scanlon, *The Law of Partnership* (1st ed 1995); J Bennett Miller *The Law of Partnership in Scotland* (2nd ed 1994); Higgins and Fletcher, *The Law of Partnership in Australia and New Zealand* (7th ed 1996); Mark Blackett-Ord, *Partnership* (1st ed 1997); and Charles D Drake, *Law of Partnership* (3rd ed 1983).

<sup>2</sup> The words used in the long title.

<sup>3</sup> Section 46.

<sup>4</sup> (1877) 5 Ch D 458, 471.

<sup>5</sup> The personal nature of a partnership means that a partner has agreed to associate with his co-partners and no-one else.

<sup>6</sup> *Sadler v Whiteman* [1910] 1 KB 868, 889, *per* Farwell LJ.

2.4 A change in the membership of a firm “destroys the identity of the firm”.<sup>7</sup> The “old” firm is dissolved, and if the surviving members 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.<sup>8</sup> This involves a contractual arrangement between the members of the old firm and the new firm, to continue the old firm’s business. But 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>9</sup>

2.5 This legal analysis can be contrasted with the commercial view of the partnership. Lord Lindley summarised this approach in the following way:

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>10</sup>

2.6 It has been suggested on a number of occasions that it would be appropriate to reform the English law of partnership to reflect more closely this commercial perception by introducing separate legal personality.<sup>11</sup> By contrast the Scots law of partnership conforms substantially to Lord Lindley’s summary of the commercial view.<sup>12</sup>

2.7 These contrasting views can be characterised on a conceptual level as partnership as an “aggregate” - that is, a relationship among the partners - or as an “entity” - that is, a personality existing separately from its partners.<sup>13</sup>

2.8 To date English law has maintained the “aggregate” approach. There are, however, some exceptions to this approach. These are mainly for administrative convenience. For example the firm name is recognised for the purposes of court proceedings.<sup>14</sup> Also the firm name may be recognised for VAT purposes and, where it is, no account is taken of changes in membership of a firm.<sup>15</sup> Apart from such exceptions, the name of the firm is, in English law, no more than convenient shorthand for referring to a group of persons who conduct a business together.

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<sup>7</sup> Lord Lindley quoted in *Lindley & Banks*, para 3-04; and see *De Tastet v Shaw* (1818) 1 B & A 664; 106 ER 244; *Richardson v The Bank of England* (1838) 4 My & Cr 165; 41 ER 65; *Lee v Neuchatel Asphalte Co* (1889) 41 Ch D 1; *Green v Hertzog* [1954] 1 WLR 1309.

<sup>8</sup> Transfer of obligations will normally require the consent of the creditor.

<sup>9</sup> Eichelbaum CJ in *Hadlee v Commissioners of Inland Revenue* [1989] 2 NZLR 447.

<sup>10</sup> Quoted in *Lindley & Banks*, para 3-02.

<sup>11</sup> Mercantile Law Amendment Commission, 2nd Report, 1855, p 18 and *Lindley & Banks*, para 1-09.

<sup>12</sup> See paras 2.9 - 2.10 below.

<sup>13</sup> See particularly the academic debate in the United States of America, eg Gary S Roslin, “The Entity-Aggregate Dispute: Conceptualism and Functionalism in Partnership Law” (1989) 42 *Arkansas Law Review* 395-466.

<sup>14</sup> CPR, Sched 1, RSC, O 81 r 1; CPR, Sched 2, CCR, O 5, r 9(1).

<sup>15</sup> Value Added Tax Act 1994, s 45.

## **Scots law**

2.9 Scots law adopts an entity approach to partnership. In Scotland “a firm is a legal person distinct from the partners of whom it is composed”.<sup>16</sup> The firm is able to own property,<sup>17</sup> hold rights and assume obligations.<sup>18</sup> It can sue and be sued.<sup>19</sup> It can be a partner in another firm.<sup>20</sup> It can have a partner in common with another firm whilst remaining separate from that firm, and can also be its debtor or creditor. A firm can enter into contracts with its partners, who can thus be creditors or debtors of the firm.<sup>21</sup>

2.10 The doctrine of the separate personality of the Scottish partnership has limitations.<sup>22</sup> A Scottish partnership can own moveable property<sup>23</sup> and can hold title to a lease of immovable property.<sup>24</sup> In practice however trustees for the firm usually hold leases.<sup>25</sup> Also, as a result of a peculiarity of Scottish feudal tenure, a firm cannot hold title to feudal property.<sup>26</sup> There is also serious doubt as to whether the legal personality of a Scottish partnership can continue on a change in the composition of the partnership.<sup>27</sup> On one view, in contrast with English law, partners can agree that the partnership will continue on a change of membership and thus the separate 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 view the entity approach is qualified and the contrasts between English law and Scots law are less marked.

2.11 Nevertheless the legal personality of the Scottish partnership has effects on the relationship between the firm and the partners and between the partners themselves. In summarising the basic features of partnership law, below, we draw attention to some of these effects which distinguish the English and Scots laws of partnership.

## **Agency**

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<sup>16</sup> 1890 Act, s 4(2).

<sup>17</sup> *Forsyth v Hare* (1834) 13 S 42.

<sup>18</sup> Bell, *Comm. II*, 507.

<sup>19</sup> Bell, *Comm. II*, 508.

<sup>20</sup> Bell, *Comm. II*, 514.

<sup>21</sup> Clark, Vol. I, 369-370.

<sup>22</sup> Burgess & Morse, *Partnership Law and Practice in England and Scotland* (1980) at p 11, refer to a “lack of follow through on the question of personality of partnerships in Scotland”.

<sup>23</sup> *Forsyth v Hare* (1834) 13 S 42, 47.

<sup>24</sup> *Dennistoun, Macnair and Company v Macfarlane* February 16, 1808 FC, Mor App “Tack” No 15.

<sup>25</sup> See *Moray Estates Development Co v Butler* 1999 SCLR 447; see also para 11.5 below.

<sup>26</sup> Bell, *Comm. II*, 508. This anomalous prohibition will disappear when section 70 of the Abolition of Feudal Tenure etc (Scotland) Act 2000 is brought into force.

<sup>27</sup> See paras 2.34 – 2.35 below.

2.12 In England and Wales a partner cannot be an agent of the firm as an entity because it lacks legal personality.

2.13 The critical concept in the English law of partnership is the concept of mutual agency.<sup>28</sup> Whenever a partner makes a contract, it is on behalf of that partner and the other partners. If they breach the contract, they will be liable for any consequential loss. There is no limit to this liability. This is a facet of the law of agency: a partner is both an agent and a principal and, as a principal, has unlimited liability for the acts of the agent. This extends to any debt or obligation contracted by the agent,<sup>29</sup> any wrongful act done by an agent - that is, a partner - within the limits of his authority,<sup>30</sup> and any misuse of any property which has been received by an agent in the ordinary course of his principal's business.<sup>31</sup>

2.14 In Scots law the partners are agents of the firm, which is the principal.<sup>32</sup> The firm 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>33</sup> This means that a third party must constitute the debt against the firm (usually by obtaining a court decree against the firm) before enforcing his claim against the individual partners' assets. In effect, the partners are guarantors or cautioners for the firm. Because the partners are agents of the firm, we suggest that the concept of mutual agency does not apply in Scots partnership law.<sup>34</sup> The partners are neither the agents nor the principals of one another. Of course, because they have subsidiary liability for the firm's debts and obligations, anything which they do (as the firm's agents) to bind the firm binds the partners indirectly. Partners of a Scottish partnership are jointly and severally liable for the obligations of the firm.<sup>35</sup> As in English law, their liability is unlimited.

2.15 In both jurisdictions therefore partners have a material interest in the dealings of their co-partners in the course of their agency.<sup>36</sup>

2.16 The liability of a partner (in English law as principal and in Scots law as a 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>37</sup> and he is not liable for obligations incurred by his former partners after the agency relationship has ended.<sup>38</sup>

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<sup>28</sup> See 1890 Act, s 5.

<sup>29</sup> 1890 Act, s 9. In English law the liability of the partners is joint.

<sup>30</sup> 1890 Act, s 10. Liability under s 10 now includes (as a matter of statutory construction) accessory liability in equity: see *Dubai Aluminium Co Ltd v Salaam*, *The Times* 21 April 2000. Partners' liability under section 10 is joint and several: see 1890 Act, s 12.

<sup>31</sup> 1890 Act, s 11. Partners' liability is joint and several under this section: see 1890 Act, s 12.

<sup>32</sup> See 1890 Act, s 5.

<sup>33</sup> See *Mair v Wood* 1948 SC 83, 86, *per* Lord President Cooper.

<sup>34</sup> See further paras 9.2 - 9.7 below.

<sup>35</sup> 1890 Act, s 9.

<sup>36</sup> This provides the context for the fiduciary relationship between partners. See paras 2.17 - 2.20 below.

<sup>37</sup> 1890 Act, s 17(1) (in absence of agreement to the contrary).

<sup>38</sup> See paras 10.49 - 10.53 below and 1890 Act, s 36.

## **Fiduciary duties**

2.17 As 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>39</sup>

2.18 It is worth noting briefly some of the aspects of the partners' fiduciary relationship. One partner cannot make a profit at the expense of his co-partners without their full knowledge and consent.<sup>40</sup> A partner should not make a secret profit in the course of a sale to or purchase from his firm and must account for such profit.<sup>41</sup> To avoid this duty to account a partner must make full disclosure of his interest to his fellow partners.

2.19 A partner will be liable to account if he secures (or tries to secure) a personal benefit which should, as a consequence of his duties to his fellow partners, be obtained for the benefit of the firm.<sup>42</sup> This obligation applies equally where the benefits are the result of the use of partnership property.<sup>43</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>44</sup> A partner must not, without his co-partners' consent, carry on any business in competition with the firm, although he may carry on a non-competing business.<sup>45</sup>

2.20 In English law a partner's fiduciary duties are owed to his fellow partners. It would be consistent with principle in Scots law for a partner to owe certain duties to the firm as an entity rather than to his co-partners. The reference in sections 29 and 30 of the 1890 Act to the obligation to account "to the firm" allows this approach in relation to a Scottish partnership.<sup>46</sup> 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 firm.<sup>47</sup>

## **Management and financial rights**

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<sup>39</sup> See *Carmichael v Evans* [1904] 1 Ch 486. Honest in this context means abstaining from fraud. For a discussion of the content of the duty of good faith see para 14.9 *et seq.*

<sup>40</sup> 1890 Act, ss 29 and 30.

<sup>41</sup> *Gordon v Holland* (1913) 108 LT 385.

<sup>42</sup> *Powell and Thomas v Evan Jones & Co* [1905] 1 KB 11.

<sup>43</sup> 1890 Act, s 29.

<sup>44</sup> *Boardman v Phipps* [1967] 2 AC 46.

<sup>45</sup> A partnership agreement may impose an express duty to account for profits from a non-competing business.

<sup>46</sup> 1890 Act, s 4(2).

<sup>47</sup> 1890 Act, s 28.

2.21 Section 24 of the 1890 Act sets out partners' management and financial rights which apply in the absence of contrary agreement.<sup>48</sup> These default rules provide, for example, that partners are entitled to share equally in the capital and profits of the firm,<sup>49</sup> are entitled to take part in the management of the business<sup>50</sup> and can agree ordinary matters connected with the partnership business by a majority<sup>51</sup> so long as all partners are present and able to express a view.<sup>52</sup> To reflect the contractual nature of partnership unanimity is required for the introduction of a new partner.<sup>53</sup>

### **Partnership property**

2.22 In England and Wales the firm does not have separate legal personality and, unlike a company, cannot own property. It is necessary therefore 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>54</sup> It is of fundamental importance in distinguishing between the assets available to meet claims of the creditors of individual partners and the creditors of the firm and in attributing the benefit of any increase in the value of the property.

2.23 The question of what is partnership property is not always straightforward. Property can be used for the purposes of the partnership and yet not be part of the partnership's property: its status depends on the agreement, express or implied, between the partners. In practice the preparation of accounts may well disclose whether an asset is partnership property. If every partner has assented to the inclusion of an asset in the balance sheet, this will normally be sufficient agreement. If there is no express agreement sections 20 and 21 of the 1890 Act set out the factors which will generally be relevant. 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 property.

2.24 In English law a legal estate in land can only be held by a maximum of four partners.<sup>55</sup> For larger firms four partners will hold the legal estate on trust for themselves and their co-partners according to their beneficial interests. An alternative option is for partnerships to vest land either in a company controlled by the partnership and set up for that purpose or in a nominee which holds the land on a bare trust for the partnership. This avoids the need to transfer the estate on the death or retirement of one of the trustees.

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<sup>48</sup> 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." A person cannot agree to a contractual term of which he is unaware. Consequently, a new partner would be bound by an implied variation only if his assent could be inferred either from a further course of dealing or if the existing partners had informed him of the variation.

<sup>49</sup> 1890 Act, s 24(1).

<sup>50</sup> 1890 Act, s 24(5).

<sup>51</sup> 1890 Act, s 24(8).

<sup>52</sup> *Const v Harris* (1824) Turn & R 496, 525; 37 ER 1191, 1202; *Lindley & Banks* para 15-08, Clark, Vol I p 189.

<sup>53</sup> 1890 Act, s 24(7).

<sup>54</sup> 1890 Act, s 20(1).

<sup>55</sup> Trustee Act 1925, s 34(2); Law of Property Act 1925, s 34(2).

2.25 In Scots law, as mentioned above, the partnership can hold moveable property such as vehicles, computers, photocopiers, furniture and intellectual property rights. Although the Scottish firm can also hold title to a lease of heritable property, it is common practice to take title in the name of trustees for the firm.<sup>56</sup> Similarly the prohibition against the firm holding title to feudal property results in partners taking title to heritable property as trustees for the firm.<sup>57</sup> It is also possible to vest land in a company controlled by the firm or in a nominee as in England and Wales.

2.26 Notwithstanding the separate personality of the Scottish firm<sup>58</sup> it is not uncommon for one or more of the partners to own property in trust for the firm. As such a trust is often implied rather than express, similar issues as to the status of the property arise in Scotland as in England and Wales. The agreement of the partners, express or implied, determines the status of the property.<sup>59</sup> Again sections 20 and 21 illustrate factors which are relevant to establishing such agreement.

### **Duration of partnership**

2.27 A partner has no right to retire from a partnership otherwise than by agreement. A partnership falls into one of two categories namely a partnership at will or a partnership for a fixed term. A partnership at will exists where the partnership agreement is silent as to the duration of the partnership.<sup>60</sup> A partner in a partnership at will can, however, dissolve the partnership immediately by notice.<sup>61</sup> Transactions begun but unfinished may then be completed<sup>62</sup> and the partnership's assets distributed.<sup>63</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>64</sup> In English law, where a new partner is admitted to a fixed term partnership, that

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<sup>56</sup> See para 11.5 below.

<sup>57</sup> See n 26 above.

<sup>58</sup> This separate personality prevents partners' having title to sue for damage to partnership property or an insurable interest in partnership property. See *MacLennan v Scottish Gas Board* (unreported) 16 December 1983, First Division; *Arif v Excess Insurance Group Ltd* 1987 SLT 473; *Mitchell v Scottish Eagle Insurance Co* 1997 SLT 793.

<sup>59</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>60</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.

<sup>61</sup> 1890 Act, ss 26 and 32.

<sup>62</sup> 1890 Act, s 38.

<sup>63</sup> 1890 Act, ss 39 and 44.

<sup>64</sup> 1890 Act, s 27(1). It may be difficult to determine which clauses are consistent with a partnership at will. See for example *Lindley & Banks* paras 10-20 - 10-21.

partnership is determined and a new one is created, which may also be a fixed term partnership or may be at will, depending upon the terms of the original agreement.<sup>65</sup> Scots law is unclear as to the effect of a change in membership of the firm on the continuance of its legal personality, where partners have agreed that the firm is not to be dissolved by such a change.<sup>66</sup>

2.30 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>67</sup> This is so even if the partnership was entered into for a fixed term which has not expired.<sup>68</sup>

2.31 All the partners can agree to dissolve the partnership. Parties to a contract can agree to terminate the relationship; and this applies to the relation of partnership as much as to any other contract. The partnership agreement may, of course, vary these requirements, so that unanimity is not needed.

2.32 A temporary cessation of the partnership business may not cause a dissolution.<sup>69</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.

2.33 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>70</sup> Repudiation of the partnership contract, which is accepted by the partner or partners not in breach, may also bring a partnership to an end.<sup>71</sup> The 1890 Act does not regulate withdrawals from a firm, expulsions or the effect of the assumption of a new partner but does provide 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>72</sup>

2.34 In Scots law, in contrast with English law, where any change in the membership of a firm dissolves the old firm, it is arguable that the partners of a firm may agree that the firm is to continue as a legal person on a change of composition. Where a partnership agreement provides that the partnership is not to be dissolved on the death of a partner, the 1890 Act envisages that there will be no dissolution.<sup>73</sup> Many partnership agreements provide for the partnership to continue notwithstanding the death, retirement or expulsion of a partner or the assumption of a new partner. In such circumstances, case law suggests that the

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<sup>65</sup> *Firth v Amslake* (1964) 108 SJ 198.

<sup>66</sup> See paras 2.34 - 2.35 below.

<sup>67</sup> 1890 Act, s 33.

<sup>68</sup> *Crawford 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>69</sup> *Millar v Strathclyde Regional Council* 1988 SLT (Lands Tribunal) 9.

<sup>70</sup> 1890 Act, s 34.

<sup>71</sup> See paras 6.28 - 6.29 below.

<sup>72</sup> 1890 Act, s 35.

<sup>73</sup> 1890 Act, s 33(1).

partnership as a contractual relationship does not come to an end so long as two or more partners remain in business together.<sup>74</sup>

2.35 There are differing views in Scotland on whether the continuing partnership remains the same legal person on a change of its membership. One view is that the legal person is the group of individuals who have entered into partnership and that a differently constituted group is a different person.<sup>75</sup> The other view is that legal personality can continue because the 1890 Act provides that persons who have entered into partnership with one another constitute the firm.<sup>76</sup> This can be construed as meaning that the persons, whether original or assumed partners, who from time to time are in the partnership relationship constitute the firm.<sup>77</sup> The firm is a legal person.<sup>78</sup> The continuation of the contractual relationship on a change in the membership thus preserves in existence the firm as an entity. Again there is case law which supports this latter view<sup>79</sup> but uncertainty remains.

## **Relations with third parties**

### ***Effect of change in membership of firm***

2.36 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>80</sup> But there is no objection to a third person's performance of a contracting party's obligations where the contract is not connected with the skill, character or other personal qualifications or attributes of that party.<sup>81</sup> This does not mean that the original party is released,<sup>82</sup> unless express agreement between all of the parties or their conduct is sufficient to effect a novation. Whether a contract has a nexus with the skill, character or other personal attributes of a party is a question of construction of the true intention of the parties to the contract.

2.37 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. Whether a change in the identity

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<sup>74</sup> *Jardine-Paterson v Fraser* 1974 SLT 93 and *William S Gordon & Co Ltd v Mrs Mary Thomson Partnership* 1985 SLT 122. See also *Knapdale (Nominees) Ltd v Donald* (unreported) 25 May 2000, Lord Kingarth, in which doubts were expressed as to the correctness of the decision in *William S Gordon & Co Ltd*.

<sup>75</sup> *Garden Haig-Scott & Wallace v Prudential Approved Society for Women* 1927 SLT 393, 396, *CIT v Gibbs* [1942] AC 402, 414 & 430, *Jardine-Paterson v Fraser* 1974 SLT 93, 97.

<sup>76</sup> 1890 Act, s 4(1).

<sup>77</sup> This would be consistent with a club or voluntary association in which the contractual relationship between members continues notwithstanding changes in membership.

<sup>78</sup> 1890 Act, s 4(2).

<sup>79</sup> *William S Gordon & Co Ltd v Mrs Mary Thomson Partnership* 1985 SLT 122 (in which the court proceeded on a concession by counsel) and *James & George Collie v Donald* 1999 SCLR 420, 425.

<sup>80</sup> *Humble v Hunter* (1848) 12 QB 310, 317; 116 ER 885, 887; *Don King Productions Inc v Warren and Others* [1999] 3 WLR 276, 301; Gloag, *Contract* (2nd ed 1929) p 416, but cf *Cole v CH Handasyde & Co* 1910 SC 68.

<sup>81</sup> See Halsbury's Laws of England, Vol 9 (4th ed 1974) para 337; *Don King Productions Inc v Warren and Others* [1999] 3 WLR 276, 301; McBryde, *Contract*, para 17-36 et seq.

<sup>82</sup> *Tolhurst v Associated Portland Cement Manufacturers Ltd* [1903] AC 414, 423-424, per Lord Lindley.

of the party determines the contract and whether or not it amounts to a breach of contract also depends on the nature of the change and the proper construction of the contract.<sup>83</sup> In general, it is more likely that dissolution of the firm on a change in its membership terminates a contract where the firm is small, for example a two-man partnership, than where the contract is with a larger firm.<sup>84</sup>

2.38 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 that contract is with the firm as it is then constituted,<sup>85</sup> or is with the firm (viewed as a continuing entity) as it might be constituted from time to time. Where the partnership comes to an end on a change of membership and thus ceases to exist as a separate personality Scots law has developed a rather elusive concept of a contract “with the house”.<sup>86</sup> This allows third parties to contract with the firm and its successors which carry on the same business. The conceptual basis of this device is unclear.<sup>87</sup>

### ***Contracts of suretyship, cautionary obligations and insurance contracts***

2.39 In contracts of suretyship in English law and in cautionary obligations in Scots law any act of the principal debtor or creditor which may prejudice the right of the surety or cautioner discharges him from future liability.<sup>88</sup> A change in the identity of the person for or to which a third party stands as surety or cautioner may alter the third party’s risk and so relieve him from liability, unless he consents to this change. Section 18 of the 1890 Act recognises this:

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.

2.40 Insurance contracts are also examples of personal contracts. In the absence of contrary agreement,<sup>89</sup> an insurance policy cannot normally be assigned without the insurer’s

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<sup>83</sup> *Tasker v Shepherd* (1861) 6 H & N 575; 158 ER 237; *Brace v Calder* [1895] 2 QBD 253; *Sheppard & Cooper Ltd v TSB Bank plc* [1997] 2 BCLC 222, 227.

<sup>84</sup> *Briggs v Oates* [1990] ICR 473, 482.

<sup>85</sup> See, eg, *Jardine-Paterson v Fraser* 1974 SLT 93; *Moray Estates Development Co v Butler* 1999 SCLR 447.

<sup>86</sup> See, eg, *Alexander v Lowson’s Trustees* (1890) 17 R 571.

<sup>87</sup> It may be explained partly by the law on *jus quaesitum tertio* on the basis that the third party agrees to confer rights under the contract on the successors in business of the partnership which is the other contracting party. But this does not suffice to transfer obligations, rather than rights, to the new firm. Another possible explanation is that the third party agrees in advance to a novation of the contract so as to substitute each successor firm as the other party. This would enable each successor firm to opt in to the contract but it does not explain how the new firm could be compelled to adhere to the contract if it did not wish to do so. In any event there may be difficulty in deciding whether a firm is in fact a successor firm. The “house” concept is an unprincipled response to problems caused by the firm’s disappearing legal personality.

<sup>88</sup> See *Chitty on Contracts* (28th ed 1999), paras 44-080 et seq; Gloag, *Contract* (2nd ed 1929) pp 214 - 215, *Stair Memorial Encyclopaedia*, Vol 3, para 964 et seq.

<sup>89</sup> *Chitty on Contracts*, op cit, para 39-053. *Stair Memorial Encyclopaedia*, Vol 12 paras 845 - 846. In practice most insurance policies will deal expressly with the issue of assignment/assignment. The proper

consent and must be accompanied by the assignment or assignation of the matter of the insurance.<sup>90</sup> If the policy is assigned without consent, it appears that it becomes voidable.<sup>91</sup> This restricts the ability of a firm effectively to assign such contracts to the new firm, resulting from a change of membership.

### ***Loans and the rule in Clayton's case***<sup>92</sup>

2.41 Lenders to a firm that has changed its membership may, under the terms of the loan, charge a "rearrangement" fee for the substitution of the "new" firm as "new" borrowers in place of the old. Even if this is done, they may refuse to release the outgoing partner from his contractual liability.

2.42 If a single running account is maintained with the bank, on a change of membership of the firm, the well-known rule in *Clayton's Case*<sup>93</sup> will apply. 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 a liability of the "new" firm alone.<sup>94</sup> If the "new" firm becomes insolvent, the creditor has no recourse against the "old" firm whose indebtedness has been discharged.

2.43 The rule in *Clayton's Case* applies even if the bank is unaware of a change in composition,<sup>95</sup> provided that both firms have been treated on the basis of one running account. In practice the rule in *Clayton's Case* does not present problems for banks. A bank may keep accounts of the "old" and "new" firms separate. To prevent the operation of the rule when a partner leaves the firm, banks will frequently "freeze" the current account, unless:

- (1) on a debit balance, the bank is content to accept the "new" firm's assumption of the indebtedness of the "old", and thereby discharge the outgoing partner; or
- (2) on a credit balance, the outgoing partner confirms that he has no claim to the deposit.

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construction of the contract may be that it continues notwithstanding a change in the firm's composition. See in general *MacGillivray & Parkington on Insurance Law* (8th ed 1988), para 1616.

<sup>90</sup> A marine insurance contract is an exception: see Marine Insurance Act 1906, s 50(1).

<sup>91</sup> *Doe d Pitt v Laming* (1814) 4 Camp 73, 75; 171 ER 24.

<sup>92</sup> In this section the discussion of *Clayton's Case* is relevant not only generally in England and Wales but also in Scotland in circumstances where a change in the membership of a firm terminates the legal personality of the "old" firm and gives rise to a "new" firm.

<sup>93</sup> (1816) 1 Mer 572; 35 ER 781.

<sup>94</sup> If a new partner has joined, he will only be liable if he has expressly or impliedly consented to treating debts before and after his admission as forming one continuous account. See 1890 Act, s 17(1).

<sup>95</sup> See *Lindley & Banks*, para 13-88. The rule is based on the parties' presumed intentions. It can be modified by express or implied agreement: see *Barlow Clowes International v Vaughan* [1992] 4 All ER 22, 28 - 29.

### ***Partner's liability and a third party's access to information***

2.44 A partner's liability<sup>96</sup> 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>97</sup> Nonetheless, third parties are entitled to assume that other partners remain agents until they are notified to the contrary.<sup>98</sup> This means that partners should notify any future clients by advertising their withdrawal from partnership in the London Gazette (if the firm is English or Welsh) or in the Edinburgh Gazette (if the firm is Scottish).<sup>99</sup> An outgoing partner who wishes complete freedom from post-withdrawal partnership debts may require to notify clients who had dealings with the firm before his withdrawal as the Gazette advertisement under section 36 of the 1890 Act is notice only to persons who had no such dealings.

2.45 It is often difficult for a third party to ascertain who was a partner at a particular time. The Business Names Act 1985<sup>100</sup> requires the disclosure of the names of current partners where a 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).<sup>101</sup>

2.46 There is no obligation under the Business Names Act 1985 to record when a person became a partner. There is no requirement to keep a record of "old" partners. Consequently the Business Names Act 1985 does not help a third party establish at a later date who were the partners at the time a liability was incurred.

### **Insolvency**

2.47 English law and Scots law have radically different insolvency regimes for partnerships.<sup>102</sup> In English law the Insolvency Act 1986, as applied by the Insolvent Partnerships Order 1994,<sup>103</sup> tries to assimilate partnerships into the framework that governs corporate insolvency. By contrast in Scotland partnership insolvency is regulated under the Bankruptcy (Scotland) Act 1985, which provides the regime for individual insolvency.

2.48 Under English law, a partnership may be wound up as an unregistered company and be subject to the legislation governing corporate insolvencies. Under this procedure a partner will be regarded as an officer of the firm and also as a contributory. As an officer the partner may be subject to the provisions of the Company Directors (Disqualification) Act 1986.<sup>104</sup> To bring it into line with corporate rescue options a partnership can now be subject

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<sup>96</sup> In England and Wales as a principal and in Scotland through his subsidiary liability for the firm's debts.

<sup>97</sup> See paras 2.13 - 2.16 above.

<sup>98</sup> 1890 Act, s 36.

<sup>99</sup> 1890 Act, s 36(2).

<sup>100</sup> This Act is discussed in more detail in Part 21 below.

<sup>101</sup> These permitted additions include the forenames and initials of the partners and the letter "s" if there is more than one partner sharing the same surname.

<sup>102</sup> This Paper does not consider the reform of the law of insolvency as this is beyond our terms of reference.

<sup>103</sup> SI 1994/2421.

<sup>104</sup> As modified by Schedule 8 to the 1994 Order.

to an administration order<sup>105</sup> and to voluntary arrangements<sup>106</sup> but these procedures do not protect the personal estates of the partners.

2.49 Under Scots law the Bankruptcy (Scotland) Act 1985 provides for the sequestration of the estate of a partnership either by itself or in combination with the sequestration of the estates of any of the partners.<sup>107</sup> The statutory provisions for disqualification of directors and for corporate rescue - administration orders and voluntary arrangements - are not available.

2.50 Discussion of the insolvency regimes for partnerships in each jurisdiction can be found in textbooks.<sup>108</sup>

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<sup>105</sup> 1994 Order, art 6 and Sched 2.

<sup>106</sup> 1994 order, art 4 and Sched 1.

<sup>107</sup> Bankruptcy (Scotland) Act 1985, s 6(1) & (5).

<sup>108</sup> English Law: P Totty and G Moss, *Insolvency*; Scots law: McBryde *Bankruptcy* (2nd ed 1995).

# **PART III**

## **PRINCIPAL PROBLEMS AND PROPOSALS FOR REFORM**

### **Principal problems**

3.1 It is clear from the comments received in the 1994 feasibility study and in response to our preliminary consultations<sup>1</sup> that there are perceived to be three main defects in the existing law, all of them reflected in our terms of reference.

3.2 First, partnerships have no legal personality in English law and an insufficiently clear and continuing legal personality in Scots law.<sup>2</sup> This leads to practical difficulties in relation to the ownership of property, the continuance of rights and obligations and, in English law, the execution of deeds.<sup>3</sup> Some special rules have been developed in an attempt to avoid the difficulties caused by the failure of the law to recognise, or sufficiently recognise, the partnership as a continuing legal person. Not all are satisfactory.<sup>4</sup>

3.3 Secondly, the existing law often leads unnecessarily to the complete dissolution of partnerships. There are several common situations, such as the death of a partner or the attempted withdrawal of a partner from a partnership of undefined duration, where, in the absence of agreement to the contrary, the result under the existing law is that the partnership is dissolved as regards all the partners.<sup>5</sup> Well drafted partnership agreements will usually avoid this result but it is arguable that the default rule ought to be that, provided that two or more partners remain, the partnership is not dissolved as regards all the partners in such cases. Instead the deceased or outgoing partner could be bought out, leaving the partnership to continue between the remaining partners.<sup>6</sup>

3.4 Thirdly, the rules on winding up the affairs of a dissolved partnership are unsatisfactory, both in theory and in practice. In theory there is the unsatisfactory position, particularly acute in Scotland because of the legal personality of the partnership, that the partnership must be supposed both to continue and not to continue for the purposes of the winding up. In practice there are difficulties caused by the lack of appropriate mechanisms and powers.<sup>7</sup>

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<sup>1</sup> See paras 1.19 - 1.20 above.

<sup>2</sup> The existing law is discussed more fully in Part 2 above.

<sup>3</sup> See Parts 4 (Legal Personality: Options for Reform); 10 (Liability for Partnership Obligations); 11 (Partnership Property) and 19 (Execution of Deeds by Partnerships) of this Paper.

<sup>4</sup> See, in particular, the discussion of “contracts with the house” at para 2.38 above and paras 4.41 - 4.42 below. See also the discussion of the rules on the liability of a partnership for a preceding partnership’s obligations discussed at paras 10.62 - 10.69 below.

<sup>5</sup> See the 1890 Act, ss 32 and 33.

<sup>6</sup> We discuss the rules on, and options for, the duration of partnerships and the rights of outgoing partners in Parts 6 and 7 of this Paper.

<sup>7</sup> We discuss the existing law and possibilities for reform in Part 8 of this Paper.

3.5 In addition to these three main problems there are minor defects, or possible defects, in the 1890 Act.

### **Comparative material**

3.6 We have carried out research on the partnership laws of other countries. A study of various Commonwealth countries<sup>8</sup> has shown that broadly similar frameworks to that of the 1890 Act are in place. A study of European systems has shown that they are too different to be helpful, except for some parallels for a system based on registration.<sup>9</sup> We have found the Revised Uniform Partnership Act (“RUPA”), adopted in the United States by the National Conference of Commissioners on Uniform State Laws in 1994, helpful.<sup>10</sup>

3.7 The 1890 Act has formed the basis of partnership law in many Commonwealth countries. However, our research revealed provisions in some jurisdictions which are significantly different. We highlight two such differences, as they relate to issues we deal with in this Paper, namely continuity and registration. In British Columbia continuity occurs in more circumstances than under the 1890 Act.<sup>11</sup> In Ghana there is a compulsory system of registration which confers the benefits of corporate personality upon partnerships.<sup>12</sup>

3.8 In many European countries<sup>13</sup> it is possible for an ordinary commercial partnership to acquire legal personality by registration. Sweden is one such country. Under the Swedish Act on Partnership and Non-registered Partnerships,<sup>14</sup> there is, as the name of the Act suggests, a distinction between partnerships and non-registered partnerships. Both firms require an agreement (written or oral) between two persons that they will jointly engage in business. If the partnership is registered in the trade register, it becomes a legal entity. If it is not registered, it is treated as a non-registered partnership without legal personality.

3.9 There is a current debate in the Netherlands about the merits of legal personality for partnerships. It was proposed in a 1972 draft of the Civil Code that some partnerships<sup>15</sup> should have legal personality in order to overcome certain difficulties experienced by

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<sup>8</sup> Including Australia, Canada, Ghana and New Zealand.

<sup>9</sup> See para 3.8 below.

<sup>10</sup> See Uniform Laws Annotated. Parts of RUPA are reproduced in this paper with the kind permission of the National Conference of Commissioners on Uniform State Laws.

<sup>11</sup> Partnership Act [RSBC 1996] Chapter 348. For partnerships of more than two partners, subject to agreement between the partners, the death, bankruptcy or dissolution of a partner only dissolves the partnership as between the affected partner and the other partners. Similarly where the share in the partnership property of a partner is charged under the Act, if there are two or more other partners, they may dissolve the partnership as between them and the partner whose share is charged. The court may also dissolve partnerships on specified grounds and if there are three or more partners, it may dissolve it as between the partner whose condition or conduct gave rise to the application to the court and the remaining partners.

<sup>12</sup> Incorporated Private Partnerships Act 1962.

<sup>13</sup> Including France, Belgium, Greece, Norway and Sweden.

<sup>14</sup> 1980:1102.

<sup>15</sup> These are public partnerships. A partnership is a public partnership if its name identifies it as a partnership, it has dealings with third parties and conducts business under a common name, ie the name of the partnership as distinct from the names of the individual partners.

partnerships.<sup>16</sup> The 1972 draft is presently under review and it is possible that a system of registration for partnerships to obtain legal personality will be introduced there.

3.10 RUPA, a model Act, already adopted in 44 States, addresses directly some of the main problems with which we are concerned. We have noted with interest that it introduces a separate legal personality for all partnerships by operation of law (without any need for registration)<sup>17</sup> and it moves away from a system based on the general dissolution of partnerships on, for example, the death or retirement of a partner towards a system whereby a partner can be “dissociated” and bought out while the partnership continues.<sup>18</sup>

### **Proposals for reform**

3.11 The main areas which we consider in this Paper and our most significant proposals are:<sup>19</sup>

(1) *Legal personality.* The law in England and Wales should make it possible for a partnership to have a legal personality which can continue despite changes in its membership. The doubts in Scotland on this point should be resolved to make it clear that this is also possible under Scots law. We present two main options: (1) voluntary continuing legal personality dependent on registration in a new register of partnerships; and (2) compulsory separate legal personality not dependent on registration with optional continuing legal personality. Our provisional preference is for the second option.

(2) *Duration of partnership.* A partnership should not necessarily be dissolved when a partner joins or leaves.<sup>20</sup> There should be a distinction between the dissolution of the partnership as between a partner who leaves, and dissolution as regards all of the partners. We provisionally propose that the right of a partner in a partnership at will to determine the partnership by giving notice should be replaced by a right to withdraw from the partnership. We provisionally propose that the default rules should be altered so that certain situations, for example, death, which would currently terminate the partnership should only dissolve it as regards one partner. We also ask whether the court should be able to dissolve the partnership as regards one partner on certain grounds. We also provisionally propose that there should be a general provision that the whole partnership comes to an end at any such time, or on the occurrence of any act or event, as may be provided for, expressly or impliedly, in the partnership agreement as having this effect. If consultees favour

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<sup>16</sup> The main purpose of the reform is to clarify the law on the separate estate of a partnership and to allow a single partner to bind the partnership as a whole. A public partnership has a separate estate which means that the assets of the partnership are the assets of the partners held jointly, distinct from the estates of the individual partners.

<sup>17</sup> Section 201 provides that “A partnership is an entity distinct from its partners.”

<sup>18</sup> Section 601.

<sup>19</sup> See Appendix B for a table setting out how the sections of the 1890 Act are dealt with in this Paper.

<sup>20</sup> This is consistent with European policy in favour of business continuity in the operations of small or medium sized enterprises. See the European Commission’s Communication of 7 December 1994 on the Commission recommendation on the transfer of small and medium sized enterprises (“SMEs”) 94/C400/01, art 5(a) and the further communication of 28 March 1998 (98/C93/02,A4(a)) re-affirming that the legal principle of continuity should be introduced into all national civil laws “in order to avoid the unwarranted closure of SMEs”.

altering the default rules to limit the circumstances in which a partnership is dissolved but without introducing separate legal personality in English law, the differences between the English law and the Scots law of partnership would become more stark. An English partnership would have no legal personality. By contrast in many cases a Scottish partnership would have continuing legal personality.

(3) *Position of outgoing partner.* An outgoing partner should not have the right to force a winding up unless this is provided for in the partnership agreement. The outgoing partner's share should be transferred to the other partners on his leaving the partnership, and he should become entitled to the value of that share. Instead of having a right to a share of the profits attributable to his share, he should have a right to be paid interest on that share. However, if the remaining partners are unlikely to be able to pay out the outgoing partner's share or indemnify him against the liabilities of the partnership he should have a right to apply to the court to have the partnership wound up.

(4) *Winding up dissolved partnerships.* In relation to partnerships which have legal personality, we provisionally propose that, on dissolution, the dissolved partnership should be deemed to continue for the purposes of winding up its affairs and completing unfinished transactions. We provisionally propose that there should be a new system for winding up the affairs of a solvent dissolved partnership under court supervision, the key feature of this new system being the appointment of an officer with powers and duties modelled on those of the liquidator in a members' voluntary winding up of a company.

(5) *Partnership and agency.* It should be made clear that where a partnership does not have legal personality, the partners are agents of each other. Where the partnership does have legal personality, the partners are agents of the partnership.

(6) *Liability for partnership obligations.* The liability of partners for the debts and obligations of the partnership should be joint and several in both England and Wales and Scotland. Where the partnership has legal personality, it should be made clear that the partnership has the primary liability, with the partners' liability being subsidiary.

(7) *Partnership property.* It should be made clear that a partnership with legal personality can own property of any kind in its own name and that property can be held in trust for it.

(8) *Partners' duties.* We consider that there should continue to be a duty of good faith in partnership relations and that it should be set out in the Act. We also ask whether consultees agree with our view 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 in that line of business have or purport to have.

(9) *Litigation* It should be made clear that a partnership with separate legal personality can sue and be sued in its own name, and that the partners can be sued in the same proceedings as the partnership. Any partner or former partner sued should

have an 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.

(10) *Registered partnership.* We set out proposals for a system of registration as an option for conferring continuing legal personality on partnerships. The creation of a registered partnership would bring partnership law in the United Kingdom closer to those legal systems in the European Union which confer legal personality on partnerships by registration.

(11) *Partnership information.* We ask whether the categories of information to be disclosed under the Business Names Act 1985 should be extended to include the names and addresses of former partners and the name and address of any partnership whose business the partnership had taken over. We also ask whether third parties should be given rights to obtain information on demand from the partnership about former partners and predecessor partnerships.

## **Taxation**

3.12 We have approached the Inland Revenue to obtain their views on whether the proposed partnership with separate and continuing personality would be taxed as a partnership. Understandably, the Inland Revenue wishes to refrain from expressing a view before seeing the detail of the recommendations which will follow from consultation. We consider that it will be appropriate to tax a partnership with separate and continuing personality as a partnership. Scottish firms, which have separate personality, are taxed as partnerships. The Inland Revenue proposes to tax LLPs as partnerships and not as companies.<sup>21</sup> LLPs have more of the attributes of a registered limited liability company than the partnerships with separate and continuing personality which we propose. We think it likely that for the purposes of income tax and capital gains tax respectively members of a partnership will be treated as carrying on business in partnership and holding and dealing in assets as partners.

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<sup>21</sup> Limited Liability Partnerships Act 2000, ss 10 and 11.

# **PART IV**

## **LEGAL PERSONALITY: OPTIONS FOR REFORM**

### **Introduction**

4.1 In this Part we consider options for reform of the law on the legal personality of partnerships. In so doing we straddle the first two topics mentioned specifically in our terms of reference – independent legal personality and continuity of business notwithstanding changes in ownership. One way of avoiding discontinuity caused by changes in ownership is to ensure that ownership does not change unnecessarily. The most obvious way of doing that is to enable the firm to have a legal personality capable of continuing notwithstanding changes in membership. Before considering options for reform, however, we consider the question of continuity in more detail.

### **Aspects of continuity**

4.2 There are several different aspects of continuity in relation to partnerships. In this Part we are concerned principally with continuity of legal personality. In order to distinguish that aspect of continuity from other aspects, we set out the different aspects below.<sup>1</sup>

#### ***Continuity of business***

4.3 A business may continue, apparently unchanged so far as customers are concerned, although a partnership comes to an end. It may be taken over by a new partnership, or by a sole trader, or by a company. Conversely, a business may come to an end, although the partnership which carried it on continues. A partnership carrying on a car repairing business may, for example, start to deal in cars as a sideline. Finding the dealing more profitable than the repairing, it may abandon the repairing business and move to new premises. The original business is ended but the partnership continues legally unchanged.

#### ***Continuity of partnership contract***

4.4 The duration of a contract is largely a matter for the contracting parties. In the case of a partnership contract the parties may provide for it to continue as between two or more surviving or remaining partners even if one of the original partners dies or retires. The surviving or remaining partners will then be bound by the contract. One of them cannot claim to be free from it merely because another partner has died or retired.<sup>2</sup> Although this seems clear, we have been made aware of a view that a multilateral contract necessarily

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<sup>1</sup> Paras 4.3 - 4.8 below.

<sup>2</sup> *Cf Hill v Wylie* (1865) 3 M 541. In this case a partnership agreement between two partners provided that on the death of one the partnership was to continue between the survivor and the representative of the deceased partner. It was held that the survivor was bound by this agreement and was not entitled to a declarator that the contract was terminated by the death. The position would be even clearer in the more usual case where the agreement is, according to its terms, to continue between two or more survivors – see *Hannan v Henderson* (1879) 7 R 380. No one survivor could withdraw on the ground that the agreement was at an end.

becomes a different contract when the parties to it change. We suggest later that any doubt on this point should be resolved.<sup>3</sup>

4.5 As long as there is some sort of continuing agreement that the partnership will continue, the partnership contract can be substantially amended without that bringing the partnership relation to an end.<sup>4</sup> Suppose that the partners decide that their agreement has already been so heavily amended that, instead of amending it yet again, it would be better to draw up a new, clean agreement. If they provided that the new agreement was to come into operation immediately on the cessation of the old, and that the partnership relation was to continue without break, it seems that they could bring about the result that the partnership relation continued although the original partnership contract came to an end. So long as there was an agreement that the partnership relationship was to continue without a break, there could even be a gap between express contracts setting out the terms of the relationship. During the gap the default rules of the 1890 Act would apply, but the partnership as a relation could continue. The question here is largely semantic. For the partnership relation to continue, there must be a continuing agreement to be in partnership; but the terms of the contract may change from time to time. They might change so radically that, in ordinary language, it might be said that there is a new contract.

### ***Continuity of partnership relation***

4.6 It is implicit in the 1890 Act that the partnership relation between one partner and two or more other partners can come to an end without the partnership relation between those others necessarily coming to an end.<sup>5</sup> Whether it does come to an end between the others will depend on the terms of the partnership contract. Although we think that this too seems clear, there are doubts on the point. We make proposals later for resolving them.<sup>6</sup>

### ***Continuity of partnership as a voluntary association***

4.7 The partnership as a voluntary association will come to an end when the partnership relation comes to an end between all the partners but will not come to an end so long as it continues between two or more.<sup>7</sup> This seems obvious but again there may, in relation to partnerships, be doubts caused by a confusion between the partnership as a voluntary

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<sup>3</sup> See para 4.28 below.

<sup>4</sup> Section 19 of the 1890 Act provides that “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”.

<sup>5</sup> See, eg, s 25 (recognising possibility of expulsion of a partner); s 31(2) (recognising that a partnership can be dissolved “whether as respects all the partners or as respects the assigning partner”); s 33(1) (recognising that a partnership can be dissolved “as regards all the partners” or, impliedly, not as regards all the partners); s 37 (referring to “dissolution of a partnership or retirement”); ss 42 and 43 (referring to “outgoing” partner and “surviving or continuing partners”). See also *Abbott v Abbott* [1936] 3 All E R 823 (retirement); *Jardine-Paterson v Fraser* 1974 SLT 93 (death); *William S Gordon & Co Ltd v Mrs Mary Thomson Partnership* 1985 SLT 122 (death); *Walters v Bingham* [1988] 1 FTLR 260 (expulsion).

<sup>6</sup> See para 5.26 below.

<sup>7</sup> We discuss later whether partnership should continue to be defined as a relation, or whether it should be defined as a voluntary association: see paras 5.12 - 5.17 below.

association and the partnership as an entity capable of holding rights. We propose later that any doubts on this point should be resolved.<sup>8</sup>

### ***Continuity of partnership as a legal person***

4.8 In this part of the paper we are not concerned with continuity of the business, nor with continuity of the partnership contract, nor with continuity of the partnership relation, nor with continuity of the partnership as a voluntary association.<sup>9</sup> We are concerned only with the continuity of the holder of rights and owner of property - that is with the continuity of the partnership as a legal person. That requires us to consider whether legal personality, and more specifically continuing legal personality, should be introduced in English law and whether the doubt in the existing Scots law should be resolved by its being made clear that the legal personality of partnerships is capable of continuing after changes in membership.

### **No case for a non-continuing legal personality**

4.9 There is no justification for introducing in England and Wales a partnership personality which changes on a change in composition of the partnership. Nor do we believe that there is a respectable argument for resolving on that basis the doubts about the existing Scots law. We have set out above some of the disadvantages of such a solution. It would not foster continuity in business relations. It would be worse in some respects than having no legal personality for partnerships at all, because technical discontinuities would be even sharper than they are under English law at present. Instead of one group of persons being succeeded, in many cases, by another group with an overlapping composition there would be the complete disappearance of one legal person and its replacement by another.

4.10 We therefore proceed in this part on the assumption that the first question for consideration is whether a continuing legal personality for partnerships should be introduced as a possibility in English law and confirmed in Scots law. The second question is how that could best be done.

### **The case for enabling English partnerships to have a continuing legal personality**

4.11 We have seen in Part 2 that the lack of a continuing personality for partnerships, one which is unaffected by changes in the membership, gives rise to difficulties where there is a change in the composition of the partnership. There are three particular problems:

(1) Difficulties arise for partners holding property, particularly land. Title often needs to be transferred from the old group of partners to the new or from an outgoing partner to remaining partners.<sup>10</sup>

(2) Where property is transferred, third parties who had claims against the old group of partners may have no claim against the assets of the new group.

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<sup>8</sup> See para 6.4 below.

<sup>9</sup> We deal with the duration of the partnership in Part 6 and discuss the partnership as a voluntary association in paras 5.12 - 5.17.

<sup>10</sup> As noted in para 2.24 above, to avoid these difficulties, a partnership can set up a company to hold land.

(3) Difficulties may arise in transferring contractual rights and obligations from the old group to the new group, particularly where the contracts cannot be freely assigned or where the partners are unaware of the need to take any steps.

4.12 The introduction of a continuing legal personality unaffected by changes in membership could reduce the incidence of these problems:

(1) The entity could hold property, so that title would not need to be transferred on every change in membership.

(2) A creditor could execute against the entity's assets, as well as against those of the partners, who are jointly and severally liable.<sup>11</sup> From the creditor's point of view there would be no artificial discontinuity in the person of the debtor.

(3) The entity could enter into contracts and would continue to be a party notwithstanding changes in its composition.

4.13 The introduction of a continuing entity would promote continuity of business. The entity would conduct the business, and would not have to be wound up merely because its membership changed. Of course, it is already possible for partners to provide contractually for the partnership to continue despite the death or retirement of a partner, and for the business to be continued by the surviving or remaining partners, but this does not solve the problem that, legally, the business may be continued by a succession of differently constituted groups of people (in England and Wales) or by a succession of different legal persons (on one view of the existing law in Scotland), with the problems that we have identified. Unnecessary legal difficulties, following the death or retirement of a partner, may on occasion cause the winding up of businesses that might otherwise have continued.

### **The case for making it clear that Scottish partnerships can have continuing legal personality**

4.14 On the basis of preliminary consultations, the Scottish Law Commission believes that a proposal to remove legal personality from partnerships would face strong resistance in Scotland. This would be seen as a step backwards, necessitating various special remedial devices. However, it is clearly unsatisfactory that there should be doubt on the fundamental question of whether the legal personality of the firm can continue after a change in membership.<sup>12</sup> The minimum reform required for Scotland is a clarification of the law on this point.

4.15 We consider that clarification should be in the direction of making it clear that a Scottish partnership, and its legal personality, is capable of continuing notwithstanding changes in its composition. Whether the partnership should continue after the death, retirement or expulsion of a partner only if the partners have opted for continuity, or as the

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<sup>11</sup> In practice, a claim against the partnership entity might not amount to much (or at the very least could be made to amount to little). If there is a continuing firm, there would be nothing to stop a partnership doing an asset 'strip' (ie, the partners can withdraw all the assets of the entity). The unlimited liability of the individual partners remains the most important protection for the creditor.

<sup>12</sup> See paras 2.34 – 2.35 above.

default rule unless the partners have opted out of continuity, is a matter which we consider later.<sup>13</sup> We also consider whether continuity should be conferred by a system of partnership registration.<sup>14</sup>

4.16 The important point is that we see no reason why the law should not give full effect to a partnership contract which provides, expressly or by not disapplying a default rule, that the partnership should continue notwithstanding a change of membership. The contract which creates the partnership can create a continuing relationship where on the death or retirement of one partner, leaving two or more remaining, the remaining partners remain bound by the contract, and where on the assumption of a new partner the existing partners remain bound by, and the new partner adheres to, the contract. We see no logic in separating the idea of a continuing undissolved partnership, which sections 32 and 33 of the 1890 Act already envisage, from the idea of a continuing firm with a continuing legal personality. If the partnership as a relation and voluntary association continues, then so should the firm consisting of the partners who are bound for the time being by the relation and who are members for the time being of the voluntary association. If the firm continues, so should its legal personality. There is no necessary contradiction between a relationship between persons and the survival of that relationship on a change of some of those persons. We are not persuaded that the existing definition of partnership in section 1(1) of the 1890 Act excludes the continuity of the personality of the Scottish firm. If it did, it could be amended.

### **Invitation for views**

4.17 We invite views on the following provisional proposals:

**(1) The law of England and Wales should make it possible for a partnership to have a legal personality capable of surviving changes in its composition.**

**(2) The existing doubts as to the law of Scotland on this point should be resolved by making it clear that it is possible for a partnership to have a legal personality capable of surviving changes in its composition.**

### **Method of conferring continuing personality**

4.18 The next question for consideration is the best way to confer continuing personality. There are two main options. We present these as general options, applying to English and Scots law. Later we consider the possibility that different solutions may be required for the two legal systems.<sup>15</sup>

#### ***Option 1: legal personality dependent on registration***

4.19 Under this option, legal personality would depend on registration in a new register of partnerships. The legal personality would continue, notwithstanding changes in the composition of the partnership, so long as the partnership continued or, possibly, so long as

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<sup>13</sup> See Part 6 below.

<sup>14</sup> See para 20.8 *et seq* below.

<sup>15</sup> See paras 4.33 – 4.35 below.

it was registered. We discuss a possible scheme for registered partnerships more fully in Part 20 and readers may wish to consult that Part before forming a conclusion on the options for reform presented here.<sup>16</sup> Under option 1, non-registered partnerships would have no legal personality.

### ***Option 2: legal personality without registration***

4.20 Legal personality could be conferred directly by the Act on all partnerships, as is currently done for Scots law. The personality would go with the partnership. The act constituting the partnership would remain, as at present, a contract; but, once constituted by the initial contract, the partnership as an association would be recognised by the law as an entity distinct from the partners of whom it was composed. The entity would have a legal personality, conferred by the Act, which would not necessarily be terminated on a change in the membership, provided always that the number of partners did not fall below two. So long as the partnership, as an association, was not dissolved, the personality would continue. The circumstances in which the partnership as an association was dissolved would be regulated by the Act.<sup>17</sup> The partnership would, for example, be dissolved on the expiry of a fixed term, by the reduction of the number of partners to less than two, by unanimous agreement of the partners, or by order of the court on one of the statutory grounds. The effect of other events, such as the death or bankruptcy of a partner, the retirement or expulsion of a partner, or the admission of a new partner, would depend on what the partnership agreement provided. It would be for consideration in relation to each event of this type whether it should lead to dissolution unless the agreement provided otherwise, in which case the partners would have to opt in to continuing legal personality, or should lead to dissolution only if the agreement so provided, in which case the partners would have to opt out of continuing legal personality.<sup>18</sup> In summary, all partnerships would have separate legal personality. What would be optional would be continuing legal personality.

### ***Other options***

4.21 There are other options. For example, the legislation on partnerships could contain a set of different models into which partners could opt – including a simple contractual relationship with no recognition at all of the partnership as a collectivity; a partnership as a form of business association with some recognition of its existence as an entity but without legal personality; a partnership with legal personality acquired without registration; a partnership with legal personality acquired only by registration. We invite views on all such possibilities. Our preliminary view, however, is that there would be much to be said for a reasonably simple set of options and that the two main options are those set out above.

### **Assessment of main options**

4.22 Option 1 would give partners the choice of having a partnership with or without legal personality. The choice would be clear cut. Registration would make it clear how the

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<sup>16</sup> A summary of a possible scheme for registered partnerships is contained in para 20.74.

<sup>17</sup> See Part 6 below.

<sup>18</sup> See Part 6 below.

partners had chosen. The option would also have the advantage of providing more information for third parties, such as creditors of partnerships. If the register were kept up to date it would provide a historical record of partnership changes which could be of use to third parties. This would be a significant advantage as one of the disadvantages of existing partnership law is lack of access to information - particularly historical information - about the membership of a partnership.<sup>19</sup> It could be easier to provide for such things as transfers of land by partnerships and creation of floating charges by partnerships. Outgoing partners would have a clear way of publicising the fact that they had left the partnership. A registered partnership would find that its legal personality was more easily recognised abroad.

4.23 On the other hand option 1 would have, for those partnerships which decided to register, the disadvantage of extra bureaucracy and filing requirements and extra costs, which may not be very heavy. As the main advantage of registration would be for third parties, it is not clear that there would be sufficient incentive to register. If few partnerships were registered, little would have been achieved by a complex reform. It would be clear that not all partnerships would register. Those who did not know that they were partners would not register. It is possible that many smaller firms would see no advantage in registration significant enough to outweigh the disadvantages. Option 1 might also sit uneasily with the rules on the definition and duration of partnerships. It might be easier and more logical to provide for a new form of small company, free from the rules on partnerships, than to force partnerships as such into a form of legal personality conferred by registration.

4.24 Another disadvantage of option 1 is that it would be legislatively and administratively complex. It would require the creation of a new set of rules on registered partnerships, which would be in addition to the rules on non-registered partnerships. It would also require the setting up and maintenance of a new register of partnerships. This could not be self-financing to begin with. Whether it could be self-financing later would depend on how popular registration was and on the fees charged for registration.

4.25 A further disadvantage of option 1 is that the position of non-registering English partnerships, of which there would probably be many, would not be improved so far as continuity of the partnership as an entity was concerned. It would necessarily remain the case that each time there was a change in the composition of a partnership there would be a new group - a new firm - with consequential difficulties and dangers relating to the transfer of property, contracts and liabilities. The effect of option 1 for non-registering Scottish partnerships would be even more serious. They would lose the legal personality which they possess under the existing law. It is probable that option 1, in its pure form, would be unacceptable in Scotland and that it would be necessary to keep the legal personality of Scottish partnerships, while making registration simply an optional extra for those partnerships that wanted some formal recognition and any other advantages which might go with registration, such as perhaps the ability to grant a floating charge. This would add a further layer of complication to the legislation.

4.26 Option 2 would have the advantage of legislative and administrative simplicity. There would be no need for a new set of rules on registered partnerships. There would be no need for a new administrative system. There would be one set of default rules for

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<sup>19</sup> See Part 21 below.

English and Scots law. The reform could be implemented by relatively minor changes to the 1890 Act to make its provisions fit the new basic rule that the partnership had a distinct legal personality. Many of these changes would be desirable in any event to cater for the existing separate personality of the Scottish firm even if no other changes at all were made to the 1890 Act.

4.27 Option 2 would also have the advantage of conferring the benefits of greater legal continuity without requiring the partners to comply with any formalities or incur any costs. It would preserve what are seen as two of the greatest advantages of the partnership as opposed to the company as a business vehicle, namely informality and flexibility. Partners could control the effects of changes in composition by including in their partnership agreements the type of provisions that they would want to include in any event and without having to comply with initial, and continuing, registration requirements. They could decide what effect the death, bankruptcy, expulsion or retirement of a partner, or the admission of a new partner, would have on the partnership. If they preferred such events not to dissolve the partnership as regards all the partners they could secure that result, either by providing for it or by not excluding it, depending on whether the law provided for opting into or out of continuity on that event,<sup>20</sup> and the partnership would continue as a legal and business entity. If they preferred such events to dissolve the partnership as regards all the partners they could secure that result equally easily.

4.28 Option 2 would have the disadvantage that it would not, by itself, provide a historical record of partnership information. This could create practical problems both for persons entering into a partnership and for persons transacting with an apparent partnership unless they had access to adequate information as to the circumstances of the partnership. We invite consultees to consider the option for the registered partnership<sup>21</sup> and the possible improvements to the disclosure of information about partnerships<sup>22</sup> before reaching a concluded view on the provisional proposal in paragraph 4.32 below.

4.29 It is unlikely that problems will occur frequently in substantial, well-organised partnerships. In less formal partnerships the partners might be unaware of the legal consequences of their carrying on business with a view to profit. They might not know about continuing legal personality and its consequences. Persons entering into partnership with others might be unaware that they were entering a pre-existing partnership rather than forming a new firm. As a result, they might not know that their capital contributions would be available to meet the pre-existing creditors of that continuing partnership. Persons dealing with a partnership over time might have difficulty in ascertaining whether they are dealing with a continuing partnership or with succeeding or separate partnerships. These problems for the third party may occur whenever the composition of the partnership changes and may be exacerbated where it changes the nature of its business, where it changes the location of its business premises and where it changes its name. Continuing personality would confer less practical benefits if both the partners and third parties were ignorant of its existence.

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<sup>20</sup> See Part 6 below.

<sup>21</sup> See Part 20 below.

<sup>22</sup> See Part 21 below.

4.30 We believe, on the other hand, that the informality of existing partnership law can give rise to no less uncertainty as to the identity and characteristics of a partnership in the absence of continuity of personality. If most partnerships continued as legal entities regardless of changes in membership, persons dealing with partnerships would become aware of continuity of personality as a norm. There might be ways of improving access to partnership information, including a historical record of membership.<sup>23</sup>

### **Invitation for views**

4.31 We invite the views of consultees on the relative significance of the practical advantages and disadvantages of each option when responding to the provisional proposal in the next paragraph.

4.32 We invite views on the following provisional proposal:

**On balance, option 2 is to be preferred; namely that all partnerships would have separate legal personality and that continuing legal personality would be optional. Do consultees agree?**

### **Different solutions for English and Scots law?**

4.33 We have presented these options on a general basis, but it is quite possible that respondents in England and Wales, on the one hand, and in Scotland, on the other, might have different preferences. English respondents might think that option 1 would ensure more certainty and control and would be more in line with the method of conferring legal personality on other entities. They might consider that the disadvantages of the existing law for unregistered partnerships would be more theoretical than real and would be readily tolerated by those partnerships choosing not to register. Scottish respondents might think that it would be a step backwards to remove the existing personality from non-registered Scottish partnerships. They might consider that all that was required was the removal of a doubt in the existing law in the direction of favouring greater continuity and that there was no need to make personality dependent on registration in a new register.

4.34 If there were to be a difference of opinion on these lines, we would see no reason why the differences in this respect between the two laws should not continue. The existing differences on the matter of legal personality have not, so far as we are aware, given rise to any problems. We would also envisage that even if registration were not, in the light of the Scottish consultation, to be necessary for the acquisition of continuing personality by Scottish partnerships, it should, if introduced in England and Wales, be available as an optional step for Scottish partnerships for any incidental advantages it might have.

4.35 It is also possible that respondents in both jurisdictions may favour the introduction of continuing personality without registration and also the option of the registered partnership to obtain the additional benefits which registration may offer. We invite views on this in Part 20.

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<sup>23</sup> See Part 21 below.

## **Supplementary matters**

### ***Attributes of a partnership with continuing personality***

4.36 We envisage that a partnership with legal personality, whether by operation of law or by registration, would be a full legal person with all the attributes that go with legal personality. However, the partners would still have unlimited liability for the partnership's debts. They would be liable jointly and severally<sup>24</sup> but their liability would be subsidiary<sup>25</sup> in that a creditor would have to proceed first against the firm and constitute the debt against the firm. Partners could contract with the firm and would owe fiduciary duties to the firm and to each other.

4.37 We discuss the other rules required for partnerships with a continuing legal personality later in the context of particular aspects of partnership law. We also discuss later and in some detail a possible scheme for a registered partnership.<sup>26</sup> In many areas the same rules would apply whether legal personality were to be conferred by operation of law or by registration. However, registration would open up possibilities for new rules on some matters, such as the liability of partners for partnership debts.

### ***Facilitating the holding of property by English partnerships***

4.38 A partnership with a continuing legal personality would be able to hold property in its own name. There would be no need to transfer the property from one firm to another every time there was a change in the membership of the partnership. These would be significant advantages. However, it might be feared that there would be practical problems, particularly in relation to the ownership of land by unregistered partnerships having legal personality. If a partnership wished to sell land acquired many years earlier when the composition of the firm was different, how, for example, would a purchaser know that the partnership selling the land was the same legal person as the partnership on the records as the owner?

4.39 In relation to registered land in England and Wales, the register currently protects purchasers in the following way. At least two but not more than four of the partners are registered as proprietors and they hold it on trust for all the partners as tenants in common.<sup>27</sup> The interests of the partners are protected by the entry on the register of certain common-form restrictions.<sup>28</sup> Any purchaser is entitled to assume that the registered proprietor has full dispositional powers in the absence of any entry to the contrary on the register.<sup>29</sup> It follows that a purchaser only needs to look at the register. In the absence of any

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<sup>24</sup> See para 10.10 below.

<sup>25</sup> See para 10.20 below.

<sup>26</sup> See Part 20 below.

<sup>27</sup> This is in the absence of the partnership using a nominee company to hold the land.

<sup>28</sup> See Ruoff and Roper, *Registered Conveyancing*, 32-15; 38-15; b-350.

<sup>29</sup> *State Bank of India v Sood* [1997] Ch 276, 284.

restriction<sup>30</sup> he can assume that the proprietors have an unrestricted power to sell or otherwise dispose of the land. Provided that he is buying with vacant possession he need make no further enquiry.<sup>31</sup> However if there is a restriction that states (for example) that the consent of A, B or C is required, no disposition of the land can be made unless such consent is forthcoming. Provided that measures could be adopted to protect the Land Registry from an increase in claims in relation to partnerships, there is no reason why the current law as to the effect of registration should not continue to apply.<sup>32</sup>

4.40 To some extent the problem whether the seller is the same person as the person who appears from the titles or registers to be the owner arises in the case of any sale. The fact that the name is the same is not conclusive. Similarly, in a sale by a company, a purchaser has to be sure that the company selling is the same as the company appearing from the titles or registers to be the owner. In the case of a sale by a trust, not only could there be different trusts with the same or similar names but also there could have been several changes of trustees 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 that 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 readily detectable. The real owner has an interest in preventing such frauds and practical considerations usually make them difficult.

### **Contracts “with the house”**

4.41 As we have seen,<sup>33</sup> the Scottish courts have recognised that a person contracting with a partnership may choose to confer rights not only on the partnership but also on successor partnerships.<sup>34</sup> The contract is then said to be a contract “with the house”.<sup>35</sup> The practical value of this device in ensuring continuity of contractual relations has been recognised,<sup>36</sup> but its conceptual basis is not clear. It is of most obvious use where the contract confers continuing rights, but does not impose any continuing obligations, on the partnership and

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<sup>30</sup> Or caution. A caution entitles the cautioner to be informed of any dealing with the land. He can then take steps to protect any interest in the property which he may have.

<sup>31</sup> If he is not buying with vacant possession, he will take the property subject to the proprietary rights of any person in actual occupation of the land, whether or not that person has protected those rights on the register: Land Registration Act 1925, s70(1)(g).

<sup>32</sup> We deal in Part 11 with the schemes which could be adopted for dealing with changes in legal personality that may occur in registered or unregistered partnerships. The measures in Part 11 that may protect the Land Registry are as follows:- in relation to registered land either the deed or the certificate of registration of partnership would contain the information to be placed on the land register; in relation to unregistered partnerships there could be a voluntary register of authority to transact in land. In drafting legislation to give effect to our proposals it will be necessary to consider the position of the Land Registry and whether it requires extra protection to guard against fraud or other provisions such as s 60 of the Land Registration Act 1925 dealing with companies and encumbrances. See para 11.22 for a discussion on unregistered partnerships and a voluntary register of authority to transact in land.

<sup>33</sup> Para 2.38 above.

<sup>34</sup> See *Alexander v Lowson's Trustees* (1890) 17 R 571; *Inland Revenue v Graham's Trustees* 1971 SC (HL) 1; *Jardine-Paterson v Fraser* 1974 SLT 93.

<sup>35</sup> This concept appears to have been developed by Bell originally from English case law. See Bell, *Comm.* II, 526. The concept does not appear to have been developed under English law. This is probably because a partnership under English law is not a legal person, rendering the concept unnecessary.

<sup>36</sup> See, eg, Lord Reid in *Inland Revenue v Graham's Trustees* 1971 SC (HL) 1, 20.

its successors – for example, if it is a contract of indemnity. In such cases the device of the contract with the house can be conceptually explained in terms of rights conferred on third parties.

4.42 Any increase in the number of cases where partnerships had continuing legal personality would reduce the need for resort to the idea of contracts with the house and we considered whether the opportunity should be taken to clarify this area of the law. On reflection, however, we consider it better to let it develop or wither, as the case may be, without statutory intervention. There can be no objection to contracting parties conferring rights on third parties, provided they do that in accordance with the general law on third party rights and sufficiently identify the third parties on whom rights are conferred. There can also be no objection to allowing a contracting party to agree in advance to a novation of the contract so as to substitute a new party, provided that the new party is willing to be bound and opts in to the contract. It is more difficult to see how a new partnership could be bound automatically by a contract between two other parties even if it purported to be “with the house”. We suspect that, if properly tested, the “house” concept would be found to be deficient in this respect. However, we propose no statutory reform.

#### ***Contracts with partnership “as presently constituted”***

4.43 Even if all partnerships had continuing legal personality, there would be nothing to prevent any person contracting with a partnership from including a term to the effect that the contract was only with the partnership as constituted at the time of the contract. Any change in the composition of the partnership would then bring the contract to an end in accordance with its terms. At present it seems that the courts will fairly readily imply such a term in cases where the element of personal choice of the actual partners is important. If, for example, the partners in a firm which is the tenant under a lease have been chosen for their personal skill and reliability as farmers it may be fairly readily implied that the contract was with the partnership as constituted at the time.<sup>37</sup> We propose no change here.

#### ***Holding out by new partnership***

4.44 The 1890 Act contains rules protecting persons dealing with a firm after a change in its constitution. Section 36(1) provides that:

Where a person deals with a firm after a change in its constitution he is entitled to treat all apparent partners of the old firm as still being members of the firm until he has notice of the change.

This is framed with reference to English law rather than Scots law. For Scotland it would have been useful to provide that the person could also treat the new firm as still being the old firm until notice of the change had been given. If continuing legal personality were to become the norm it would be useful to generalise such a provision for English law and Scots law. The essential point is that the risk of secret breaks in the legal personality of apparently continuing partnerships should not fall on third parties. Section 36(2) enables notice of a change, which will be effective against persons who did not have dealings with the firm before the change, to be given in the London or Edinburgh Gazettes. We invite views as to

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<sup>37</sup> See *Moray Estates Development Co v Butler* 1999 SCLR 447.

whether, if continuing personality without registration were to be introduced, rules like those in section 36(1) and (2), but relating to the partnership itself rather than individual partners, should be introduced for the protection of third parties.

**If continuing personality without registration were introduced (or, in Scotland, confirmed) should there be rules, on the lines of those in section 36 of the 1890 Act, enabling third parties dealing with a firm to treat the firm as continuing until they had notice of a change?**

4.45 We have considered whether it is necessary to go further and design a provision specifically to protect the title of purchasers acquiring property in good faith and for value from a partnership. Title affects not only the parties to a transaction but also third parties. A rule for the protection of title would bring about a secure legal result. But, as we have stated, the problem whether the seller is the same person as the person who appears from the titles or registers to be the owner arises in any case of sale. We do not propose any special protection for purchasers.

### ***Transitional provisions***

4.46 The introduction of continuing legal personality for partnerships on the basis of registration could, of necessity, apply only to partnerships which registered after the new regime was established. Transitional problems would solve themselves.

4.47 The introduction of continuing personality by operation of law would, in English law, be a clear change from the existing position. In Scotland it would be more a question of resolving a doubt than of introducing a new regime. There appear to be three options for introducing continuing legal personality. The first option is to introduce continuing personality to all partnerships from the commencement of legislation implementing the reform. The second option is to delay the introduction of continuing personality to partnerships until a fixed date some time after the commencement of the legislation, to allow firms which wish to do so to organise their affairs in the light of the proposed reform. Thirdly there is the option of applying the new rules only to partnerships created after the new law came into force. We examine each option in turn.

4.48 The introduction of continuing legal personality to existing firms from the date when the new legislation came into force would, in English law, alter the contracts into which parties have entered. In Scotland also it is likely that many partnerships have ordered their affairs on the basis of advice that a firm could never continue after a change in membership whatever the partnership agreement may provide. If the new rules were combined, as we provisionally propose, with a reform of the entitlement of an outgoing partner,<sup>38</sup> this would amount to a significant change to the rules which govern the relations between partners in a firm which is subject to the default provisions of the 1890 Act. An instantaneous introduction of the new rules could therefore be criticised as being retrospective, involving as it would a rewriting of parties' contracts. It could also affect third parties, such as the owners of land and buildings which are let to a partnership. Parties may have entered into agreements to let property, and in particular agricultural land, on an understanding that a

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<sup>38</sup> See Part 7 below.

change in membership of the partnership, which is the tenant, could be used to bring a lease to an end.

4.49 In Scotland in particular it is an established practice for a landlord of an agricultural holding to control the existence of the tenant by granting a lease to a limited partnership, in which the landlord is the limited partner. The landlord takes power in the partnership deed to dissolve the partnership and thereby to determine the lease. Where the landlord is prepared to take a commercial risk by entering into an ordinary partnership, the landlord can achieve similar results by reserving power to dissolve the partnership.<sup>39</sup> The Scottish courts have upheld the validity of such arrangements.<sup>40</sup>

4.50 In view of the potential to disrupt existing commercial arrangements, both among partners and between the firm and third parties, our provisional view is that the new rules should not be introduced instantaneously.

4.51 The second option, which was adopted by RUPA,<sup>41</sup> is to provide a transition period for the application of the new rules to partnerships. Under RUPA it is provided that the application of the Act is mandatory for all partnerships formed after the effective date of the Act and permissive, by election, for existing partnerships. This provides an opportunity for existing partnerships and partners to consider the changes to be effected by the new rules and to amend their partnership agreements, if appropriate. Thereafter, on the expiry of a specified period following the effective date of the Act the new rules are applied to all partnerships.<sup>42</sup> Where during the transitional period a partnership elects to be governed by the new rules, RUPA provides that certain provisions affecting a partner's liability to third parties are to apply only after the third parties doing business with the partnership have been notified of the election.<sup>43</sup>

4.52 This option has the benefit of avoiding an instantaneous alteration of the rights of contracting parties. It has the advantage that it creates a degree of certainty, as after a fixed date the new rules will apply to all partnerships. On the other hand we are aware that there are concerns that even a delayed implementation of the new rules to all partnerships will prejudice some contracting parties who may not be aware of the need to review their contractual relations or who, if aware, may not be in a position to renegotiate their contracts.<sup>44</sup> This could cause significant problems where agricultural holdings are leased to partnerships.<sup>45</sup>

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<sup>39</sup> See Gill, *The Law of Agricultural Holdings in Scotland* (3rd ed 1997) para 1.13 *et seq.* Most new lettings in Scotland in the last 30 years have been concluded with a limited partnership as the tenant.

<sup>40</sup> *MacFarlane v Falfield Investments Ltd* 1997 SLT 518.

<sup>41</sup> See RUPA, s 1006.

<sup>42</sup> In Florida, for example, the legislation adopting RUPA provided for a two-year transitional period before the new rules applied to all partnerships.

<sup>43</sup> RUPA, s 1006(c).

<sup>44</sup> For example the landlord of an agricultural holding may not be able to terminate a tenancy before the change in the law as a result of initial ignorance of the proposed change in the rules and the existence of a lengthy contractual notice period for terminating the lease. Unless the partnership agreement gave the landlord power to dissolve the partnership, which could be invoked notwithstanding a change in the default rules, the landlord might be burdened by a tenant with continuing legal personality.

<sup>45</sup> See para 4.49 above.

4.53 These problems could be avoided if there were to be a sufficiently long transitional period to allow partners to organise their affairs before the changes to the law are introduced. We consider that a period of two or three years should be sufficient.

4.54 In addition, if consultees consider that it is necessary to protect the interests of landlords and tenants of agricultural holdings in Scotland, it could be provided that a partner of an existing partnership should have the option to elect that the partnership would not have continuity of personality. The partner could make the election during the transitional period and thus avoid having to dissolve the existing partnership. We would welcome the views of consultees, and particularly Scottish consultees with experience in the agricultural sector.

4.55 The third option - to apply the new rules only to partnerships created after the new law came into force - has the advantage that it avoids the risk of injustice by rewriting parties' contracts. It would comply with the normal rule against retrospectivity. On the other hand there may be doubt as to when a partnership was formed or reformed after a change of partner and therefore as to whether it is subject to the new rules, under this option. It is not clear whether such uncertainty would be a widespread problem such as would give rise to practical difficulties.

4.56 We invite views on the following:

- (1) Our provisional view would be to favour a transition period for the application of the new rules to partnerships (option 2) as it creates more certainty in the longer term.**
- (2) The advantages and disadvantages of the first option and the third option.**
- (3) The proposed measure to protect the interests of landlords and tenants of agricultural holdings.**
- (4) If continuing personality without registration were introduced, do consultees agree that the transitional rules should provide for the delayed application of the new rules to all partnerships (as in RUPA)?**
- (5) If consultees favour a delayed application of the new rules, how long should the transitional period be?**
- (6) If consultees favour the option of delayed application of the new rules, should a partner in an existing partnership have the option to elect that the partnership should not have continuity of personality?**

# **PART V**

## **DEFINITION, FORMATION AND SIZE OF A PARTNERSHIP**

### **Introduction**

5.1 In this part of the paper we invite views on possible changes to the definition of partnership in section 1 of the 1890 Act and to the rules in sections 2 and 3 of the Act for determining the existence of a partnership. We also consider the rules restricting the size of certain partnerships.

### **The existing statutory definition**

5.2 Section 1 of the 1890 Act provides that:

- (1) A 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

is not a partnership within the meaning of this Act.

### **Features of the existing definition**

5.3 There is no requirement that a partnership should have a written contract or deed.

5.4 For a partnership to exist, two or more persons must be carrying on a business in common. An employer and an employee do not carry on a business in common. It is the employer who carries on the business. Also, mere co-operation is not carrying on a business in common. If two genuinely separate businesses do no more than co-operate, there is no partnership between them.<sup>1</sup>

5.5 Business is defined in section 45 as including “every trade, occupation, or profession”.

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<sup>1</sup> See *Lindley & Banks*, para 2-04.

5.6 Persons who form a relationship which the law characterises as that of a partnership can do so without being aware that they are partners.<sup>2</sup>

### **Features not requiring reform**

#### ***No need to require writing***

5.7 We would not favour any requirement of writing for a partnership agreement. It is, in our view, important that a partnership should be a form of business association that can be established without formality.

#### ***No need to refer to division of profits***

5.8 There has been some academic debate<sup>3</sup> on whether the division of profit is an essential component of the definition of a partnership.<sup>4</sup> It is not mentioned in the statutory definition.<sup>5</sup> The pre-1890 English case law held it to be part of the definition<sup>6</sup> and the Partnership Act 1890 is compatible with this. The pre-1890 position may therefore have been preserved by section 46 which provides that rules of common law applicable to partnerships shall continue in force unless they are inconsistent with the express provisions of the Act.<sup>7</sup>

5.9 It is not necessary for us to express a view on the arguments. The important question is whether the definition would be better if it did, in the future, include a requirement as to the sharing of profits. Our provisional view is that there is no need to include such a requirement. It is possible to imagine a rare case where one partner might not share in the profits but where it would be reasonable to conclude that a partnership existed. For example, a retired man with an adequate pension might be pleased to enter into partnership with his daughter in order to contribute his skills to the business, feel useful and help her and his grandchildren, without taking any share of the modest profit. We are not convinced that there is any good reason for preventing a partnership from coming into existence in such circumstances, particularly as any requirement for the sharing of profits would be easily avoided by providing for a nominal amount for the altruistic partner. To require that there be a sharing of profits could also, if there were to be any implication that the sharing had to take the form of a sharing in proportions, cause difficulties in relation to those salaried partners who participate in the profits. We do not therefore suggest the addition to the statutory definition of a requirement for the sharing of profits. Instead, we suggest that

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<sup>2</sup> Likewise merely describing yourself as a partnership does not create a partnership: see the comment of Lord President (Clyde) in *Inland Revenue Commissioners v Williamson* (1928) 14 Tax Cas 335, 340: “you do not constitute or create or prove a partnership by saying that there is one”; and see *Saywell v Pope* [1979] STC 824.

<sup>3</sup> See for example *Lindley & Banks*, para 2-06; *Prime & Scanlon*, para 15-16; and *Morse*, p 18.

<sup>4</sup> There is a possible interpretation of s 1 that “in common” qualifies the carrying on of a business with a view of profit, and so a share of profits *must* be contemplated: see *Morse*, *op cit*. It can equally be argued that “in common” merely qualifies the carrying on of the business. This accords more readily with the order of the section, ie a “business carried on in common with a view of profit”.

<sup>5</sup> It did, however, feature in an earlier definition in the Partnership Bill of 1888 (Bill [206], 12 April 1888, HC).

<sup>6</sup> Important pre-1890 cases did consider that a division of profits formed part of the definition, eg *Pooley v Driver* (1877) 5 Ch D 458, 472 and *Mollwo, March & Co v The Court of Wards* (1872) LR 4 PC 419, 437. In Scotland *Bell (Comm. II, 499)* did not treat the division of profits as essential. See also *Aitchison v Aitchison* (1877) 4 R 899, 919. But *Clark (I 46)* treated the right to share profits as the essence of partnership.

<sup>7</sup> We consider section 46 below at paras 23.17 - 23.18.

the statute should contain a clarificatory provision stating expressly that the sharing of profits is not an essential feature of partnership.

### ***No need to re-define “business”***

5.10 It has been suggested to us that the definition of “business” in section 45 of the 1890 Act as including “every trade, occupation, or profession” requires amendment because it is not clear whether it covers investment activities.<sup>8</sup> Section 45 is, however, not an exhaustive list of activities which can constitute a business. It is difficult to conceive of a term wider than “business” to cover all commercial undertakings. The term seems clearly apt to include investment activities as a commercial venture. In these circumstances we do not suggest amending the definition of “business” in section 45.

### ***No need to restrict capacity***

5.11 The current definition of partnership imposes no restriction on the partnership’s capacity to act. We think that partnerships should continue to have unrestricted capacity. For the avoidance of doubt, especially in relation to registered partnerships,<sup>9</sup> we provisionally propose the inclusion of an express statutory provision that a partnership has unlimited capacity to act.

## **Criticisms and possible reforms**

### ***Definition out of touch with ordinary usage***

5.12 In ordinary usage “a partnership” usually refers to a business association or entity.<sup>10</sup> In this sense, a partnership is just an example of a voluntary association or club, distinguished from other such associations by being for the purpose of profit and by not being incorporated under the legislation on companies. Voluntary associations are “group[s] of persons bound together by agreement for a particular purpose.”<sup>11</sup> They include, for example, social clubs, societies and trade unions. Although they are distinguishable from partnerships primarily because they do not have to be formed with a view to making profit, and, in Scotland, because they do not have independent legal personality, they also have many characteristics in common with partnership.<sup>12</sup>

5.13 The contract which creates the association and which, as supplemented by the law, forms the legal link or links between the partners is normally referred to as the partnership agreement or partnership contract. The term “partnership” may be used as an abstract noun to refer to the relationship between partners – as in the phrase “in partnership” - but this is a subsidiary use of the word which hardly merits a statutory definition. The word “partnership” may also be used as an adjective to describe something pertaining to the

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<sup>8</sup> In particular attention is drawn to *Smith v Anderson* (1880) 15 Ch D 247 in which it was held that the forerunner to the unit trust was not a business.

<sup>9</sup> See para 5.26 below.

<sup>10</sup> It does not matter for this purpose whether that entity or group has, or has not, legal personality.

<sup>11</sup> *Stair Memorial Encyclopaedia* Vol 2 “Associations and Clubs” para 801. See also, *Halsbury’s Laws of England*, Vol 6 (4th ed 1993 Reissue) p 64, para 201.

<sup>12</sup> Eg, in the application of agency law, and in the way title to heritable or real property is held.

partnership as an association or entity – as in “the partnership agreement” or “the partnership property” or “the partnership accounts”.

5.14 In defining “partnership” as a “relation”<sup>13</sup> the 1890 Act is out of touch with ordinary usage. It is defining the wrong thing. What the reader wants to know is what “a partnership” is, not what the abstract “partnership” relation is. It is as if an Act on company law began by defining corporateness. Having defined “partnership” in terms of a “relation”, the Act then has to find another word for the partnership as a group or entity. It chooses the word “firm”.<sup>14</sup> However, as we have noted earlier, it is not consistent in this usage and sometimes uses “partnership” where, according to its own scheme, “firm” would be more appropriate.

5.15 The consequences are not merely cosmetic. Defining partnership as a contractual relation leads to such arguments as “A contract cannot have a legal personality. A partnership is a contract. Therefore a partnership cannot have a legal personality.” It also leads to potential confusion. For example, when the 1890 Act talks of the dissolution of a partnership, is it referring to a single “relation”? How many “relations” are there between the members of a partnership? Is there just one, or is there a separate relation between each partner and all the others? Or is there a composite “relation”, made up of a number of separate relations? This is important when considering the effect of the death, retirement or assumption of a partner.

5.16 Language and the use of language have changed since 1890. It is unusual to speak of partnership as a “relation”. Our provisional view is that it would be preferable to define a partnership as a form of voluntary association rather than as a “relation”. This would be more in accordance with ordinary usage and it would help to avoid unnecessary problems and difficulties. We seek consultees’ views below on whether partnership should continue to be defined as a relation, or whether it is now more appropriate to define it as a voluntary association.<sup>15</sup>

5.17 A change in the definition, so as to define the business association rather than the underlying relationship, would probably be desirable for English law even if no partnerships in England and Wales were to have legal personality. It would be much more desirable for those partnerships which have legal personality already under Scots law and for any partnerships which acquire legal personality under a reformed English law.

### ***No reference to agreement***

5.18 The existing statutory definition gives the impression that there could be an involuntary partnership. It does not contain any requirement that the partners should have agreed to carry on the business in common with a view of profit. In fact, however, this requirement for an agreement is probably present anyway, being present in the common laws of both England and Scotland and being so fundamental that it did not need to be

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<sup>13</sup> Section 1(1).

<sup>14</sup> Section 4(1).

<sup>15</sup> Para 5.26 below. We also note that the meaning of ‘partner’ has broadened since 1890. However, our preferred option is to retain the terms ‘partner’ and ‘partnership’.

expressed.<sup>16</sup> It is for consideration whether it should be expressed. As being a member of a partnership has important legal consequences, it is not necessarily desirable to give the impression that there could be a partnership if the parties had not agreed, expressly or impliedly, that the essential ingredients of a partnership should come into existence.<sup>17</sup> It could be useful to make it clear that it is an agreement that constitutes the partnership.

5.19 Our provisional view is that the element of agreement, whether express or implied from the whole facts, should be included in the statutory definition.

### ***Need for business to be carried on***

5.20 It is for consideration whether it should continue to be a requirement that a business is actually carried on. An alternative would be to require the object of the association to be the carrying on of a business with a view to profit.

5.21 The existing requirement has potentially awkward consequences at the beginning and end of a partnership enterprise. There can be no partnership before business is actually carried on. Yet it may be the intention of the partners to be in partnership during the preparatory stages and it may be reasonable to recognise that there is a partnership during such stages. Similarly there can be no partnership after a business ceases to be carried on. Yet it may be reasonable to recognise that a partnership may continue to exist while a business is being wound up. If the partners, by unanimous agreement, wish to cease carrying on the business, wind up the affairs of the partnership and then dissolve it, is there any reason why they should not be allowed to do so? The existing requirement can also give rise to difficulty if there is a temporary cessation of trading, as opposed to a mere suspension or pause for such purposes as holidays. Strictly speaking, the partnership would cease to exist and would have to be reconstituted when trading resumed.

5.22 Other problems with the existing requirement were highlighted in *Khan v Miah*.<sup>18</sup> If the partnership is not in existence before commencement of business, a relationship of agency and of trust is created between the partners. Every transaction entered into by them in relation to the future partnership then has to be litigated separately for its effects between the partners, if something goes wrong between them.<sup>19</sup> There can also be adverse consequences for third parties who contract with one of the proposed partners. Their remedies in the event of, for example, a breach of contract, would be against the person with whom they had dealt alone. They would not have remedies against the other purported partners.<sup>20</sup>

5.23 A change in the existing definition so that partnerships should have as their object the carrying on of business would therefore benefit both the partners and third parties

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<sup>16</sup> See *Lindley & Banks*, para 5-03, quoting Lord Lindley's view that "Although this principle [that the existence of a partnership depends on the true contract and intention of the parties as appearing from the whole facts of the case] is no longer expressed it is still the law."

<sup>17</sup> See, for example, A report into business legal structures: published by the Forum of Private Business (research conducted by Manchester Business School), November 1991.

<sup>18</sup> [1998] 1 WLR 477.

<sup>19</sup> Buxton LJ, *ibid*, at 492 - 493.

<sup>20</sup> Roch LJ, *ibid*, at 485.

dealing with them in the setting up of that business.<sup>21</sup> It would also benefit any proposed registered partnership, which would then be able to register prior to the commencement of its business.<sup>22</sup>

### ***In common***

5.24 If partnerships or some partnerships were, in English law, to have a legal personality distinct from that of the members it would be for consideration whether the definition should, in relation to those partnerships having a separate legal personality, refer to the business being carried on by the partnership rather than by the partners in common. The existing definition already causes difficulty in this respect in Scots law.<sup>23</sup> If a partnership has a separate personality, it is the partnership which has the right to enforce and incurs the primary liability in contracts entered into in carrying on business. It would seem logical that it is the partnership which should be stated to carry on business. We are aware that this may have tax implications, as the case of *Major v Brodie*<sup>24</sup> shows. We will require to discuss this with Inland Revenue.

### ***Modernising the exceptions***

5.25 There is an obvious need to modernise the list in section 1(2) of the 1890 Act of things that do not constitute partnerships. At present it refers, for example, to companies registered under the Companies Act 1862.

### **Invitation for views**

5.26 We invite views on the following provisional proposals and question:

- (1) The statutory definition of a partnership should be a definition of a type of voluntary association rather than a definition of a type of “relation”.**
- (2) The definition should make it clear that the association must be constituted by an agreement.**
- (3) It should not be necessary for a business to be actually carried on before there can be a partnership only that that should be the object of the partnership.**

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<sup>21</sup> An agreement to form a business association at a future date would not create a partnership until that date arrived. See Lindley’s Supplement on the 1890 Act, pp 13 - 14 and *Dickinson v Valpy* (1829) 10 B & C 128, 141 - 142; 109 ER 399, 404, *per* Parke J.

<sup>22</sup> See Part 20 below.

<sup>23</sup> In *Major v Brodie* [1998] STC (ChD) 491, conflicting expert opinion was given as to whether the business was carried on in Scotland by the partners or by the partnership. The Special Commissioner found that the business was carried on by the partners. However, there is no direct authority on this point. The Special Commissioner’s finding was a finding of fact as it was made in an English case.

<sup>24</sup> [1998] STC ChD 491.

- (4) In cases where the partnership has a legal personality distinct from that of the members, the definition should refer to the business being carried on by the partnership rather than by the partners.**
- (5) Companies incorporated under the Companies Acts or other legislation should continue to be excluded but the terms of the exclusions should be updated.**
- (6) For the avoidance of doubt, it should be made clear that the division of profits is not an essential feature of partnership.**
- (7) For the avoidance of doubt, it should be made clear that a partnership has unlimited capacity to act.**
- (8) Are any other changes in the statutory definition desirable?**

### **The partnership agreement**

5.27 We wish to consider whether it should be made clear that so long as the partnership is not dissolved under the rules on dissolution considered later,<sup>25</sup> the partnership agreement is treated as continuing between those who are partners under it for the time being, whether or not it has been amended, notwithstanding changes in the composition of the partnership. There is Scots case law which supports the proposition that, if a partnership relation is not dissolved by a change in the composition of the partnership, this means that the same contract continues, not that a new contract is entered into on the same terms as before.<sup>26</sup> These cases involved the death of a partner, but there is no reason to suppose that the same principle would not apply where the change in composition had another cause. It is not necessary for the contract to state expressly that it is not to be dissolved on such a change; it is sufficient for there to be an implication that the contract will continue.<sup>27</sup>

5.28 In England and Wales the effect on the partnership contract of a change in the partnership composition may depend on the circumstances of the change.<sup>28</sup> Where a partner leaves a partnership the original contract only continues where the leaving of a partner is an event contemplated by the contract and it is clear from the contract that the remaining partners remain bound.<sup>29</sup> Where a fixed term partnership becomes one at will upon the expiration of the term, the original partnership contract ends and is replaced by another

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<sup>25</sup> See Part 6 below.

<sup>26</sup> See *Warner v Cunningham* (1798) M 14603; *Hill v Wylie* (1865) 3 M 541; *Hannan v Henderson* (1879) 7 R 380; *Alexander Trustees v Thomson* (1885) 22 SLR 828; *Jardine-Paterson v Fraser* 1974 SLT 93; *William S Gordon and Co Ltd v Mrs Mary Thomson Partnership* 1985 SLT 122.

<sup>27</sup> *William S Gordon and Co Ltd v Mrs Mary Thomson Partnership* 1985 SLT 122, 122, per Lord Justice-Clerk Wheatley.

<sup>28</sup> See for examples para 6.3 and the footnotes to that paragraph.

<sup>29</sup> A provision in the partnership contract that a partner can leave the partnership via a contractual exit while the remaining partners remain bound would be rare in a partnership at will. This provision will not restrict the right of a partner to seek the dissolution of the partnership in accordance with the 1890 Act and in essence merely provides the outgoing partner with an election either to leave the partnership via a contractual exit or to dissolve the partnership.

contract, although there is no change in the membership of the firm.<sup>30</sup> Where a new partner is admitted to an existing partnership and agrees to be bound by the terms of the original contract there is a novation of the original contract.<sup>31</sup>

5.29 We invite views on the following question:

**Would it be useful to provide that a change in the composition of the partnership does not necessarily mean that there is a new partnership agreement?**

## **Rules for determining the existence of a partnership**

### ***The existing rules***

5.30 Section 2 of the 1890 Act contains the following rules to which regard is to be had in determining whether a partnership exists.

(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>32</sup>

(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;<sup>33</sup> 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

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<sup>30</sup> Under s 27(1) of the 1890 Act in the absence of an 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>31</sup> If the new partner has not agreed expressly or impliedly to be bound by the agreement the new partnership may be at will. See for example *Firth v Amslake* (1964) 108 SJ 198 and para 6.7 and footnote 13 below.

<sup>32</sup> *Moore v Dempster* (1879) 6 R 930.

<sup>33</sup> *Badeley v Consolidated Bank* (1888) 38 ChD 238; *Lawrie v Lawrie's Trustees* (1892) 19 R 675.

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.

5.31 Whether a partnership exists depends on an inference as to the true intention of the partners. It is always necessary to consider *all* the circumstances to determine this. The rules in section 2 merely provide guidance. As Lord Lindley explained in his Supplement on the 1890 Act:

The rules contained in [section 2] only state the weight which is to be attached to the facts mentioned, when such facts stand alone. Those facts, when taken in connection with the other facts of the case, may be of the greatest importance, but when there are other facts to be considered this section will be found to be of very little assistance.

5.32 Section 2(3) is the most significant of the rules in section 2. It was largely declaratory of the House of Lords decision in *Cox v Hickman*<sup>34</sup> that persons who share the profits of a business do not incur any liability as partners, unless they carry on the business, either personally or through their real or ostensible agents.<sup>35</sup>

5.33 Section 2(3)(b) is important in relation to the so-called salaried partner. There is no precise meaning to the phrase salaried partner. A salaried partner may be a 'real' partner. The substance of the relationship between the parties must be discerned.<sup>36</sup> A salaried 'partner' may alternatively be an employee, paid a fixed salary (with a possible bonus related to profits) or entitled to a fixed share of the firm's profits payable irrespective of the profitability of the firm.<sup>37</sup> Within the partnership a salaried partner will often have limited rights consistent with the status of an employee. As section 2(3)(b) makes clear such a

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<sup>34</sup> (1860) 8 HL Cas 268; 11 ER 431.

<sup>35</sup> See also *Badeley v Consolidated Bank* (1888) 38 Ch D 238 (CA).

<sup>36</sup> This is also pertinent if genuine or equity partners enter into a 'salaried partnership' agreement with X under which obligations are imposed on X that are not reciprocated. The equity partners may then enter into a separate 'salaried partnership' agreement with Y on the same terms. There is, therefore, no contractual nexus between X and Y. Such an arrangement may amount to two different partnerships between the equity partners and X on the one hand and between the equity partners and Y on the other. Or, arguably, there may be one single partnership between the equity partners and X and Y. Alternatively X and Y may be employees only.

<sup>37</sup> In this respect, see *Horner v Hasted* [1995] STC 766.

contract does not of itself make the recipient a partner in the contemplation of the law, nor does this factor mean that the recipient incurs any liability as if a partner.

5.34 However, the typical salaried partner, whether truly a partner or not, is also held out to the outside world as a partner. Section 14 of the 1890 Act imposes on such a person liability to third parties who on the faith of such a representation have given credit to the firm.<sup>38</sup> The salaried ‘partner’ is normally indemnified against this liability by the ‘real’ partners, and the right to an indemnity may be a necessary implication from an entitlement to a guaranteed fixed share of the profits.<sup>39</sup>

5.35 Apart from the employer-employee relationship it is often important to distinguish between a partnership and a creditor who has funded a business in consideration of a share of the profits.<sup>40</sup> The principal purpose of section 2(3)(d) was to protect such a lender.

### ***Possible changes***

5.36 One possibility would be to delete section 2 entirely. It is not clear that it serves a useful function. If the existence of a partnership depends on an agreement, express or implied from all the circumstances, then it is obvious that none of the factors listed in section 2 will by itself create a partnership. Section 2 served a historical purpose in clarifying some doubts which had arisen in the cases, but that purpose has now been served. The section is no longer needed.

5.37 A more modest suggestion put to us was that, if section 2 is retained, the deletion of the words “*prima facie*” in the opening words of section 2(3) would help to weaken the provision and make it clear that the receipt of a share of profits did not raise a presumption of being a partner which would then have to be rebutted. We are not persuaded that this would be the result of deleting the words. The removal of the words *prima facie* might lead readers to suppose that some other change was intended – for example, that the receipt of a share of profits was to be stronger evidence of partnership than it is at present. We would not favour this change. A better way of achieving the desired result might be the replacement of the words “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 does not of itself make him a partner in the business” by the words “The receipt by a person of a share of the profits of a business does not of itself make him a partner in the business”.

5.38 It has been suggested to us that section 2(3) could be amended by expressly stating that for there to be a partnership the business must be carried on by the recipient of a share of profits as a principal, whether personally or through an agent. This would seem, however, to be more a matter for the definition of a partnership than for the indicative rules in section 2, if retained. Whether any such provision were necessary in the definition would depend on whether the partners as individuals or the partnership as an association should be regarded as carrying on the business.

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<sup>38</sup> See paras 10.27 – 10.28 below.

<sup>39</sup> *Lindley & Banks*, para 21-06.

<sup>40</sup> See *Pooley v Driver* (1877) 5 Ch D 458.

5.39 The usefulness of the *proviso* to section 2(3)(d) requiring a written contract, signed by or on behalf of the parties, is questionable. As Lord Lindley commented in his Supplement on the 1890 Act:<sup>41</sup>

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

5.40 We agree with this analysis and suggest that, if section 2 is retained, the *proviso* to section 2(3)(d) should be repealed. It appears to be a relic of earlier times when there was a much greater emphasis on writing in relation to contracts.

5.41 We are aware that it can be difficult to determine whether arrangements between independent persons constitute a partnership, where there appears to be an element of profit-sharing.<sup>42</sup> However, we doubt whether any further help could usefully be provided by section 2, if retained. All the surrounding circumstances of the case must be looked at to discern the true nature of the agreement.<sup>43</sup>

5.42 A curious feature of the rules in section 2(3) is that paragraphs (a) to (e) all provide that the factors set out in them not only do not by themselves make the person in question a partner in the business but also do not make that person “liable as such”. This is a relic of an earlier period of English law in which there was a doctrine that a person who received a share of the profits of a business, even if not a partner, was also liable for a share of the debts and obligations.<sup>44</sup> This rule was effectively removed from the law by the case of *Cox v Hickman*.<sup>45</sup> The references to a person being “liable as such” are now out of place and inappropriate in section 2. Their repeal would not revive the earlier rule and would improve the section, if retained.

### ***Invitation for views***

5.43 We invite views on the following provisional proposal and question:

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<sup>41</sup> Quoted in *Lindley & Banks*, para 5-39.

<sup>42</sup> See *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1996 SLT 186 (OH); *Hibernia Management and Development Co v Newfoundland Steel Inc* (Newfoundland Sup Ct) [1996] 140 Nfld & PEIR 91; *Nay v Chan* (1997) 430 WA 6; and *Whywait Pty Ltd v Davison* (1997) 1 QdR 225.

<sup>43</sup> See for example, *Pooley v Driver* (1877) 5 Ch D 458 and *Stekel v Ellice* [1973] 1 WLR 191 .

<sup>44</sup> See *Lindley & Banks*, paras 5-32 - 5-39.

<sup>45</sup> (1860) 8 HL Cas 268; 11 ER 431.

**(1) On the basis that it has served its historical purpose and is no longer needed, section 2 of the 1890 Act, which contains rules for determining the existence of a partnership, should be repealed.**

**(2) If consultees disagree with the provisional proposal in the preceding paragraph, should section 2 be amended by:**

- (a) changing the opening words of section 2(3) so that they simply provide that the receipt by a person of a share of the profits of a business does not of itself make him a partner in the business; and / or**
- (b) repealing the proviso to section 2(3)(d); and / or**
- (c) repealing the references in section 2(3) to a person being “liable as such”?**

### **Section 3 – postponement of rights of certain creditors**

5.44 Section 3 provides that:

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 [that is, one providing for the creditor to receive a rate of interest varying with the profits, or a share of the profits], 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.

5.45 Section 3 refers to “any person”, and to “the lender”. Person includes a company.<sup>46</sup> *Prima facie* it applies to loans made by any person to any person.<sup>47</sup> The reference to “such a contract” in section 3 is to any loan contract with a return out of net profits, whether or not in writing.<sup>48</sup> The postponement of a lender takes place without prejudice to the right of the lender to retain<sup>49</sup> or foreclose on any security taken for the advance.<sup>50</sup> If a lender substitutes

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<sup>46</sup> Interpretation Act 1978, s 5.

<sup>47</sup> It could be argued that the reference to the borrower “being adjudged a *bankrupt*” limits its application to individuals and not companies. A winding up order is made against a company if insolvent: it is not adjudged a bankrupt. However, none of the 1890 Act provisions are specifically related to companies, yet it is clear that partnerships can be formed between corporate entities. It is submitted that the true position is that references in the 1890 Act, whether in s 3 or s 33, should be interpreted to equate, as far as possible, individual concepts with corporate ones. This presents no practical difficulty for s 3. Any other interpretation would be inconsistent with both the policy behind s 3 and the general application of the 1890 Act to companies.

<sup>48</sup> *Re Fort* [1897] 2 QB 495. The reference in s 2(3)(d) to a contract being in writing is only relevant to those wishing to rely on section 2(3)(d). Section 9 of the Western Australia Partnership Act 1895 expressly provides that its equivalent to s 3 (s8(3)(d)) applies to contracts, whether in writing or not.

<sup>49</sup> *Ex parte Sheil* (1877) 4 Ch D 789.

a fixed rate of return for one varying with the profits, the loan will remain within section 3, unless the proper analysis is that the old loan has been repaid and a new loan made.<sup>51</sup>

5.46 The policy behind this provision is a relic of old case law<sup>52</sup> in which the recipient of a share of the profits of a business was held liable as a partner for its debts and obligations.<sup>53</sup>

5.47 The provision has an adverse practical impact today, particularly in start-up and rescue financings. Section 3 is at variance with the acceptance of the concept of the corporate rescue, for example the making of voluntary arrangements under the Insolvency Act 1986. If the most suitable form of financing is a loan with variable interest, then the principal practical effect of section 3 may, ironically, be for a lender to avoid its terms by taking a secured interest over the borrower's property.

5.48 It cannot be right that a lender can make an advance to a company and charge a rate of interest which consumes all of the company's profits and not be postponed, while a rate of interest expressed as a mere share of the profits, which by definition cannot be *all* the profits, is postponed, especially when any security the lender takes can still be enforced.

5.49 The position appears even more unsatisfactory when it is borne in mind that there is no question in practice of there being a partnership between the borrower and lender.<sup>54</sup> Lenders to a struggling firm would generally take great care to avoid any appearance of partnership. If a relationship is that of debtor and creditor, we cannot see why a particular loan relationship ought to be disadvantaged, especially when it may be the most appropriate financing tool.

5.50 We invite views on the following provisional proposal:

**We see no justification for section 3 of the 1890 Act which postpones the rights of certain creditors of a partnership. It should be repealed.**

### **Partnership size restrictions: the 20 partner limit**

5.51 Except for certain professional firms, partnerships are illegal if they have more than twenty partners.<sup>55</sup> The partnership is automatically dissolved by illegality if it exceeds this number.<sup>56</sup>

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<sup>50</sup> For the rationale for this see Lindley LJ's judgment in *Badeley v Consolidated Bank* (1888) 38 Ch D 238, 261.

<sup>51</sup> *Ex parte Taylor* (1879) 12 Ch D 366; cf *Re Abenheim* (1913) 109 LT 219.

<sup>52</sup> Dating from before *Cox v Hickman* (1860) 8 HL Cas 268; 11 ER 431.

<sup>53</sup> The rationale behind this was clearly stated in De Grey CJ's judgment more than 200 years ago in *Grace v Smith* (1775) 2 Wm Bl 998, 1000: "every man who has a share of the profits of a trade, ought also to bear his share of the loss. And if any one takes part of the profit, he takes a part of that fund on which the creditor of the trader relies for his payment."

<sup>54</sup> If there were, then they could not properly be described as lender and borrower.

<sup>55</sup> See CA 1985, ss 716 and 717 and the 1907 Act, s 4(2) for limited partnerships. Sections 716 and 717 exempt firms of solicitors, accountants and stockbrokers from this limit. Statutory instruments have lifted the size restrictions for both ordinary and limited partnerships composed of auctioneers, surveyors, valuers, estate agents, insurance brokers or members of the Stock Exchange, as well as medical partnerships. For ordinary partnerships there are also no size restrictions for firms of actuaries, patent agents, consulting engineers, building designers, chartered surveyors, loss adjusters, town planners, trade mark agents, or lawyers in a multinational

5.52 The origin and purpose of the rule lie in the use of deed of settlement companies in the eighteenth and nineteenth centuries.<sup>57</sup> A deed of settlement was made between the subscribers and a trustee binding the members to observe the deed and declaring that the shareholders for the time being constituted the unincorporated company. The subscribers agreed to have a prescribed joint stock divided into a specified number of shares, which were transferable. The management of the company was transferred to a body of directors who held the company's property as trustees. In effect this represented a corporation with continuity of life and transferable interests. In the eyes of the law, however, it was nothing more than a large partnership with, in English law, no legal personality of its own.

5.53 To be sued at common law all the shareholders in the unincorporated deed of settlement company had to be joined in the action. An action in a court of equity was subject to more lenient rules.<sup>58</sup> The notion of suing and, in particular, levying execution against such a fluctuating body of members was fanciful. This difficulty could be, and was, used for improper purposes. The free transferability of the interests in these unincorporated companies effectively meant that members could achieve limited, or indeed nil, liability.

5.54 Eminent legal opinion considered that such difficulties were sufficient to render the deed of settlement company illegal at common law. In *van Sandau v Moore*,<sup>59</sup> the Lord Chancellor, Lord Eldon, decried the position as follows:<sup>60</sup>

...ought the jurisdiction of the court, which can be administered usefully only between a limited number of persons, to be employed for a purpose which it cannot by possibility accomplish? Here is a bill with nearly three hundred defendants. How can such a cause ever be brought to a hearing?

and later:<sup>61</sup>

I must repeat here that I have frequently ventured an opinion ... that the impossibility of suing with effect was with me a very strong argument to prove, that such a constitution of a body could not be legal.

5.55 This fear was the basis for the size restrictions on partnerships that were introduced in the Joint Stock Companies Act 1844. This provided for registration of all new companies,

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practice. The exceptions define the necessary professional qualification of the partners for the firm to be exempted.

<sup>56</sup> 1890 Act, s 34.

<sup>57</sup> For a discussion of the origins of the modern company, see ICB Gower, *Principles of Modern Company Law* (6th ed 1997) pp 19 - 54.

<sup>58</sup> These today form the basis of the representative action: see *Commissioners of Sewers v Gellatly* [1876] 3 Ch D 610, 615 *per* Jessel MR.

<sup>59</sup> (1825) 1 Russ 441; 38 ER 171. The case was actually concerned with a statutory company and whether it was possible for a shareholder to sue the other shareholders for a dissolution. Lord Eldon gives a valuable historical account of the various problems of suing such businesses. His comments apply *a fortiori* to unincorporated companies.

<sup>60</sup> At p 449.

<sup>61</sup> At p 472.

associations or partnerships with more than twenty-five members, or with shares transferable without the consent of all the other members. This limit was reduced to the present-day twenty by the Joint Stock Companies Act 1856.

5.56 The rationale for this limit has been clearly understood when it has subsequently come before the courts. In *Harris v Amery*,<sup>62</sup> Mr Justice Willis summed up its purpose succinctly:

It should seem, by the 25 & 26 Vict. c.89, s.4,<sup>63</sup> that the Legislature, viewing the frauds which had been committed by large companies, and the great inconvenience which was found to arise by reason of the difficulty of enforcing claims and settling accounts ... have determine[d] that no ... partnership consisting of more than twenty persons, shall be formed ...<sup>64</sup>

5.57 From one point of view the twenty partner limit is an anachronism. Much of its rationale ended as long ago as 1873 when the fusion of equity and common law saw the possibility of representative actions.<sup>65</sup> Partnerships in England and Wales can sue and be sued in the firm name.<sup>66</sup> The rules in Scotland are anomalous.<sup>67</sup> There may not appear to be any legal or policy reason which can now justify the retention of the size restrictions on partnerships. On the other hand, it may be said that partnerships, with the unlimited liability of partners, depend to a large degree on trust and confidence between partners and that it is unrealistic to expect partners in a very large partnership to be able to place the necessary trust or confidence in other partners whom they may never have met and may never meet.

5.58 Whatever view may be taken on that question, it is undoubtedly true that serious inroads have already been made into the purity of the rule by the increasing number of exceptions. These have been conceded on an *ad hoc* basis as demand warranted. They have been confined so far to professional firms, which may seem paradoxical as it is precisely in those firms that mutual trust and confidence may be most necessary. It is unlikely that allowing other businesses similar latitude would impair the utility of the partnership as a business structure or lead those in large business organisations to prefer partnerships, with unlimited liability, to companies with limited liability.<sup>68</sup>

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<sup>62</sup> (1865) 1 LR CP 148, 154.

<sup>63</sup> Now CA 1985, s 716.

<sup>64</sup> Also see *Smith v Anderson* (1880) 15 Ch D 247, 273, *per* James LJ.

<sup>65</sup> See the schedule to the Supreme Court of Judicature Act 1873. The representative action now forms CPR, r 19(6). The purpose of this procedural rule was clearly expressed by Vaughan Williams LJ in *Walker v Sur* [1914] 2 KB 930, 934: "I cannot doubt that the intention of Order 15, r 12 was to make easier the bringing of actions for the enforcement of rights against an unincorporated aggregate of people."

<sup>66</sup> CPR, Sched 1, RSC, O 81, r 1; CPR, Sched 2, CCR Ord 5, r 9.

<sup>67</sup> In Scotland, a firm with a 'social' name (ie, one comprising the names of people) can sue and be sued in its own name – *Forsyth v Hare and Company* (1834) 13 S 42. A firm with a descriptive name must add the names of three partners (or two if there are only two) in the Court of Session – *Antermony Coal Company v Wingate* (1866) 4 M 1017 – but not in the Sheriff Court – Rule 5.7, Ordinary Cause Rules, 1993.

<sup>68</sup> Relaxing the rule will also remove one of the current barriers to multi-disciplinary partnerships.

5.59 To avoid the effects of the existing size restriction, partnerships can resort to a variety of expedients: parallel partnerships; a trustee or nominee partner holding for two or more beneficiaries;<sup>69</sup> and a corporate partner with two or more shareholders. If a ten partner firm wishes to merge with an eleven partner one, or form a group partnership, it cannot do so unless it adopts one of the above artificial devices.

5.60 The arguments in favour of size restriction are outdated. This view is shared by the DTI which is consulting on the abolition of the twenty partner limit.<sup>70</sup> Further, in the context of a number of significant professions, the restriction has already been removed.<sup>71</sup> Our proposal is therefore that the size restriction should be abolished.

5.61 We invite views on the following provisional proposal:

**The size restriction affecting partnerships should be abolished.**

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<sup>69</sup> It is, however, highly questionable whether the device of a nominee partner will succeed in its intention to avoid the size limits.

<sup>70</sup> DTI press release P/2000/222 dated 27 March 2000.

<sup>71</sup> See n 55 above.

# PART VI

## DURATION OF PARTNERSHIP

### Introduction

6.1 One of the key objectives of reform of the law on partnership is to foster continuity and stability in business relationships. Unnecessary legal breaks can lead to difficulties and to unnecessary business dissolutions. We have already considered several ways of fostering legal continuity and stability.<sup>1</sup>

6.2 We are considering more ways of increasing continuity.<sup>2</sup> In this Part we consider an additional way of reducing legal discontinuity - namely, ensuring that the law does not compel partnerships to come to an end earlier than the partners wish.

### Dissolution as regards all the partners

6.3 We are concerned in this Part with the rules on when a partnership comes to an end with regard to all the partners - what the 1890 Act calls dissolution “as regards all the partners”.<sup>3</sup> We deal in Part 7 with the situation which arises when one partner in a partnership consisting of three or more partners dies or otherwise ceases to be a partner and the partnership continues as a legal relationship and voluntary association between the remaining partners. It is common for partnership agreements to provide expressly that the death, retirement or expulsion of a partner will not dissolve the partnership between the remaining partners. The idea that a partnership contract can continue as regards some but not all the partners is recognised in the 1890 Act<sup>4</sup> and in the case law.<sup>5</sup> For example, in *Hannan v Hendersorff* where the agreement provided that a partner should cease to be a partner on his declared insolvency and his share and interest in the partnership property vest in his co-partners, the Lord President said:

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<sup>1</sup> See paragraphs 3.11, 4.18 - 4.30 above.

<sup>2</sup> The measures in this Part are an additional way of reducing discontinuity without conferring continuing legal personality. Some of these measures may however be equally useful with continuing legal personality.

<sup>3</sup> Section 33(1).

<sup>4</sup> See, for example, s 31 (a dissolution of the partnership, whether as respects all the partners or as respects the assigning partner); s 33(1) (dissolved as regards all the partners); s 36(3) (assumption that partnership debts can be contracted after death, bankruptcy or retirement of one partner); s 37 (reference to dissolution of a partnership or retirement of a partner); s 42 (reference to partner dying or otherwise ceasing to be a partner and surviving or continuing partners); s 43 (reference to surviving or continuing partners and outgoing partner).

<sup>5</sup> See, for example, *Abbott v Abbott* [1936] 3 All ER 823; *Jardine-Paterson v Fraser* 1974 SLT 93; *William S Gordon & Co Ltd v Mrs Mary Thomson Partnership* 1985 SLT 122; *Walters v Bingham* [1988] 1 FTLR 260, 268 per Browne-Wilkinson VC - “in large modern partnerships there is a fundamental difference between expulsion (leaving the partnership continuing between the remainder) and dissolution (which puts an end to the whole partnership as between all partners)”; *Hurst v Bryk* [1999] Ch 1, 6G, per Gibson LJ - “There can be no doubt that in fact and in law this was not an expulsion of Mr Hurst from a partnership which then continued but the termination of the partnership...”

<sup>6</sup> (1879) 7 R 380.

... [I]t was very reasonably provided that the ascertained and declared insolvency of any partner should put an end to the contract as far as he was concerned.

There ought to be no difficulty in achieving the result that the partnership continues as a legal relationship and voluntary association.

6.4 However, as there is a possibility of conceptual doubt in this area,<sup>7</sup> we invite views on the following provisional proposals:

**(1) For the avoidance of any doubt, it should be made clear that a partnership consisting of three or more partners is not necessarily dissolved as a legal relationship or voluntary association between the surviving or remaining partners when one partner ceases to be a partner.**

**(2) Accordingly, in any case where two or more partners would remain after the act or event giving rise to the dissolution, a clear distinction should be drawn between (i) the dissolution of the relationship between a particular outgoing partner and the other partner or partners and (ii) the dissolution of the partnership as regards all the partners.**

6.5 It is important to be clear about the effect of one partner ceasing to be a partner, while the partnership continues as a legal relationship and voluntary association between the others. This means that the remaining partners continue to be bound by the partnership agreement. They are not free, in the absence of unanimous agreement, to tear it up and start again. They are not suddenly operating, contrary to their intention, under the default rules in the 1890 Act. However, although the partnership as a legal relationship and voluntary association continues between the remaining partners, there is not, in the current English law, any continuing legal person. This is because a partnership has no separate legal personality in English law. We have provisionally proposed that this should be changed for all partnerships.<sup>8</sup> The effect in Scots law, where the firm does have a separate legal personality, is unclear.<sup>9</sup> On one view, if the partnership continues as a legal relationship and voluntary association then the firm and its separate personality also continue. On another view, even if the partnership continues as a legal relationship and voluntary association, a new group of partners is necessarily a different firm and a different legal person. We have already suggested that this doubt as to the existing Scots law should be resolved.<sup>10</sup>

6.6 RUPA allows a partner to ‘dissociate’ from a partnership at any time.<sup>11</sup> A partner’s dissociation can be caused by, amongst others, the partner giving notice of dissociation, an event agreed in the partnership agreement, the partner’s expulsion in certain circumstances, the partner’s bankruptcy, death or incapacity, or the termination of a partner which is not an individual.<sup>12</sup> On a partner’s dissociation, the partnership is not dissolved but continues

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<sup>7</sup> It can be argued that the relationship between the remaining partners is not the same relationship, with different incidents, but is in essence a different relationship.

<sup>8</sup> See para 4.30 above.

<sup>9</sup> See para 2.35 above.

<sup>10</sup> See para 4.17 above.

<sup>11</sup> Section 602(a).

<sup>12</sup> Section 601.

amongst the remaining, and any new, partners. Our question above is whether English and Scots law should allow something similar to this dissociation and, if so, in what circumstances.

6.7 No-one coming fresh to the subject of partnership law would imagine that a partnership would be dissolved by the admission of a new partner. It would seem obvious that a new partner must be admitted to something and that the only thing the new partner can be admitted to is a continuing partnership. Different wording would be used if a new partnership were being formed. There is no provision in the 1890 Act that a partnership comes to an end as a contractual relationship or voluntary association when a new partner is admitted. However, there is again the possibility of conceptual doubt on this point and, for the avoidance of doubt in the future, we provisionally propose that:

**For the avoidance of any doubt, it should be made clear that a partnership is not dissolved as a legal relationship or voluntary association merely because a new partner is admitted.**

The word “merely” is important. As we have seen, it may be that, when a new person joins a business as a partner, what happens is that the existing partnership agreement is terminated by the unanimous agreement of the existing partners, a new agreement entered into and a new partnership formed. It will be a question of fact in each case whether this, or mere admission to a continuing partnership, has taken place.<sup>13</sup>

#### **Existing law on dissolution of partnership as regards all the partners**

6.8 The following are the grounds on which a partnership comes to an end as regards all the partners:

- (a) Reduction of the number of partners to below two;<sup>14</sup>
- (b) Expiry of fixed term, subject to any agreement between the partners;<sup>15</sup>
- (c) Termination of the single adventure or undertaking for which the partnership was entered into, subject to any agreement between the partners;<sup>16</sup>

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<sup>13</sup> In *Firth v Amslake* (1964) 108 SJ 198 a partnership deed between two doctors was to last for their joint lives. A third doctor was admitted to the practice on the basis that they would all enter into partnership. A deed was never signed, and the two original doctors dissolved the partnership by notice. Plowman J held that they were entitled to do this. When the third doctor joined, a new partnership was created. No agreement had been reached on its duration, and so it could be dissolved by notice by any partner.

<sup>14</sup> This is the result of the definition of a partnership.

<sup>15</sup> 1890 Act, s 32(a). Although this is said to be “subject to any agreement between the partners” an advance agreement to the contrary would normally convert the partnership into something other than one for the original fixed term and an agreement to the contrary after the termination of the partnership would, logically, be an agreement for a new partnership. See also s 27 which regulates the position where the business in fact is continued after the fixed term without any express new agreement. Section 27 implies a new agreement on the same terms as the old so far as is consistent with the incidents of a partnership at will. In Scotland, the effect of s 27 is that the partnership contract is one to which the doctrine of tacit relocation applies (although with the modification that the contract is continued indefinitely rather than for the same length of time as the original term or on a year to year basis). It should be noted that tacit relocation does not apply where the partnership continues after any other event which should terminate the partnership (eg, a partner’s death or bankruptcy).

- (d) Notice by one partner of intention to dissolve the partnership<sup>17</sup> where the partnership was entered into for an undefined time,<sup>18</sup> subject to any agreement between the partners;<sup>19</sup>
- (e) Death or bankruptcy of a partner, subject to any agreement between the partners;<sup>20</sup>
- (f) At the option of the other partners, a partnership may be dissolved if any partner “suffers his share of the partnership property to be charged under this Act for his separate debt”;<sup>21</sup>
- (g) 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>22</sup>
- (h) Dissolution by a court on one of several statutory grounds;<sup>23</sup>
- (i) Dissolution by the unanimous agreement of the partners for the time being.<sup>24</sup>

6.9 Prior to the House of Lords decision in *Hurst v Bryk*,<sup>25</sup> it was assumed that a rescission or setting aside of an underlying partnership agreement led to an automatic

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<sup>16</sup> Section 32(b). Again, it may be observed that if the partners have agreed to the contrary in advance then the partnership could no longer be regarded as one entered into for that undertaking or adventure. If they agree later to continue the partnership then that comes too late and they are really agreeing to a new partnership.

<sup>17</sup> A right to give such notice, in any case where no fixed term has been agreed for the duration of the partnership, is conferred by s 26. Section 32(c) regulates the effect, on the partnership as a whole, of giving notice.

<sup>18</sup> A partnership entered into “until dissolved by mutual agreement” is not entered into for an undefined time: *Moss v Elphick* [1910] 1 KB 465 and 846. Neither is a partnership entered into until a new partnership deed is executed: *Walters v Bingham* [1988] 1 FTLR 260.

<sup>19</sup> Section 32(c). The Act provides that: “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.” The effect of an agreement between the partners would depend on its terms. If it provides that the partnership is to be dissolved only as regards the partner giving notice then the effect would be to confer a right to retire rather than a right to dissolve the partnership as regards all the partners. See, eg, *Abbott v Abbott* [1936] 3 All ER 823. Here the partnership agreement between a man and his five sons provided that the death or retirement of any partner was not to terminate the partnership. It made provision for buying out the share of a retiring partner at book value. One son gave notice of dissolution under s 32 and asked for the affairs of the partnership to be wound up by the court. It was held that the effect of this notice was not to determine the partnership as regards all the partners but only to determine the partnership relationship between the son giving the notice and the other partners.

<sup>20</sup> Section 33(1).

<sup>21</sup> Section 33(2). This is of no application in Scotland where s 23 (on charging the partner’s share of the partnership property) does not apply.

<sup>22</sup> Section 34.

<sup>23</sup> Section 35. See para 6.37 below.

<sup>24</sup> This is a consequence of the fact that a partnership is a voluntary association which depends on there being a continuing contractual relationship between the partners. We understand that it is common practice to provide in the partnership agreement that a majority of the partners can dissolve the partnership by agreement. However, we are dealing here with default rules which apply when there is no agreement to the contrary.

<sup>25</sup> [2000] 2 WLR 740.

dissolution of the partnership.<sup>26</sup> Doubts were expressed by Lord Millett in the House of Lords as to whether this assumption was correct. We deal with the effect of *Hurst v Bryk* and the possibility of dissolution resulting from rescission on a common law ground<sup>27</sup> below.<sup>28</sup>

6.10 It will be noted that some of the terminating events apply “subject to any agreement between the partners”. Any such agreement has to be unanimous. Normally it would be contained in the partnership agreement but in any event it must, if it is to prevent termination, be made before the terminating event takes place. An agreement after that event would come too late to prevent termination.<sup>29</sup>

6.11 It will also be noted that the Act does not provide for the whole partnership to come to an end on the retirement or expulsion of a partner in terms of the partnership agreement. There is, however, nothing to stop the partners providing for this result in their partnership agreement. They may well do so if, for example, the skills of the partner in question are essential to the success of the partnership business.

### **Questions for consideration**

6.12 The main question for consideration is whether certain events which at present bring about the dissolution of the partnership as regards all the partners should do so in future. At present these events result in dissolution either always or unless there is a prior agreement to the contrary. We consider whether in future in any case where there are two or more partners left after the occurrence of the event in question, the event should bring about the dissolution of the partnership as regards all the partners only if the partnership agreement so provides. The events in question are – notice by one partner of intention to dissolve the partnership; death or bankruptcy of one partner; illegality affecting only one partner; and the termination or setting aside of the partnership contract on a common law ground affecting only one partner. If the law were to be changed in this way then the effect of any of these events would be that the relationship between the partner concerned and the others would be terminated but the relationship between the other partners would not be. We consider the rules on the rights of the outgoing partner in the next part of this paper. Here we are concerned only with the question of the duration of the partnership as such.

6.13 Another important question for consideration is whether a court should have power, not only to dissolve the partnership as a whole on certain grounds, but also, in any case where there are three or more partners, to expel one partner on certain grounds, leaving the partnership continuing as between the remaining partners.

6.14 Other questions are of a more technical nature and relate to such points as rationalising and updating the grounds for dissolution by the court and avoiding overlapping or unnecessary provisions.

6.15 Before we consider specific grounds of termination it would be helpful to have the views of consultees on the general policy to be followed. We therefore invite views on the following provisional proposal:

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<sup>26</sup> See for example, the Court of Appeal decision of *Hurst v Bryk* [1999] Ch 1.

<sup>27</sup> Such as repudiation or material breach, error or mistake, fraud, misrepresentation, or frustration.

<sup>28</sup> See paragraphs 6.28 - 6.36 below.

<sup>29</sup> The partners could of course agree to enter into a new partnership but that is a different matter.

**The general policy should be to give the maximum duration to partnerships which is consistent with the wishes or presumed wishes of the partners.**

### **Effect of notice of intention to dissolve**

6.16 Section 26(1) of the 1890 Act provides that any partner may determine a partnership at will at any time by giving notice of his intention to do so to all the other partners. We do not suggest changing that rule; it would clearly be undesirable to lock partners into such a partnership until death or dissolution on some other ground. Our concern is with the effect of withdrawal. At present the outgoing partner's notice has the effect of dissolving the whole partnership, unless there has been an agreement to the contrary. This is not consistent with a desire for greater business continuity. The question is whether, where two or more partners would remain after giving of the notice, the effect of the notice should be limited to dissolving the relationship between the outgoing partner and the other partners and not, unless the partnership agreement so provides, to dissolve the partnership as regards all the partners. There is no doubt that, despite the tendency of the courts to restrict its use,<sup>30</sup> the power to dissolve a partnership by unilateral notice remains a powerful weapon in the hands of the disaffected partner. Our provisional view is therefore that, where two or more partners would remain, the default rule should be that the effect of a notice should be limited to dissolving the relationship between the outgoing partner and the other partners.

6.17 We have considered whether there should be a default rule that a partner in a partnership of defined duration should have a right to withdraw from that partnership. Our provisional view is that they should not, unless such a power is conferred by the partnership agreement. The partners will have contracted to be in the partnership for a defined term; the law should respect that contract. This should not create unfairness. A partner wishing to leave the partnership could, if it is just and equitable to do so, obtain an order from the court dissolving the partnership between him and the other partners only (leaving the others to carry on the partnership together).

6.18 If the default rule as to the effect of a notice is to be amended, then the formulation of the rule in section 26 of the 1890 Act might with advantage be changed so that it would be expressed along the lines of a notice of intention to withdraw from the partnership, rather than a notice of intention to determine the partnership. The reference in the heading of section 26 to a "partnership at will" might also be revised. The term "partnership at will" is not defined or explained in the Act and may carry with it the implication that, contrary to our provisional view, the partnership can be brought to an end as regards all the partners at the wish of any one partner. A "partnership of undefined duration" may be a more suitable term. The reference to "fixed term" in sections 26(1), 27(1) and 32(a) could also usefully be changed; it might be thought to refer to a case, where the partnership agreement contains

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<sup>30</sup> The courts have tended to restrict the use of s 26(1) either by construing "fixed term" widely so as to mean in effect a partnership in respect of which the partnership agreement contains any provision as to duration or termination, or by holding that the power must not be used abusively, for example in order to prevent the investigation of alleged fraudulent activities by the outgoing partner: *Walters v Bingham* [1998] 1 FTLR 260. Whilst the result of a partnership contract is a partnership at will unless there is contrary agreement, the courts have been prepared to find contrary agreement (ie that there is a defined duration) in such a wide range of circumstances that a partnership with "no fixed term" (ie of undefined duration) will probably only arise where the partnership contract is silent as to duration and termination: see the cases referred to at footnote 31 below.

any provision as to the duration or termination of the partnership.<sup>31</sup> Defined duration may be a more appropriate term. We are cautious at this stage of suggesting definite terms to replace “fixed term”, “partnership at will” and “notice of intention to determine the partnership” before enlisting the expertise of the draftsman. However, we welcome the views of consultees as to whether these terms could usefully be revised.

6.19 We invite views on the following provisional proposals:

**(1) The following terms used in the Act could usefully be revised along the lines in paragraph 6.18:**

- (a) “fixed term”**
- (b) “partnership at will”**
- (c) “notice of intention to determine the partnership”.**

**(2) A partner should not have the right to withdraw from a partnership which is for a defined duration, subject to agreement to the contrary.**

**(3) Section 26 of the 1890 Act (“Retirement from partnership at will”) should be amended:**

- (a) so that the heading refers to withdrawal from a partnership of undefined duration; and**
- (b) to provide that where the partnership is of undefined duration any partner may withdraw from, rather than determine, the partnership by giving notice.**

6.20 If consultees agree with our provisional proposal in (3)(b) above, it would be necessary to amend section 32(c) of the 1890 Act which states that in a partnership entered into “for an undefined time” a partner giving notice to the other partners of his intention to dissolve, dissolves the partnership.<sup>32</sup> However, as the exact form of the amendment would depend on how other related sections were framed, we include no specific proposition on the point.

### **Effect of death or bankruptcy of a partner**

6.21 The same question arises in relation to the effect of the death or bankruptcy of a partner. At present, as we have seen, the 1890 Act provides that

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<sup>31</sup> In *Moss v Elphick* [1910] 1 KB 465 and 846 it was held that a provision that termination would be by mutual agreement created a fixed, defined, term. In *Abbott v Abbott* [1936] 3 All ER 823 a provision that death or retirement would not terminate the partnership was held to oust s 26(1). In *Walters v Bingham*, agreement to carry on a partnership on the basis of a drafted deed until another deed was executed was also held to be sufficient to oust 26(1).

<sup>32</sup> See para 6.8(d) above.

Subject to any agreement between the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.<sup>33</sup>

6.22 In relation to modern partnerships of three or more people this rule seems contrary to commercial realities. It is arguable that continuation would be more likely to accord with the presumed wishes of partners who have not provided for death or bankruptcy one way or the other in the partnership agreement. If, in such a case, the surviving partners were unwilling to continue in partnership, as might be the case if for example the skills of the deceased or bankrupt partner were considered essential for the success of the business, they would be able to dissolve the partnership by mutual agreement. If the partnership agreement is silent as to the duration of the partnership any one of them could withdraw from it.

6.23 We have given particular consideration to the case of informal partnerships where partners have joined in a profit sharing joint enterprise without even knowing that they are partners in the eyes of the law. It might be considered undesirable to have a default rule which meant that such partners had, without their knowledge, created a partnership which would not automatically come to an end on the death or bankruptcy of a partner. Several factors must, however, be kept in mind. First, such informal partnerships will usually involve only two partners. In such a case the death or bankruptcy of one would always dissolve the partnership. Secondly, such partnerships would, there being no defined term, be partnerships for an undefined duration and hence partnerships at will. Even if they consisted of more than two partners, any partner could withdraw on giving notice. There would be no question of any partner being locked into a continuing partnership against that partner's will. Thirdly, in the rare case where neither of the above considerations applied, the partners could always end the partnership by mutual agreement. Given this freedom of exit, the question is whether, even in the case of such informal partnerships, continuity or non-continuity would be the better default rule. It seems to us that continuity as the default rule would give more rather than less freedom to the partners to organise their affairs in an appropriate way. In the case of the death or bankruptcy of one partner in an informal, perhaps unwitting, partnership between three or more partners, the others would either carry on as before or wind up the business. In the first case they would be unlikely to realise the need for transfers of property, rights and obligations and a default rule of continuity of partnership - if combined with continuity of personality<sup>34</sup> would produce better results. In the second case the default rule would do no harm because the partnership would be dissolved by mutual agreement in any event.

6.24 Technical improvements could be made to the provision on death or bankruptcy. It could be made clear what counts as "death" in the case of a corporate partner or other partner with legal rather than natural personality. It could be made clearer what "bankruptcy" means in this context in the case of English, Scottish or foreign partners, whether individuals or legal persons. We would propose to address these questions in any reformulation of section 33(1). The precise way in which they would have to be addressed would depend on the way the rules on duration were eventually formulated.

6.25 We would welcome views on the following proposition in (1) and any suggestions as to appropriate solutions in the case of propositions (2) and (3):

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<sup>33</sup> Section 33(1).

<sup>34</sup> See paras 4.11 - 4.13 above.

**(1) In the case of a partnership where two or more partners would remain after the event in question, the effect of the death or bankruptcy of a partner should be only to dissolve the relationship between that partner and the others and not, unless the partnership agreement so provides, to dissolve the partnership as regards all the partners.**

**(2) An equivalent of “death” should be referred to in the case of a partner which is a legal person.**

**(3) The meaning of “bankruptcy” in relation to English, Scottish or foreign partners, whether natural persons or legal persons, should be clarified.**

### **Effect of illegality affecting only one partner**

6.26 Section 34 of the 1890 Act provides that:

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.<sup>35</sup>

It can quite easily happen that an illegality affects only one partner. For example, in a professional partnership where each partner must have a licence or certificate to practise, one partner may lose the licence or certificate and may be unable to practise lawfully as a partner.<sup>36</sup> In such circumstances it would seem to be preferable if the default rule were that the partnership is dissolved only so far as the relationship between the disqualified partner and the others is concerned.

6.27 We invite views on the following provisional proposal:

**In the case of a partnership where two or more partners would remain after the illegality, the effect of illegality affecting only the ability of one partner to carry on the business of the partnership should be only to dissolve the relationship between that partner and the others and not, unless the partnership agreement so provides, to dissolve the partnership as regards all the partners.**

### **Effect of challenge to partnership agreement on common law ground**

6.28 In *Hurst v Bryk*, at first instance and in the Court of Appeal it was assumed that ordinary principles of contract law applied to partnership contracts.<sup>37</sup> According to that view, the partnership contract may be terminated by a partner if there has been a repudiation of it or a material or fundamental breach<sup>38</sup> of it by the other partner or partners. The effect would be to bring the contract to an end, subject to certain qualifications.<sup>39</sup>

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<sup>35</sup> Section 34.

<sup>36</sup> See *Hudgell Yeates & Co v Watson* [1978] QB 451. It is possible for a partnership agreement to provide that a disqualified partner is deemed to have retired immediately prior to the disqualification.

<sup>37</sup> *Hurst v Bryk* [1999] Ch 1.

<sup>38</sup> These are the Scottish and English terms respectively.

<sup>39</sup> For example, clauses like arbitration clauses may survive. Section 38 of the 1890 Act will apply. See *Hurst v Bryk* [1999] Ch 1.

However, in *Hurst v Bryk* in the House of Lords, Lord Millett has expressed the obiter view that an accepted repudiatory breach terminates the partnership contract, but that it does not bring about an automatic dissolution of the partnership.<sup>40</sup> He reserved for future consideration whether this was the case. His main reason was that such a dissolution would circumvent the court's discretion under section 35(d) as to whether or not to order a dissolution. In his opinion in entering a partnership relationship parties submit to the equitable jurisdiction and give up their right to bring about a dissolution by repudiatory breach. He was of the view that there should not be another ground for dissolution outside the provisions of the 1890 Act.

6.29 We respectfully question Lord Millett's view. If it is correct, the termination of the contract will bring about a partnership at will which the accepting parties may then terminate immediately, rendering section 35(d) otiose. It seems strange that the accepting partners, having terminated the partnership agreement, should have to take any further step to terminate the partnership at will. In the circumstances of a repudiatory breach and an acceptance putting an end to the formal contract the conduct of the accepting partners is likely of itself to put an end to the partnership at will at the same time as it would commence under Lord Millett's analysis.

6.30 We think that it would be helpful to clarify the law as to the effect of an accepted repudiatory breach by making a statutory provision.

6.31 Our provisional view is that in cases of partnership, acceptance of a repudiatory breach should not terminate the contract and dissolve the partnership, but that "innocent" partners must apply to the court for dissolution under section 35. If this were combined with the option of a dissolution in respect of a particular partner<sup>41</sup> that would be consistent with our policy to preserve continuity of business.<sup>42</sup>

6.32 We invite views on the following provisional proposal:

**In cases of partnership, acceptance of a repudiatory breach should not terminate the contract and dissolve the partnership. "Innocent" partners must apply to the court for dissolution under section 35.**

6.33 If consultees agree with our view in the preceding paragraph, we welcome their views as to whether it may be necessary to admit exceptions to this rule. One exception may be in the case of a partner who is locked out from the management and the working of the partnership. This is because dissolution by the court under section 35 may occur several months after the lockout and this may prejudice the partner locked out who would continue to have liability as a partner in the interim. In this situation, it could be provided that acceptance of the repudiatory breach would bring about an automatic dissolution of the partnership. The rights and obligations that had already accrued would continue unaffected but the parties would be discharged from further performance of the partnership contract.<sup>43</sup>

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<sup>40</sup> *Hurst v Bryk* [2000] 2 WLR 740, 746-750.

<sup>41</sup> See para 6.38 below.

<sup>42</sup> Under the existing law any partner who was the aggrieved party in a repudiation of the contract by the other partners, and who accepted the breach as terminating the contract, would retain full rights to damages: see *Hurst v Bryk* [1999] Ch 1 (CA). It is not clear how such rights to damages would be affected by a dissolution under s 35.

<sup>43</sup> *Johnson v Agnew* [1980] AC 367.

On dissolution by accepted repudiatory breach the winding up provisions of the Act would apply. We seek views as to whether there should be an exception in such a situation and as to whether there should be any other exceptions to the basic rule which we have provisionally proposed. It should be noted that such exceptions would be contrary to our general policy favouring continuity of business wherever possible. We invite views on the following questions:

**(1) Where a partner is locked out from the management and the working of the partnership, should there be an exception to our provisional view that acceptance of a repudiatory breach would not terminate the contract and dissolve the partnership? In this situation, accepted repudiatory breach could amount to a dissolution of the partnership.**

**(2) Are there any other situations where such an exception may be warranted?**

### ***Fraud and misrepresentation***

6.34 There is a common law right of rescission where a partner makes a fraudulent, negligent or innocent misrepresentation to a prospective partner, inducing him to enter into partnership.<sup>44</sup> Section 41 of the 1890 Act provides for the situation where a partnership contract is rescinded on the ground of fraud or misrepresentation, by conferring certain rights on the partner entitled to rescind the partnership contract. Although it need not be, the rescission would normally be effected by court order. Consistent with our provisional view in relation to repudiatory breach we suggest that rescission in cases of fraud and misrepresentation should only be effected by court order.

6.35 We invite views on the following provisional proposal:

**In cases of partnership, rescission on the grounds of fraud or misrepresentation should not terminate the contract or dissolve the partnership but “innocent” partners must apply to the court for an order of rescission.**

6.36 In certain situations, dissolution of the partnership can be a more extreme solution than is required. If the common law ground on which the partnership contract is terminated (whether automatically or by the court) affects only the relationship between one partner and the others then the partnership could be dissolved only so far as that relationship is concerned.<sup>45</sup> Again, this would help to preserve continuity of business. We consider below<sup>46</sup> whether the court should have the power to dissolve only the relationship between the partner in question and the other partners on application under section 35 of the 1890 Act.

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<sup>44</sup> *Adam v Newbigging* (1888) 13 App Cas 308; *Redgrave v Hurd* (1881) 20 ChD 1. See generally, *Chitty on Contracts* (28th ed 1999) paras 6-101 *et seq.*

<sup>45</sup> RUPA has a similar device through dissociation from the partnership of a partner in material breach of the partnership contract. See section 601. The one affected partner would also have the rights dealt with in Part 7 of this Paper.

<sup>46</sup> Paras 6.38 - 6.42.

## Dissolution by court

6.37 At present section 35 of the 1890 Act provides as follows:

On application by a partner the Court may decree a dissolution of the partnership in any of the following cases:

- (a) [mental incapacity of a partner]<sup>47</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:
- (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.

The court only has power to dissolve the partnership as a whole. It cannot expel the partner who is causing the difficulty, while allowing the partnership to continue as between the other partners.

6.38 The first question here is whether the court should have power, in a case where a partner has become permanently incapable (whether or not because of mental incapacity) of performing partnership duties, not only to dissolve the partnership as a whole (if that is requested) but also, if there are three or more partners and the capable partners so request, to dissolve only the relationship between the incapable partner and the other partners.

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<sup>47</sup> The provisions vary for different parts of the United Kingdom. In Scotland the original s 35 still applies. It provides for dissolution by the court “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”. This archaic language clearly needs to be updated. In England and Wales the original wording has been repealed and the current provisions are now found in the Mental Health Act 1983 s 96(1)(g) which provides that ‘the judge shall have power to make such orders and give such directions and authorities as he thinks fit for the purposes of [section 95] and in particular may for those purposes make orders or give directions or authorities for ... the dissolution of a partnership of which the patient [ie, a person who the judge is satisfied, after considering medical evidence, is incapable, by reason of mental disorder, of managing and administering his property and affairs – section 94(2)] is a member’.

6.39 The same question arises in relation to the cases where a partner has been guilty of such conduct as “is calculated to prejudicially affect the carrying on of the business”<sup>48</sup> and where a partner “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.”<sup>49</sup> It would seem to be reasonable, in a case where there are three or more partners, for the court to have power, on the request of the non-guilty partners, to exclude the guilty partner while leaving the partnership in existence as between the other partners.

6.40 It is also for consideration whether, in situations akin to that mentioned in the last paragraph of section 35 of the 1890 Act,<sup>50</sup> the court should have power to exclude one of several partners, leaving the partnership subsisting as between the others, if circumstances have arisen making it just and equitable that that course should be adopted.<sup>51</sup> The application to the court to dissolve the partnership as regards only one partner could be made either by the majority of the partners wishing to have their relationship with another partner or partners dissolved, or by a partner wishing to leave the partnership for specific reasons but who does not otherwise have the right to withdraw.

6.41 There is a clear need to modernise some of the language of section 35 but that is a technical issue which can be addressed at a later stage.

6.42 We invite views on the following question:

**Should the court have an 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, in any or all of the following cases:**

- a) **when a partner has become permanently incapable of performing the partnership duties;**
- b) **when a partner 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;**
- c) **when a partner wilfully or persistently commits a breach of the partnership agreement, or otherwise so behaves in matters relating to the partnership business that it is not reasonably practicable for the other partners to carry on the business in partnership with that partner;**
- d) **whenever in any case circumstances have arisen which, in the opinion of the court, render it just and equitable that the**

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<sup>48</sup> The ground covered by s 35(c) of the 1890 Act, set out in para 6.37 above.

<sup>49</sup> The ground covered by s 35(d) of the 1890 Act, set out in para 6.37 above.

<sup>50</sup> Namely when “circumstances have arisen which, in the opinion of the court, render it just and equitable that the partnership be dissolved”.

<sup>51</sup> See Part 13 (Expulsion, Suspension and Compulsory Retirement) below.

**relationship between one partner and the others should be dissolved?**

6.43 There may be suggestions that there should be other grounds of dissolution by the court or that the existing grounds should be stated in some other way. It seems clear, for example, that a general ground like that in paragraph (d) above makes specific grounds unnecessary. We have not, in our preliminary consultations, been made aware of any suggestions for reform of this type but we invite views on the following question:

**Should there be any other reform of the rules on grounds for dissolution by a court?**

**Other possible reforms**

***Frustration of the partnership contract***

6.44 It is unclear whether a frustrating event automatically dissolves the partnership contract. It is submitted in *Lindley & Banks* that the doctrine of frustration cannot be applied to partnership agreements.<sup>52</sup> This view is formed on the basis that “a number of potentially frustrating events are specifically catered for by the Partnership Act 1890, so that, by necessary implication, the application of the doctrine to those and other events must be excluded.” Sections 33(1) (death or bankruptcy), 34 (illegality) and 34(b) (permanent incapacity) are given as examples by *Lindley & Banks* of potentially frustrating events specifically covered by the 1890 Act. The doubts expressed in *Hurst v Bryk*<sup>53</sup> as to whether normal rules of contract apply to partnership contracts add to the uncertainty regarding frustration.

6.45 We see no reason why a frustrating event other than those provided for by the 1890 Act should be prevented from dissolving a partnership. However, there is no justification for dissolving the whole partnership where frustration arises in respect of one partner only.

6.46 It is for consideration whether frustration of the partnership contract should be treated in the same way as illegality, involving the possibility of an automatic dissolution, restricted in certain cases to terminating only the relationship between the party affected by the frustration and the other partners. There could, however, be a question of overlap with other grounds of dissolution. For that reason it would be preferable to make it clear that the death, bankruptcy or incapacity of a partner continued to be governed by the rules on these grounds.<sup>54</sup>

6.47 An alternative, which may be preferable, would be to do nothing on the basis that cases of frustration not specifically dealt with by the 1890 Act fall within the just and

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<sup>52</sup> *Lindley & Banks*, para 24-05.

<sup>53</sup> [2000] 2 WLR 740. See paras 6.28 - 6.31 above.

<sup>54</sup> In English law a complication arises because the remedies for frustration are governed by the Law Reform (Frustrated Contracts) Act 1943. The interrelation of its provisions with those of the 1890 Act have not been tested. If the above reform were to be enacted it would probably be necessary to include legislative clarification that the 1943 Act would not apply. This would not appear to defeat the intention of the legislation as s 2(3) of the 1943 Act provides that contractual provisions intended to take effect on frustration should take effect and that those of the Act should only be given effect if consistent with the contractual provisions.

equitable ground of judicial dissolution under section 35(f). This option is supported by the view that the purpose of the doctrine of frustration is to achieve a just and equitable result on a change of circumstances.<sup>55</sup> This would be in keeping with our desire to preserve continuity of business wherever possible. We have already asked whether the court's power under section 35 should allow it to dissolve only the relationship between the partner affected and the other partners.<sup>56</sup>

6.48 The attitude of consultees to the treatment of repudiatory breach<sup>57</sup> is likely to inform their response to these options. We invite views on the following questions:

**(1) Should the frustration of the partnership contract be treated in the same way as illegality, involving the possibility of a dissolution restricted to terminating the relationship between the party affected by the frustration and the other partners? or**

**(2) Is it sufficient that cases of frustration not otherwise dealt with by the 1890 Act fall within the just and equitable ground of judicial dissolution of the partnership under section 35(f)?**

### ***Suffering share to be charged***

6.49 Section 33(2) of the 1890 Act provides that:

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.

6.50 Several questions arise. First, why does it apply only to cases where the partner's share is charged "under this Act" and not to cases where it is charged under some other rule – for example, under the Scots common law on arrestment in execution?<sup>58</sup> Secondly, why does it apply only to the situation where the partner "suffers" the share to be charged and not, for example, to cases where a partner voluntarily assigns the share,<sup>59</sup> whether or not in security for a debt? Thirdly, should the partners other than the one concerned have an option to expel the partner concerned as well as the existing option to dissolve the partnership? This would be consistent with the policy of not bringing partnerships to an end unnecessarily. The effect would be that the creditor who had effected the charge would be entitled to receive the value of the expelled partner's share.<sup>60</sup> Minor drafting improvements would seem also to be required. For example, the word "charge" is not

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<sup>55</sup> *Lauritzen AS v Wijsmuller BV* [1990] 1 Lloyd's Rep 1, 8.

<sup>56</sup> See para 6.42 above.

<sup>57</sup> Discussed above at paragraphs 6.28 - 6.33.

<sup>58</sup> Section 23 of the 1890 Act, on charging a partner's share at the instance of a judgment debtor, does not extend to Scotland where the equivalent procedure is arrestment in execution at common law. See Bell, *Comm.* II, 536; *Cassells v Stewart* (1879) 6 R 936, 956. The Scots common law in this area is not entirely satisfactory and we invite views later on possible reforms – see Part 18. If these were implemented by amendments to the 1890 Act then s 33(2) might apply automatically to Scotland.

<sup>59</sup> The effect of such an assignment is regulated by s 31 of the Act.

<sup>60</sup> The same solution as currently applies, under s 31 of the 1890 Act, in the case of a voluntary assignation in security.

appropriate in Scotland and it is not the share of the actual property that is the subject of the “charge” but the share in the partnership.

6.51 If the provision were to be extended beyond charging orders under the Act, which require a court order on the application of a judgment creditor and therefore provide some assurance that the debt is not trivial and that the partner has not simply overlooked it or delayed slightly in its settlement, then it would be for consideration whether safeguards would be required to prevent the power of dissolution from being unduly prejudicial to the partner whose share is affected. It may, for example, be for consideration whether there should be a threshold amount below which the other partners would not have the right to dissolve the partnership, or a period given for the partner to settle the debt before the partners could dissolve.

6.52 There appears to be a slight doubt as to whether the option to dissolve the partnership can be exercised by each partner independently, or whether unanimity is required.<sup>61</sup> Both Lord Lindley and the current editor of *Lindley & Banks* are of the view that unanimity ought to be necessary. We suggest that this point is clarified by statutory provision.

6.53 We invite views on the following questions and proposition:

**(1) Should the rule in section 33(2) of the 1890 Act, giving an option to dissolve the partnership if a partner’s share is “charged under this Act”, extend to other similar situations, such as an arrestment in execution of the share under the Scots common law or a voluntary assignment or assignation of the share, and if so which?**

**(2) If the rule were to be extended would any safeguards, such as a threshold amount or a period of grace for rectifying the situation, be necessary for the protection of the partner concerned?**

**(3) The partners, if two or more in number, other than the one concerned should have an option under section 33(2) to expel the partner concerned in addition to the existing option to dissolve the partnership.**

**(4) Should it be made clear that the option to dissolve the partnership given in section 33(2) requires the unanimity of the other partners?**

### **Provision for termination in partnership agreement**

6.54 The two grounds of dissolution, subject to any agreement between the partners, which relate to the expiry of a fixed term or the termination of a single adventure or undertaking<sup>62</sup> are just examples of a more general ground of dissolution – dissolution in terms of the partnership agreement. The reference to a “fixed term” in the Act has been construed widely by the courts but, at first reading, may tend to give the impression that it refers to a fixed term expressed in months or years or by reference to an expiry date. There might be some advantage in replacing these provisions by a general provision that a partnership comes to an end as regards all the partners at any time, or on the occurrence of

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<sup>61</sup> See *Lindley & Banks*, para 24-30.

<sup>62</sup> 1890 Act, s 32(a) and (b).

any act or event, provided for in the partnership agreement whether by express or implied terms.

6.55 We invite views on the following provisional proposal:

**There should be a general provision that a partnership comes to an end as regards all the partners at any such time, or on the occurrence of any act or event, as may be provided for, expressly or impliedly, in the partnership agreement as having this effect.**

#### **What a set of provisions favouring maximum duration might look like**

6.56 The result of favouring continuity to the fullest extent, if that should turn out to be the preferred solution,<sup>63</sup> and making the technical amendments suggested above would be as follows. A partnership would continue as a contractual relation or voluntary association<sup>64</sup> between the partners for the time being, original or assumed, until:

- a) the number of partners had been reduced below two, or
- b) the partnership was dissolved, as regards all the partners, in a way provided for in the partnership agreement;<sup>65</sup> or
- c) the partnership was dissolved, as regards all the partners, by the unanimous agreement of the partners for the time being, or by the agreement of those partners entitled by statute<sup>66</sup> to exercise an option to do so; or
- d) the partnership was dissolved, as regards all the partners, by a court on one of the statutory grounds; or
- e) the underlying partnership agreement was terminated, or set aside by a court, as regards all the partners, on ordinary principles of common law.

6.57 It would be made clear that a partner could cease to be a partner, for example, on death, retirement or expulsion, without that necessarily terminating the contractual relation or voluntary association between the other partners, if two or more remained, unless the partnership agreement so provided.

6.58 Courts would be given power, in certain cases where they have at present a power to dissolve the partnership completely, to dissolve only the relation between one partner and the rest.

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<sup>63</sup> Consultees may of course prefer certain events, such as the death of a partner, to result in dissolution of the partnership as a whole unless the partners have opted out of that solution.

<sup>64</sup> Depending on how the definition were framed. See para 5.26 above. Whether the partnership as a voluntary association has a separate personality so long as it continues is a separate question which we have considered in Part 4.

<sup>65</sup> For example, if so provided, on the expiry of a specified time, or on the completion of a task or enterprise, or on the death of any partner, or on the death or retirement of one particular partner whose skills are essential to the success of the business, or on the occurrence of any other specified act or event.

<sup>66</sup> Namely under s 33(2) which at present confers this option only in the case where a partner “suffers his share of the partnership property to be charged under this Act for his separate debt”.

6.59 Where a partnership agreement has no provision as to the duration of the partnership, a partner would have the right, unless this was excluded by the partnership agreement, to retire from the partnership but would not have the right, unless this was conferred by the partnership agreement, to dissolve the partnership as regards the other partners if two or more remained.

6.60 The bankruptcy of a partner would dissolve that partner's relation with the other partner or partners but, if two or more remained, would not terminate the relation between those other partners themselves unless the partnership agreement so provided.<sup>67</sup>

### **Special rule for partnerships in course of being wound up?**

6.61 The dissolution of a partnership does not necessarily complete the process of winding up the affairs of the partnership. Usually it will be the start of the winding up process rather than the end. This presents a problem in relation to those partnerships which have legal personality. It is necessary to stop the property of the partnership from becoming ownerless, and the rights of the partnership from coming to an end. There are two main options. The first is that the partnership can be deemed to continue after dissolution for the purpose of holding the property and rights of the dissolved former partnership until the winding up can be completed. The second option is that the property and rights can be transferred by operation of law to the former partners or some of them for the purposes of the winding up.<sup>68</sup> We discuss this problem in a later part of this paper.<sup>69</sup> If the "deemed survival" solution were to be adopted, the rules on duration discussed in this Part would have to be subject to the deemed survival rule.

### **Special rule for "one-partner" firms?**

6.62 In this Part we have assumed that a partnership will always come to an end when the number of partners is less than two. An essential feature of a partnership is no longer satisfied. It is for consideration, however, whether a period of grace (of, say, 90 days) should be allowed for the sole remaining "partner" to find a new partner. If a new partner could be found within this time the partnership might possibly be deemed to have continued. Some other legal systems have rules of this nature.<sup>70</sup> The rules on leaving a continuing partnership would then apply to the last partner but one. The advantages would be that it might be easier for the business to continue without a general winding up and that distinctions between the position of the third last partner to leave and the second last partner to leave would be avoided. If the partnership continued, and if it had a legal personality, problems of transferring property and contracts would be avoided. The disadvantage would be that there would be some logical and theoretical problems about the nature of the "partnership"

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<sup>67</sup> We have considered separately the case where a partner suffers the share of the partnership property to be charged for a personal debt. See paras 6.49 – 6.53 above.

<sup>68</sup> The liabilities of the partnership would become the liabilities of the former partners. See paras 8.24 – 8.26; 10.54 – 10.61 below.

<sup>69</sup> See Part 8 below.

<sup>70</sup> In Ghana section 41(1) of the Incorporated Private Partnership Act 1962 provides that a single remaining partner has six months in which either to admit a new member or members or to commence the winding up of the firm. In Sweden the Partnership and Non-registered Partnership Act (1980), Chapter 2, section 28 provides that where the number of partners in a registered partnership is reduced to one and this situation exists for six months the partnership is deemed to have already been placed in liquidation.

in the period of limbo. There would also be an increased period of delay and uncertainty for the last outgoing partner or the representatives of a deceased partner. It should be kept in mind that it is often possible for parties to reach agreement so that the last remaining partner takes over the assets and business, leaving that partner free to enter into a new partnership agreement with a new partner without any time constraints. The question can be seen therefore as being whether the bargaining position of the last remaining partner in relation to the last outgoing partner or the representatives of the last deceased partner should be altered. It might have to be considered whether any rules would be necessary to counter schemes whereby another partner was brought in only temporarily for the sole purpose of activating the special continuance rule.

6.63 An alternative way of trying to avoid a sale of the business and assets of the partnership when only one partner is left would be to give the last remaining partner an option to buy out the share of the last outgoing partner, leaving it up to the last partner whether or not to assume a new partner and carry on the business. It might be difficult, however, to justify an alteration in the bargaining position of the last two partners if there was not a strong chance that the partnership would continue as a partnership.

6.64 We invite views on the following questions:

- (1) Should special provision be made to enable a partnership to be deemed 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?**
- (2) Alternatively, should the last remaining partner be given an option to buy out the share of the last outgoing partner, whether or not the last remaining partner intends to assume a new partner?**
- (3) If either of the above approaches were adopted, would any special rules be necessary to prevent abuse?**

### **Special rule for registered partnerships?**

6.65 If registered partnerships were to be introduced it would be for consideration whether they should be subject to the ordinary rules on duration discussed in this Part. If they were, then provision would have to be made for the register to be cleansed of defunct partnerships from time to time. If they were not, then special rules would have to be introduced for the duration of registered partnerships. One possibility would be to disapply the normal rules on duration and provide that a registered partnership continued until the entry for it was removed from the register on one of various specified grounds. This would have the consequence that there would be one-member partnerships and no-member partnerships and partnerships which continued in existence even after having been dissolved by a court. We discuss the duration of registered partnerships more fully later.<sup>71</sup>

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<sup>71</sup> See Part 20 below.

# **PART VII**

## **POSITION OF OUTGOING PARTNER**

### **Introduction**

7.1 In this Part we discuss the rules applicable where one partner dies or leaves a partnership but the partnership continues, as a legal relation and voluntary association,<sup>1</sup> between at least two surviving or remaining partners. The law already contains relevant rules because partnership agreements often provide that the partnership is to continue notwithstanding the death, retirement or expulsion of a partner. If some of the changes suggested in earlier Parts of this paper were adopted, the rules on the position of an outgoing partner, where the partnership continues, would be of more frequent application.<sup>2</sup>

7.2 Our concern in this Part is with the right of the outgoing partner to be bought out. We deal elsewhere with the rules on the liability of the outgoing partner for partnership debts contracted before or after the date of departure.<sup>3</sup>

### **Use of term “outgoing partner”**

7.3 For the sake of simplicity we use the term “outgoing partner” to cover both the situation where the partner is still alive, as in the case of retirement or expulsion, and the situation where the partner has died. In the second situation references to the outgoing partner are references to the representatives of the deceased partner. Strictly, “outgoing” is misleading because it suggests a continuing process but it is widely understood to include the partner who has already left the partnership. We use it in that sense.

7.4 There will be an outgoing partner, in the sense in which we use the term in this Part, where one partner ceases to be a partner but the partnership continues as a relation or voluntary association between at least two remaining partners. It may continue either because the partnership agreement provides for this or because new default rules are introduced to provide for continuity.

### **General**

7.5 The 1890 Act deals with the main effects of dissolution of a partnership in sections 36 to 44.<sup>4</sup> The Act does not contain separate parts dealing respectively with the position where

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<sup>1</sup> If some of the options discussed earlier were adopted, the partnership might also continue as a legal person, but the subject matter of this Part does not depend on the adoption of any particular option as to continuing legal personality.

<sup>2</sup> Some of the changes suggested in this Part would also apply if there was a special rule for “one-partner” firms or if the last remaining partner were granted a statutory option to buy out the share of the last outgoing partner: paras 6.62 - 6.64 above. The discussion on valuation (para 7.30 *et seq*) would also be relevant to the situation where the terms of the partnership agreement granted such an option but failed to specify the method of valuing the share.

<sup>3</sup> See paras 10.42 - 10.53 below.

<sup>4</sup> It also has rules, in sections 14, 17 and 36 on the liability of an outgoing partner for partnership debts. We deal with these rules later.

a partner leaves a continuing partnership and the position where the partnership comes to an end as regards all the partners. The provisions are mixed up together. Some appear to apply to the one situation,<sup>5</sup> some to the other<sup>6</sup> and some to both.<sup>7</sup> In this Part of the paper we are concerned primarily with the rules in sections 39, 42 and 43.

### **An outgoing partner's right to enforce a sale**

7.6 Section 39 of the 1890 Act provides that:

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.

7.7 Although this appears to give an absolute right to an outgoing partner to demand a winding up, with the sanction of applying to the court if the other partners do not agree, its effects have been qualified by the courts. First, it may be held that the outgoing partner has expressly or by implication waived the right to demand a winding up, particularly if all the partners had agreed in advance that the partnership and its business would continue.<sup>8</sup> Secondly, a 'salaried partner', even though held to be a true partner, might not have a right to demand a winding up, depending on the circumstances of the case.<sup>9</sup> Thirdly, the English courts have retained a discretion to order that the share of the outgoing partner in the partnership should simply be valued and paid in lieu of having a winding up. This is known as a *Syers v Syers*<sup>10</sup> order after the decision of the House of Lords in that case.<sup>11</sup>

7.8 A *Syers v Syers* order should not be part of a ruling on the entitlement to partnership assets, but should only be made when the Court is giving directions on the method of winding up a partnership and the ascertainment and distribution of assets.<sup>12</sup> The precise extent of the availability of a *Syers v Syers* order is unclear. It may be available when the outgoing partner's share is small as in *Syers v Syers* itself.<sup>13</sup> It may also be available where a sale of the assets is impracticable.

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<sup>5</sup> For example, s 43 seems to be confined to the continuing partnership.

<sup>6</sup> For example, s 38 seems to be confined to the non-continuing partnership.

<sup>7</sup> For example, ss 39, 42 and 44.

<sup>8</sup> See, eg, *Sobell v Boston* [1975] 1 WLR 1587, 1591, per Goff J.

<sup>9</sup> See *Stekel v Ellice* [1973] 1 WLR 191, where the salaried partner was held to lack any proprietary interest in the firm's capital, goodwill or clients.

<sup>10</sup> (1876) 1 App Cas 174.

<sup>11</sup> This discretion is unaffected by the 1890 Act: see *Hugh Stevenson and Sons Ltd v Aktiengesellschaft für Catonnagen-Industrie* [1917] 1 KB 842, 857, per Lawrence J (CA); [1918] AC 239, 254 - 255, per Lord Atkinson (HL).

<sup>12</sup> *Hugh Stevenson and Sons Ltd v Aktiengesellschaft für Catonnagen-Industrie* [1918] AC 239, 255.

<sup>13</sup> Partners holding a seven-eighths interest in the firm were allowed to buy the remaining one-eighth interest of the other partners.

7.9 In the unreported Court of Appeal case of *Hammond v Brearley and Burnett*,<sup>14</sup> Hoffmann LJ noted that a *Syers v Syers* order is available in ‘exceptional’ cases.<sup>15</sup> In *Hammond*, one partner had a share in minor assets, but no interest in the firm’s goodwill. At an interlocutory hearing an order for the sale of partnership assets was made. Hoffmann LJ considered the facts of the case to be highly unusual and possibly appropriate for a *Syers v Syers* order. He held that this possibility should have been left to the discretion of the trial judge.<sup>16</sup>

7.10 The courts, by modifying the apparently unqualified right conferred by section 39, have recognised that it is not always appropriate for an outgoing partner to have an absolute right to demand a winding up of the partnership. However the above cases demonstrate the limited availability of a *Syers v Syers* order. The usual position will be that, in the absence of an express or implied waiver, an outgoing partner has the right to enforce a winding up of the business.

7.11 The right of the outgoing partner to have the partnership affairs wound up and the assets applied to meet the liabilities is arguably too strong. It places the outgoing partner in a powerful position and may lead to the break up of businesses which could otherwise have continued. On the other hand it is necessary for the default rules in the Act to recognise, and provide proper protection for, the legitimate interests of the outgoing partner who might have serious and well-founded doubts about the ability of the remaining partners to pay the value of the outgoing partner’s share in the partnership. Our provisional view is that the best approach would be to begin with the assumption that the outgoing partner’s claim is only to be paid out, but to provide recourse to the courts for exceptional cases. The exceptional cases that we provisionally propose are where the outgoing partner could show that there was a substantial likelihood either that his claim could not be met or that he would not be indemnified against the liabilities of the firm for which he retained a liability to creditors of the firm.<sup>17</sup>

7.12 We invite views on the following provisional proposals:

**(1) Where a partner leaves a partnership, which continues as between the remaining partners, the outgoing partner should not have the right to require the business to be wound up unless this right has been conferred by the partnership agreement.**

**(2) The outgoing partner should, however, have a right to apply to the court to have the business wound up on the ground that there was a substantial likelihood either that the remaining partners would not be able to pay out the share of the outgoing partner or that the outgoing partner would not be indemnified against the liabilities of the firm.**

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<sup>14</sup> 10 December 1992.

<sup>15</sup> In *Hammond v Brearley and Burnett* (unreported) 10th December 1992, Hoffmann LJ also observed that it is ‘notorious’ in the Chancery Division that *Syers v Syers* is more frequently cited than applied.

<sup>16</sup> Similarly in *Toker v Akgul* [1996] 6 CL 466 Evans LJ, giving the leading judgment of the Court of Appeal, held that the court’s ability to make the appropriate order in a partnership dispute “should reign supreme”.

<sup>17</sup> See paras 10.42 - 10.48 below.

## No provision on what happens to outgoing partner's share

7.13 Currently where there is an outgoing partner and it is agreed, expressly or by implication, that the partnership should continue among the remaining partners, section 43 will apply<sup>18</sup> so that the outgoing partner's share will be a debt normally with effect from the date of the outgoing partner's departure.<sup>19</sup>

7.14 It is clear that when a partner leaves a continuing partnership there must also be some provision for the transfer of the outgoing partner's share in the partnership to the remaining partners.<sup>20</sup> If the partnership does not have a separate continuing personality there also has to be some provision for the transfer of the outgoing partner's title to particular items of property to the new group of partners.<sup>21</sup> These important matters are not regulated expressly by the 1890 Act. They are left to be regulated by the partnership contract, by implication from provisions in the Act<sup>22</sup> or the general nature of a partnership.<sup>23</sup>

7.15 The way of dealing with this common situation may be regulated by the partnership agreement but there is a need for default rules for those cases where it is not. It seems reasonably clear that the appropriate technique is for the outgoing partner's share to be transferred automatically, at the moment of departure, to the remaining partners in return for a right to a payment by the remaining partners representing its fair value.

7.16 In the case of partnerships without a continuing legal personality it would also be necessary to provide that the outgoing partner would be bound, on request, in exchange for payment for the share in the partnership to take any necessary steps to transfer to the remaining partners the title to any particular partnership assets, or to an interest in them, standing in the name of the outgoing partner. In the case of partnerships with a continuing legal personality a provision of this nature would not normally be necessary because the partnership property would belong to the partnership. However, even in this situation there

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<sup>18</sup> If the partnership agreement provides that the outgoing partner retains the share *in specie* until its value is ascertained, the conversion of the share into a debt will be deferred.

<sup>19</sup> A consequence of section 43 treating an outgoing or deceased partner's share as a debt is that normal limitation rules will apply in respect of actions between partners. Currently the debt will be time-barred six years after the date of dissolution or death. If the partnership was constituted by deed, the limitation period will be twelve years as a specialty debt. Any lien in support of the section 43 debt is likely to be extinguished at the same time.

<sup>20</sup> In English law a partner's share is his entitlement to the net proceeds of sale of the assets of the firm: *Lindley & Banks*, paras 19-04 - 19-06. In Scots law the share in a partnership is similarly a portion of the net assets of the partnership on realisation and is a debt by the partnership to the partner. See Bell, *Comm. II*, 536, *Parnell v Walter* (1889) 16 R 917.

<sup>21</sup> We are assuming that in a new law on partnership there would be no case where the firm had a non-continuing legal personality which would come to an end on a change in composition even if the partnership continued. We do not therefore have to consider the problem (which, on one view of the law, exists in Scotland at present) of transferring assets from the old firm to the new where all that happens is that a partner ceases to be a member of a partnership which continues as regards two or more remaining partners.

<sup>22</sup> For example, s 43 (which could be read as implying that the share accrues to the "surviving or continuing partners" to be replaced by a right to a monetary "amount").

<sup>23</sup> It might be thought to be contrary to the nature of a partnership that a person could cease to be a partner and yet continue to own a share in the partnership. This would be like ceasing to be a shareholder in a company while continuing to own the shares.

could be a need to arrange for a transfer to new trustees of any assets held by the outgoing partner in trust for the partnership.

7.17 We invite views on the following provisional proposals:

**(1) The outgoing partner's share in a continuing partnership should be transferred to the remaining partners by operation of law at the moment of departure.**

**(2) The counterpart of this automatic transfer should be that the outgoing partner becomes entitled to the value of the share. This value is a debt from the date of departure.**

**(3) Where particular partnership assets are held in the name of the outgoing partner, the outgoing partner should be bound, on request, to transfer title to the remaining partners or to the partnership (if it has a continuing legal personality) or to trustees for the partnership, as may be appropriate.**

### **Interest on the value of the outgoing partner's share**

#### ***Section 42***

7.18 Section 42 deals with the situation where the continuing partners carry on the partnership business with its capital or assets without any final settlement of accounts with the outgoing partner. It applies not only where the partnership continues but also where the partnership assets are used in the way indicated – even if by a new partnership or even by a sole remaining partner.<sup>24</sup> It is a sort of special statutory rule on restitution or unjustified enrichment designed to prevent the persons using the assets from profiting from that use at the expense of the outgoing partner.

7.19 Section 42 provides that:

(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,<sup>25</sup> 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

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<sup>24</sup> See, for example, *Barclays Bank Trust Co Ltd v Bluff* [1982] Ch 172.

<sup>25</sup> The section refers to partners carrying on the business of the firm “with *its capital or assets*”. Interestingly earlier drafts of the Partnership Bill referred throughout to capital or assets. However, a partnership's assets would include its capital, so nothing turns on this.

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.

7.20 Section 24(1) provides that, subject to agreement to the contrary, partners are entitled to share equally in the capital and profits of the business. That those rights continue following dissolution is apparent from section 38.<sup>26</sup> In *Popat v Shonchhatra*<sup>27</sup> the Court of Appeal held that section 42(1) is an exception to the general application of section 24(1) post-dissolution, but that post-dissolution capital profits are covered by section 24(1), not being profits within the meaning of section 42(1).<sup>28</sup>

7.21 There are considerable practical problems in determining what profits (if any at all) are attributable to a partner's share of partnership assets.<sup>29</sup> The provision is unnecessary, given that a right to interest on the value of the partner's outstanding share would be sufficient, if interest were at an appropriate rate, to recognise the outgoing partner's rights.

7.22 Instead of an account of post-dissolution profits, the outgoing partner has the option to elect to receive interest at 5 per cent per annum on the amount of his share of the partnership assets.<sup>30</sup> This has the benefit of simplicity. The rate has not changed since it was enacted in 1890. There will obviously be times when the rate is uneconomic. There was judicial criticism of this in *Sobell v Boston*.<sup>31</sup>

7.23 We suggest that the interest should be at a commercial rate from the date the debt accrues and that the option to elect for a proportionate share of the profits attributable to the use of a partner's share of the assets in section 42 be abolished.

7.24 The rate of interest could be related to:

- (1) the Bank of England base rate;
- (2) the retail bank base rates; or
- (3) the court judgment rate.

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<sup>26</sup> See para 8.5 *et seq.*

<sup>27</sup> [1997] 1 WLR 1367.

<sup>28</sup> It is our view that an increase in value of a capital asset cannot be regarded as being attributable to the *use* of a share of the partnership assets.

<sup>29</sup> These difficulties were considered in *Willet v Blanford* (1842) 1 Hare 253, 269; 66 ER 1027, 1033; *per* Wigram V-C and in *Hugh Stevenson and Sons Ltd v Aktiengesellschaft für Catonnagen-Industrie* [1917] 1 KB 842, 849 (affirmed [1918] AC 240 (HL)) by Swinfen-Eady LJ, where it was pointed out that: "subsequent profits may be wholly attributable to the diligence, business aptitude, credit, and personal qualities of the remaining partners." Wigram V-C's guidelines amount to this: an outgoing partner *may* be entitled to an account of post-dissolution profits but this can only be satisfactorily determined when all the facts are put before the court; there are a number of conceivable outcomes.

<sup>30</sup> In *Williams v Williams* [1999] 9 CL 457 it was decided that the court could not order the payment of interest under its statutory power in cases to which section 42 applied.

<sup>31</sup> [1975] 1 WLR 1587, 1593 *per* Goff J.

7.25 The purpose of the interest is to compensate the outgoing partner for the need to borrow money pending the payment of his debt. Obviously the actual rate a partner would be quoted depends on numerous factors. However, the benchmark is invariably the Bank of England base rate. To link the value of a partner's right to compensation on this seems the most appropriate way of pegging the rate of interest to prevailing economic circumstances.

7.26 We invite views on the following provisional proposal and question:

**(1) The outgoing partner should no longer have a right under section 42 to a share of the profits attributable to the outgoing partner's share in the partnership assets. Instead there should be a right to interest, at a rate reflecting current rates, on the amount of the share due to the outgoing partner.**

**(2) Should the rate of interest be a specified percentage above the Bank of England base rate and, if so, what should it be?**

### **Indemnity to outgoing partner**

7.27 We have proposed the transfer of the outgoing partner's share to the remaining partners.<sup>32</sup> It is probably appropriate to provide that the firm or the remaining partners should indemnify the outgoing partner against the firm's debts and obligations. Lord Lindley explained the basis of such an indemnity:

if all the assets of the firm are assigned to the continuing or surviving partners, it is only fair that they should undertake to pay its debts: and if it appears that it was the intention of all parties that they should do so, effect will be given to such intention, although the undertaking on their part is not explicit in its terms.<sup>33</sup>

Such an indemnity is usually implied.<sup>34</sup>

7.28 The transfer of the outgoing partner's share would not have the effect of discharging the outgoing partner's liability to creditors of the firm.<sup>35</sup> In the absence of such a discharge, an indemnity is required to give effect to the transfer of the share. This is clear where the share is valued by reference to net assets on a notional sale. But it follows from the nature of a partner's share as a share of the net value of the firm<sup>36</sup> whatever method of valuation is adopted. We recognise that there may be circumstances in which the partners may wish to qualify an indemnity, as for example where breach of duty by the outgoing partner has caused loss to the firm.<sup>37</sup> One solution is to provide for an indemnity as a default rule and

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<sup>32</sup> See para 7.17 above.

<sup>33</sup> Quoted in *Lindley & Banks*, para 10-207.

<sup>34</sup> See *Gray v Smith* (1889) 43 Ch D 208, 213, *per Kekewich J*.

<sup>35</sup> See paras 10.42 - 10.48 below.

<sup>36</sup> See *Lindley & Banks*, paras 19-04 - 19-06, Bell, *Comm. II*, 536, *Parnell v Walter* (1889) 16 R 917.

<sup>37</sup> Often express indemnities will exclude any liability attributable to the outgoing partner's wrongful acts or omissions even if there is no breach of duty to the firm: see *Lindley & Banks*, para 10-208, and for an example, T Sacker, *Practical Partnership Agreements* (1st ed 1995) p 56.

leave it to the parties to qualify the indemnity.<sup>38</sup> Another is to provide as a default rule that the indemnity does not cover any liability attributable to the outgoing partner's wrongful acts or omissions. Another is to provide that the indemnity should be without prejudice to any claims the partners or firm may have against the outgoing partner for breach of duty to the firm which has caused loss to the firm.

7.29 We invite views on the following questions:

**(1) Do consultees agree that there should be a default rule that if the outgoing partner's share is to be paid out the outgoing partner should receive the benefit of an indemnity from the remaining partners?**

**(2) If so, should the indemnity be qualified:**

- (a) to exclude any liability attributable to the outgoing partner's wrongful acts or omissions; or**
- (b) so that it is without prejudice to any claims which the partners or firm may have against the outgoing partner for breach of duty to the firm; or**
- (c) in any other way?**

### **Valuation of an outgoing partner's share**

7.30 The introduction of continuing independent legal personality or of the provisional proposals in Part 6 would lead to a decrease in the number of general dissolutions. There would therefore be more instances of partners leaving continuing partnerships and of valuations of their shares.<sup>39</sup>

7.31 Here we deal with disputes as to the value of a partnership or of the share or as to how the share should be paid out. Methods of valuation are summarised in Appendix C, adapted for partnerships by Peter Holgate and Emile Woolf of Kingston Smith from Appendix D in *Litigation Support*.<sup>40</sup> Drawing on that text we canvas views as to two alternative measures of valuation that could be provided in statute to apply if the partners have no agreement as to such measures. We then go on to consider whether the currently available methods of dispute resolution should be reformed to deal with valuation disputes. Finally we discuss whether there should be provision for payment by instalments.

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<sup>38</sup> See for example section 701(d) of RUPA which provides for an indemnity but excludes liabilities incurred after dissociation through an act of the dissociated partner within his apparent authority. It has been drawn to our attention by English practitioners that there is more resistance in recent years to the giving of an indemnity by the continuing partners to the outgoing partner. This is apparently due to fears that it may encourage partners to leave when a partnership is encountering financial difficulties.

<sup>39</sup> Many partnerships have no formal agreement to govern them. See para 1.17 above.

<sup>40</sup> PricewaterhouseCoopers, C J Lemar & A J Mainz (eds), *Litigation Support* (4th ed 1999), published by Butterworths, a Division of Reed Elsevier (UK) Ltd.

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## **Valuation of the partnership**

7.32 The valuation of any business is a highly subjective matter. The choice of an appropriate method depends on the circumstances of the business being valued.<sup>41</sup> The effect on the business of the departure of a partner is relevant both to valuation and to arrangements for payment for the share.<sup>42</sup> In cases where there is no agreement as to how a departing partner's share is to be valued, significant costs may be incurred in taking advice on and litigating that issue. A statutory default provision would reduce or remove such costs. However, the vastly differing nature and circumstances of partnerships make it impossible to prescribe a detailed statutory basis for valuation. We call the two alternative measures considered below "notional sale" and "accounts". They would only be relevant in the absence of an agreement between the partners as to how to deal with the departure of one member of the firm.

### THE NOTIONAL SALE MEASURE

7.33 This option would measure the value of the outgoing partner's entitlement by reference to the value of the business as a whole were it to be sold. Paragraph 2 of Appendix C explains that in some businesses this would involve valuing net asset values but that the majority of businesses will be valued by reference to the likely future maintainable earnings of that business and the level of return which a third party investor would expect to receive on the acquisition of the business or a share of it.

7.34 Appendix C sets out the elements that are taken into account in the notional sale measure. Two in particular, work in progress and goodwill, have given rise to litigation.<sup>43</sup>

7.35 In the Scottish case of *Bennett v Wallace*<sup>44</sup> it was the opinion of the Inner House that "an item such as work in progress, as we have attempted to describe it,<sup>45</sup> must, in the absence of some contrary agreement, be considered to be an asset and be accounted for in some way". There are a number of divergent decisions as to how it should be accounted for but ultimately this is a matter for the valuer in the particular case.<sup>46</sup>

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<sup>41</sup> See for example Appendix C paras 4, 5 and 29 - 31.

<sup>42</sup> For example some departures, such as retirement at a certain age, can be planned and accounted for in advance. Another relevant factor is whether the outgoing partner will set up in competition to the business being valued: see Appendix C para 34.

<sup>43</sup> See Appendix C, paras 14, 16 and 35 - 37 for their treatment by accountants during the process of valuing a business.

<sup>44</sup> 1998 SC 457, 462.

<sup>45</sup> "[T]he expression 'work in progress' may include both debtors in respect of fees rendered and a value put on work done but uncompleted which would not normally be charged to the client until the work had been carried through to completion." At p 462.

<sup>46</sup> For divergent decisions on work in progress see: *Robertson v Brent* [1972] NZLR 406; *Hawthorn, Cuppaidge and Badger v Channell* 23 (unreported) November 1990 (4640 of 1988), per Cooper J at p 31 of the transcript (Queensland Supreme Court); *Lewis v Sturge* [1989 - 1992] BCLD 883 (High Court of New Zealand); and *Bennett v Wallace* 1998 SC 457, 462.

7.36 Goodwill can be particularly problematic. It is not always treated as a partnership asset.<sup>47</sup> Its definition has been discussed in a number of cases<sup>48</sup> and its treatment has changed over time.<sup>49</sup> Appendix C discusses the factors which may be included in goodwill.<sup>50</sup> One component may be the firm name.<sup>51</sup> The courts have been faced with difficult issues concerning the basis for valuing goodwill<sup>52</sup> and the use of the firm name.<sup>53</sup> As Appendix C shows, under a notional sale measure the value attached to the partnership's goodwill would be reflected in the overall valuation of the business.<sup>54</sup>

7.37 In that the notional sale measure takes into account all the relevant factors which affect the value of the business, it should produce a valuation which is fair both to the outgoing partner and the remaining partners. However this inclusivity means that it is a costly measure and its enactment as a default rule may impose disproportionate costs on small businesses.

#### THE ACCOUNTS MEASURE

7.38 The other measure which we have considered is fixing the entitlement of the outgoing partner by reference to the accounting practice adopted in the last annual accounts. Accounts could be made up on this basis on the date that partner leaves. This is a standard provision in partnership deeds relating to the entitlement of an outgoing partner.<sup>55</sup> The accounts measure is relatively simple, certain and cheap to apply.

7.39 A partner would receive back any advances made to the firm, the capital contribution standing in the name of that partner in the partnership accounts and the appropriate share of accrued profits for the year of departure. The partner would also be entitled to any share of a tax reserve maintained for the partners. Whether the profits would include a revaluation of any assets held by the firm would depend on the accounting practice adopted by the partnership in their last annual accounts; the same approach would

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<sup>47</sup> *Miles v Clarke* [1953] 1 WLR 537. In this case the plaintiff, a well-known photographer, brought his goodwill into the business. On the dissolution of the partnership, it was held that only the stock in trade was a partnership asset.

<sup>48</sup> See for example *IRC v Muller & Co's Margarine Ltd* [1901] AC 217, 223, per Lord Macnaghten, and 235, per Lord Lindley; and *Whiteman Smith Motor Co v Chaplin* [1934] 2 KB 35, 42, per Scrutton LJ, and 50, per Maugham LJ.

<sup>49</sup> In *Hammond v Douglas* (1800) 5 Ves 539; 31 ER 726 where one partner died the goodwill survived for the benefit of the surviving partner. Cf *In re an Arbitration between David and Matthews* [1899] 1 Ch 378, 384, per Romer J "...up to comparatively recent times, it was considered that the right to the goodwill belonged to the surviving partner, and that it is only recently that the importance of goodwill and the necessity of preventing its improper appropriation have been fully recognised...".

<sup>50</sup> Appendix C, para 37.

<sup>51</sup> *Churton v Douglas* (1859) Johns 174; 70 ER 385. It may also be that there is independent goodwill in part of a firm name, for example because one part of the name is particularly striking or because the name is normally shortened by the public: see the judgment of Hoffmann J in the *Baker v Benson* (unreported) 3 August 1988.

<sup>52</sup> See for example *In re an Arbitration between David and Matthews* [1899] 1 Ch 378, 382, per Romer J.

<sup>53</sup> See for example *Gray v Smith* (1889) 43 ChD 208, 221 and *Townsend v Jarman* [1900] 2 Ch 698.

<sup>54</sup> See Appendix C, paras 35 - 37. This will not, however, be possible for medical partnerships. Any direct or indirect attempt to realise the value of goodwill is an offence under the National Health Service Act 1977, s54 and Sched 10.

<sup>55</sup> See for example, Sir Peter Millett, *The Encyclopaedia of Forms and Precedents*, Vol 30, (5th ed 1990) p 85, cl 20, [212].

apply when the partner leaves. If a partnership does not have an established accounting practice, accounts could be compiled in accordance with normal accounting standards.<sup>56</sup>

7.40 There are however a number of difficulties with this approach. Annual accounts are not compiled for the purpose of valuing the firm's business: the accounting treatment that applies during the partnership, such as valuing an asset at book or market value, is not necessarily an appropriate basis for assessing the value of an outgoing partner's share. The courts have had to address these issues in cases where the partnership agreement has provided for the entitlement of the outgoing partner.<sup>57</sup> The Court of Appeal in *Re White*<sup>58</sup> held that in the context of a family partnership, where the share was to be paid out according to the terms of the partnership agreement, there was no presumption as to the method of valuation of the partnership assets; whether the value of the assets is to be calculated by reference to the accounting practice adopted by the partnership during its continuance, depended upon the construction of the terms of the partnership agreement. The effect of the decision in *Re White* was that the partnership's freehold property was valued by reference to its book value rather than its greater market value in order to determine the entitlement of the deceased partner's estate. Although this benefited the surviving partner at the expense of the deceased partner's estate, it was a just result because it accorded with the contractual intention of the parties to facilitate continuity of the business.<sup>59</sup> It could be said that a statutory provision applying the accounts measure would be unjust because it would not reflect their agreement.

7.41 Similarly annual accounts often ignore goodwill. Depriving the outgoing partner of his share of the value attached to goodwill could operate unfairly, although this will not be the case where the value of goodwill is vested in individual partners and there is a risk that the partnership will lose business on the occasion of a partner's departure.<sup>60</sup> Against this it could be argued that the potential for unfairness could operate as an incentive for partners to include appropriate provisions in their partnership agreements.

7.42 It is necessary to consider the compatibility of the accounts measure with Article 1 of the First Protocol of the European Convention on Human Rights. Article 1 protects property rights.<sup>61</sup> Ignoring goodwill and valuing assets by reference to their book value where this differs considerably from their market value for the purposes of valuing and paying the

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<sup>56</sup> See paras 12.5 - 12.7 below.

<sup>57</sup> *Cruikshank v Sutherland* (1922) 92 LJ Ch 136 (HL); *Clark v Watson* 1982 SLT 450; *Thom's Executrix v Russel & Aitken* 1983 SLT 335; *Wilson v Dunbar* 1988 SLT 93; and *White (deceased) v Minnis & another* [2000] 3 All ER 618. The Scottish cases suggest that the value of assets should be calculated at their fair market value in the absence of an agreement on a different basis of valuation.

<sup>58</sup> [2000] 3 All ER 618.

<sup>59</sup> *Ibid* at p 632 *per* Chadwick LJ: "The basis of their partnership was that, if they continued as partners throughout their joint lives, the survivor would be able to carry on the business on payment of a relatively modest sum to the estate of the deceased. That was an arrangement which was likely to benefit one at the expense of the estate of the other - but which would be the beneficiary would not be known until one or other died."

<sup>60</sup> See Appendix C para 34.

<sup>61</sup> Article 1 comprises three distinct but overlapping rules: the first is the general principle of peaceful enjoyment of property; the second relates to the deprivation of property; and the third is concerned with the control on the use of property. This was established in a line of authority beginning with *Sporrong and Lönnroth v Sweden* A 52 (1982), 5 EHRR 35, para 61.

share of the outgoing partner may amount to a control on the use of property<sup>62</sup> within the meaning of Article 1.<sup>63</sup> However states are entitled to control the use of property in accordance with the general interest, by enforcing such laws as they consider necessary for this purpose.<sup>64</sup> First there must be a legitimate aim in the general interest. Secondly there is a test of proportionality: the means employed to achieve the aim must be proportionate to that aim.<sup>65</sup>

7.43 The aim of a statutory measure of valuation is to determine the entitlement of an outgoing partner in an appropriate manner in cases where the parties fail to agree this. There can be a public interest in ensuring the fairness of private legal relations.<sup>66</sup> The accounts measure appears to satisfy the requirement of a legitimate aim in the general interest. The application of the test of proportionality requires consideration of the merits and drawbacks associated with the accounts measure. These were discussed above. In this context it is worth noting again two factors of particular importance: it would only be a default provision and therefore would not interfere with any private contractual rights; and the lack of any default provision which would be appropriate for all the circumstances to which it will apply suggests that some potential for unfairness may be proportionate to the aim sought to be realised.

### ***Invitation for views***

7.44 We invite views on the following provisional proposal and question:

- (1) There should be a statutory default measure of the value of the partnership which should be applied to determine the amount payable to a partner leaving a continuing partnership.**
- (2) Should the statutory measure be based upon:**

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<sup>62</sup> In *Van Marle v The Netherlands* A 101 (1986), 8 EHRR 483, para 41, the professional clientele which the applicants had built up through their own work, was likened to a right of property protected by Article 1. The Commission in its decision, *Karni v Sweden* (1988) 55 DR 157, considered that the vested interests in the applicant's medical practice may be regarded as "possessions" within the meaning of Article 1. Consequently, a partner's share in the partnership is within the protection afforded by Article 1.

<sup>63</sup> The situation is analogous to that in *Mellacher v Austria* A 169 (1989), 12 EHRR 391. The applicants were deprived of part of the income from their possessions. This amounted to a control on the use of property rather than a deprivation of possessions notwithstanding that in one case the control resulted in the applicants receiving only 17.6% of the income which they would have received, but for the control.

<sup>64</sup> The European Court of Human Rights accords states a wide margin of appreciation both as to the existence of a problem which warrants measures which interfere with the peaceful enjoyment of possessions in the public interest and as to the choice of rules to implement such measures: *James v United Kingdom* A 98 (1986), 8 EHRR 123, para 46 and *Mellacher*, para 45. However this doctrine is not available to national courts. Instead it appears that the domestic courts will decide human rights issues by considering questions of balance between competing interests and issues of proportionality: *R v Director of Public Prosecutions ex p Kebilene* [1999] 3 WLR 972, 993 - 994, per Lord Hope. This involves allowing a democratic legislature or executive a discretionary area of judgment in striking a balance between such interests.

<sup>65</sup> *James*, para 50; *Mellacher*, para 48. This test is also formulated in terms of striking a 'fair balance' between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights.

<sup>66</sup> *James*, para 41, "In particular, the fairness of a system of law governing the contractual or property rights of private parties is a matter of public concern and therefore legislative measures intended to bring about such fairness are capable of being 'in the public interest', even if they involve the compulsory transfer of property from one individual to another."

- (a) a notional sale of the business; or
- (b) the accounting practice adopted in the last annual accounts (or normal accounting standards if a partnership does not have an established accounting practice)?

### **Valuation: dispute resolution**

7.45 Under the current law there are two alternatives for resolving a valuation dispute: according to a term in the partnership agreement which makes provision for this scenario; or in the absence of such a provision, the parties must go to court.

7.46 There are a number of methods to resolve the valuation dispute for which the partnership agreement could provide. The partnership agreement may contain an arbitration clause. In English law arbitration is governed by the Arbitration Act 1996. In Scotland arbitration is governed largely by the common law. It differs from court proceedings in that it is largely confidential, more flexible, for example the parties may agree all the procedures themselves, and the arbitrator, in Scotland the arbiter, often has specialised experience in the relevant field. The partnership agreement may contain a general provision referring all disputes to arbitration or it may deal only with certain matters such as valuation.<sup>67</sup> The agreement may name the arbitrator or lay down a procedure for appointing one.<sup>68</sup>

7.47 Alternatively there could be a provision for valuation to be referred to expert determination. Contracts may provide for an issue to be decided by a third party expert as an expert and not as an arbitrator.<sup>69</sup> It is much less formal than arbitration and there is less judicial control.<sup>70</sup> The procedure must be determined by the parties and their expert. Consequently it is cheap, quick and private. The agreement should provide for the appointment of the expert as in the case of arbitration. It will usually also provide that the expert's decision is final and cannot be appealed.<sup>71</sup> Expert determination is often provided for in contracts to deal with valuation issues such as share valuation by auditors or rent reviews by surveyors.

7.48 If the partnership agreement fails to provide for a method to resolve the dispute and the parties are unable to agree one, then the matter must go to court. In England and Wales the court may deal with the dispute in a number of ways. Under the Civil Procedure Rules

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<sup>67</sup> See for examples, T Sacker, *Practical Partnership Agreements* (1st ed 1995) pp 31 - 32 for a general provision except where the partnership agreement provides otherwise; and pp 59 - 60 for a specific provision concerning the power to expel.

<sup>68</sup> *Ibid*, at pp 31 - 32. For example, the arbitrator will be appointed by the partners involved in the dispute if they can agree upon one or failing agreement by the president of an appropriate body.

<sup>69</sup> See Sir Peter Millett, *The Encyclopaedia of Forms and Precedents*, Vol 30, (5th ed 1990) p 90, cl 4.3, [224] for an example of a provision for expert determination in a partnership agreement.

<sup>70</sup> See further para 7.54 *et seq* below.

<sup>71</sup> Expert determination does not always produce a binding decision: the parties may instruct the expert to give non-binding recommendations.

it is part of the court's duty to encourage the parties to use an alternative dispute resolution<sup>72</sup> procedure if the court considers that appropriate and to facilitate the use of such a procedure.<sup>73</sup> The rules on costs are an incentive for parties to take the prospect of using these procedures seriously by enabling the court to take into account the parties' conduct before and during the proceedings when it makes orders for costs.<sup>74</sup> The Chancery Guide also requires legal representatives to consider with their clients and the other parties the possibility of using alternative dispute resolution.<sup>75</sup>

7.49 In England and Wales, if the case proceeds to trial, the court will closely supervise the use of expert evidence in the proceedings in accordance with the provisions in the Civil Procedure Rules.<sup>76</sup> Expert evidence must be restricted to that which is reasonably required to resolve the proceedings.<sup>77</sup> No party may call an expert or put in evidence an expert's report without the court's permission.<sup>78</sup> Where two or more parties wish to submit expert evidence on a particular issue, the court may direct that evidence be given by one expert only.<sup>79</sup> The court also has the power to appoint an assessor.<sup>80</sup> These provisions should keep the costs associated with the instruction and use of experts to the minimum necessary to resolve the particular dispute.

7.50 In Scotland the courts do not have any general power to refer a dispute to alternative dispute resolution. We do not propose to introduce a power relating to partnerships alone.<sup>81</sup> A partnership dispute of this nature would, however, fall within the scope of the Rule of Court relating to Commercial Actions in the Court of Session.<sup>82</sup> The Commercial Court has extensive powers of case management in commercial actions to achieve the expeditious resolution of the dispute and to limit the costs involved. These include deciding whether it is necessary to hear oral evidence on any issue, requiring expert witnesses to consult with a view to reaching agreement about any points held in common and appointing an expert to report to the court on the reports of expert witnesses and other evidence.<sup>83</sup>

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<sup>72</sup> Alternative Dispute Resolution Procedure is defined as the “[c]ollective description of methods of resolving disputes otherwise than through the normal trial process”: CPR, Glossary.

<sup>73</sup> CPR, r 1.4(2)(e).

<sup>74</sup> CPR, r 44.3.

<sup>75</sup> Chancery Guide, para 17.4.

<sup>76</sup> See CPR, Part 35 generally.

<sup>77</sup> CPR, r 35.1.

<sup>78</sup> CPR, r 35.4(1).

<sup>79</sup> CPR, r 35.7(1).

<sup>80</sup> Supreme Court Act 1981 s 70; County Courts Act 1984 s 63; CPR, r 35.15.

<sup>81</sup> See para 8.63 below.

<sup>82</sup> Rules of the Court of Session (“RCS”), chapter 47.

<sup>83</sup> RCS r 47.12.

## ***Options for reform of dispute resolution procedures***

### (1) NO REFORM

7.51 We invite views below on whether the existing mechanisms<sup>84</sup> for dispute resolution are adequate to deal with valuation disputes or whether the possible reforms discussed below should be implemented.

### (2) A STATUTORY DEFAULT PROCEDURE

7.52 Statute could lay down a specific procedure for partnership valuation disputes, applicable in the absence of a dispute resolution term in the partnership agreement. It would not prevent the partners from agreeing a valuation without resort to any form of dispute resolution. We do not believe that arbitration or expert determination should be compulsory for all disputes. We are only considering these options as default procedures where the parties have not agreed their own method of dispute resolution.

7.53 The main aim of creating a statutory default procedure would be to resolve disputes more efficiently in terms of costs and time. This is an important objective given that the partnerships to which it will apply are likely to have limited resources. The costs of litigation for such partnerships will often be highly disproportionate to the value of the partnership.

7.54 We suggest that the procedure be for arbitration or expert determination. Provision would be made for the appointment of an appropriate arbitrator (arbiter) or expert. The statutory procedure could reflect provisions commonly found in partnership agreements.<sup>85</sup> The question arises as to whether it should be compulsory so as to exclude the right to take the issues to court.

7.55 Some statutes make provision for compulsory arbitration. To the extent that an arbitration scheme is compulsory, it is established that the full protection afforded by Article 6(1) of the European Convention on Human Rights must be applied to it.<sup>86</sup> The relevant part of that Article provides that “in the determination of his civil and political rights and obligations everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law”.

7.56 If arbitration were made compulsory for a certain type of dispute, such as valuation, this would effectively convert the arbitration process into something approaching court

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<sup>84</sup> The Lord Chancellor's Department has announced the intention to promote further use of alternative dispute resolution, following a consultation on the subject. See Lord Chancellor's Department Press Notice, 117/00, 7 April 2000; Alternative Dispute Resolution: A Discussion Paper, Lord Chancellor's Department, November 1999; and ADR Discussion Paper: Summary of Responses, Lord Chancellor's Department, May 2000.

<sup>85</sup> See paras 7.46 - 7.47 above.

<sup>86</sup> *Bramelid, Malmström v Sweden* (Application Nos 8588/79 and 8589/79) (1983) 5 EHRR 249.

proceedings. As a result it might lose the advantages of arbitration: privacy, flexibility, expertise and the savings of costs.

7.57 It could be considered unacceptable to exclude the right of the parties to go to court in circumstances where they may not have addressed their minds properly to the implications of failing to provide for dispute resolution in the partnership agreement.

7.58 Another possibility is non-compulsory submission of the dispute to a new scheme of arbitration specially designed to deal with valuation disputes. The Company Law Review has recently suggested the creation of an arbitration scheme specifically designed to deal with shareholder disputes.<sup>87</sup> The Steering Group suggests that the existence of the scheme would encourage companies to make greater use of arbitration in order to overcome the problem of inefficient and wasteful litigation in respect of small company disputes. They say that it would facilitate the task of the court, early in the proceedings and in the course of its management responsibilities, in considering whether the dispute was more appropriate for resolution by arbitration rather than by the normal trial process. If so considered, the proceedings would be adjourned for the parties to agree on the arbitration reference.<sup>88</sup> There could additionally be a statutory presumption in favour of arbitration to encourage its use further.<sup>89</sup> Partnership valuation disputes could be submitted to arbitration in the shareholder dispute scheme or another set up along similar lines. Consultees may prefer this approach because it would not exclude the jurisdiction of the court.

7.59 We invite views below on these options.

### (3) A SELF-HELP PROCEDURE

7.60 There could be a 'self-help' procedure to encourage parties to agree a valuation without resort to litigation or a statutory default procedure. This is the approach adopted by RUPA.<sup>90</sup> The RUPA provisions apply to the extent that the partnership agreement does not provide otherwise.<sup>91</sup> Similarly we are only considering this option for cases where the partnership agreement does not provide for how much and when the outgoing partner is to be paid.

7.61 Under RUPA the outgoing partner may make a written demand for payment. This triggers a 120 day period during which the parties should try to agree a price. If at the end of this period they still cannot agree, the partnership should pay or cause to be paid in cash an estimated amount of the debt with accrued interest.<sup>92</sup>

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<sup>87</sup> Modern Company Law For a Competitive Economy, Developing the Framework, A Consultation Document from The Company Law Review Steering Group, March 2000, paras 7.44 - 7.69.

<sup>88</sup> *Ibid*, para 7.56.

<sup>89</sup> *Ibid*, para 7.57.

<sup>90</sup> Section 701.

<sup>91</sup> Section 103.

<sup>92</sup> As we have discussed in paras 17.20 - 17.21 below, under English law a partner cannot strictly be said to stand in a creditor-debtor relationship with his co-partners until accounts have been taken. The proposal in this section would not undermine this general principle; it merely attempts to estimate what these accounts would show and what sum (if any) would on their conclusion be owed to the outgoing partner.

7.62 The payment of cash must be accompanied by:

- (1) a statement of the partnership's assets and liabilities;
- (2) the latest available accounts;
- (3) an explanation of how the estimated amount was calculated; and
- (4) a written notice that the payment is in full satisfaction.

7.63 However, if the outgoing partner disputes the amount, he has a further 120 days to commence an action to determine the buyout price. If no payment or offer to pay is made, the outgoing partner has one year from the written demand for payment to begin an action to determine the buyout price.

7.64 The purpose of the RUPA procedure is to ensure that within 120 days of departure a partner is able to receive the undisputed minimum value of his interest in the partnership. The provision of information at the time an estimated amount is paid is intended to narrow the disputed areas, and flush out each party's views on the list of partnership assets and liabilities. Moreover, it will force each party to consider whether the appropriate market value is on a going concern or break-up basis.<sup>93</sup> By early disclosure it is hoped that a negotiated settlement is more likely, particularly as the outgoing partner has a limited time to dispute the estimated payment.<sup>94</sup>

7.65 There is much merit in this approach, particularly if the notional sale measure of valuation is adopted. It provides a framework to enable parties to reach agreement. It is consistent with the desire to keep the litigation of disputes to a minimum.

7.66 This is not to say that it is beyond criticism or could not be improved. Arguably 120 days is insufficient time for the first offer to be made. It may be necessary to compile a new set of accounts and arrange bank financing to fund the payment to the partner. A six month period might therefore be more appropriate. It is also not clear that a further 120 days is a sufficient period for the outgoing partner who disputes the amount in the written offer to commence an action to determine the buyout price. Similarly where no payment or offer to pay is made, the period of one year in which the outgoing partner must bring an action may not be sufficient.

7.67 The RUPA process assumes that the firm makes an offer within the 120 day period, and if not, relies on the outgoing partner bringing an action within one year of his written demand. To encourage compliance by the partnership with the time limit, it could instead be provided that the outgoing partner can claim an amount in the written demand. If no offer is made by the end of the time limit, this sum could then become a debt. It would of course be possible for the outgoing partner to include other matters in the written demand. For example, a binding restrictive covenant not to compete with the partnership, which if accepted, should not be regarded as an unfair restraint of trade. That might affect the sum

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<sup>93</sup> Section 701(b) provides for the buyout price to be whichever is the greater of these two bases of valuation.

<sup>94</sup> Notes to RUPA, p 84.

the partnership was willing to offer. We do not think, however, that it would be necessary to regulate such additional matters in any legislation.

### ***Invitation for views***

**7.68 We invite views on the following options for reform of dispute resolution procedures:**

- (1) No reform;**
- (2) A statutory default procedure; and**
- (3) A self-help procedure.**

**7.69 If option (2) is favoured, should the statute provide for:**

- (1) Arbitration; or**
- (2) Expert determination; or**
- (3) An arbitration scheme similar to that suggested by the Company Law Review for shareholder disputes in small companies?**

**7.70 If option (3) is followed:**

- (1) Should the prescribed time to pay an estimated amount of the sum due following the written demand be 120 days, or six months, or another period; and**
- (2) Should the outgoing partner be able to specify an amount in the written demand for payment which becomes a debt if the firm makes no offer?**

### **Provision for payment by instalments**

7.71 The question of a facility for payment by instalments arises whatever the method for dispute resolution. A statutory provision would not be intended to override any provisions in partnership agreements governing the timing of payments. There are several possibilities: payment by instalments in every default case; payment by instalments linked to the reason for departure of the outgoing partner; a discretion for the court or arbitrator or expert<sup>95</sup> as to payment by instalments; and no instalments except with the agreement of the parties.

7.72 The appropriate amount and timing of instalment payments is likely to differ in each case depending on all the circumstances. In the absence of contrary agreement an outgoing partner would normally be entitled to payment in full for the share from the moment of departure. Payment by instalments may result in insecurity for the outgoing partner.<sup>96</sup> In many circumstances immediate payment in full to the outgoing partner may be unfair to the

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<sup>95</sup> See paras 7.52 - 7.54 above.

<sup>96</sup> However the proposal in para 7.11 above would afford the outgoing partner some protection.

partnership as this will affect its cash flow. Sometimes payment in full within a short period of time will not be unfair to the partnership: where the date of a partner's departure is known well in advance, the partnership has the opportunity to arrange its financial affairs in anticipation of it. Consequently partnership agreements often link the timing of payments to the outgoing partner to the reason for departure.<sup>97</sup>

7.73 The Law Commission considered the issue of instalments in its work on Shareholder Remedies.<sup>98</sup> It recommended the inclusion of a shareholders' exit article in Table A.<sup>99</sup> The suggestion that Table A also provide for the purchase price to be paid by instalments was rejected on the basis that it would not be suitable for all situations.<sup>100</sup> We believe that the same argument applies to a uniform statutory provision for payment by instalments intended to apply to all default situations.

7.74 A provision which might overcome some of these difficulties would be one linking the timing of instalment payments to the reason for the departure of the outgoing partner. If the reforms suggested in Part 6 are implemented, there will be a number of acts or events which will cause the departure of a partner from a partnership which will not be dissolved as regards all the partners. The timings of payments to an outgoing partner could depend on the reason for departure.

7.75 The provision could reflect the terms commonly found in partnership agreements. An example of a clause governing payment to a partner retiring pursuant to a term in the partnership agreement is:

- (1) If any partner shall retire pursuant to Clause [ ]
- (2) any Advance made by him or her together with all accrued interest at his or her Termination Date shall be repaid to him or her or his or her personal representatives within [3] months from his or her Termination Date
- (3) [any Tax Reserve held for him or her together with all accrued interest at his or her Termination Date shall be repaid to him or her or his or her personal representatives within [3] months from his or her Termination Date]
- (4) a payment on account of his or her profit share from the previous Accounting Date until his or her Termination Date shall be paid to him or her or his or her personal representatives within [3] months from his or her Termination Date and the balance thereof as soon as the Annual Accounts for the Accounting Period ending on the Termination Date (if the Termination Date shall be an Accounting Date) or next following the Termination Date (as the case may be) shall have been signed by the Partners in accordance with Clause [ ]

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<sup>97</sup> See T Sacker, *Practical Partnership Agreements* (1st ed 1995) p 50 *et seq* and paras 7.74 - 7.76 below.

<sup>98</sup> Shareholder Remedies (1996) Law Commission Consultation Paper No 142, para 19.11 and Shareholder Remedies (1997) Law Com No 246, para 5.30.

<sup>99</sup> Shareholder Remedies (1997) Law Com No 246, para 5.32.

<sup>100</sup> *Ibid*, at para 5.30.

(5) the Retirement Capital of such Partner shall be repaid to him or her by [6] equal [6-monthly] instalments the first of such instalments to be paid to him or her [6] months after his or her Termination Date

(6) Retirement Interest calculated from the Termination Date shall be paid with each payment of his or her Advance [and his or her Tax Reserve] (including accrued interest to his or her Termination Date) his or her profit share and his or her Retirement Capital<sup>101</sup>

7.76 The substance of these provisions is likely to be the same if a partner resigns pursuant to a term in the partnership agreement or retires by reason of incapacity or leaves due to a clause for compulsory retirement or dies.<sup>102</sup> However for cases of expulsion the agreement may set out longer periods during which the payments must be made. For example, the provision equivalent to clause (5) above might be:

the Retirement Capital of such Partner shall be repaid to him by [6] equal [annual] instalments the first of such instalments to be paid to him or her [12] months after his or her Termination Date.<sup>103</sup>

7.77 The statute could set out two alternatives, one reflecting the contractual periods applicable to retiring partners and the other reflecting the periods applicable to expelled partners. The statute could set out which provision would apply to each of the grounds leading to the departure of a partner as proposed in Part 6. So, for example, the provision reflecting the retirement terms should apply where a partner departs for the following reasons: notice of the partner's intention to withdraw from a partnership of unrestricted duration;<sup>104</sup> death;<sup>105</sup> bankruptcy;<sup>106</sup> and frustration.<sup>107</sup> Where however a partner departs due to illegality,<sup>108</sup> or because he has committed a repudiatory breach of the partnership agreement,<sup>109</sup> the statutory provision could reflect the clauses applicable to expelled partners.<sup>110</sup> Where the departure is in accordance with a term of the partnership

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<sup>101</sup> T Sacker, *Practical Partnerships* (1st ed 1995), published by Jordan Publishing Limited, pp 50 - 51. © Jordan Publishing Limited 1995. "Accounting Date", "Accounting Period", "Advance", "Annual Accounts", "Partners", "Retirement Capital", "Retirement Interest", "Tax Reserve" and "Termination Date" are defined elsewhere in the partnership agreement: pp 42 - 44. It should be noted that different payment periods apply to different types of financial shares.

<sup>102</sup> *Ibid*, pp 51 - 54. There are appropriate wording adjustments for each case.

<sup>103</sup> *Ibid*, pp 52 - 53. Clauses (2) and (4) may specify longer periods. Clause (3) remains the same. Clause (6) may provide an alternative that "no Retirement Interest shall be paid".

<sup>104</sup> Para 6.16 *et seq.*

<sup>105</sup> Para 6.21 *et seq.*

<sup>106</sup> Para 6.21 *et seq.*

<sup>107</sup> Para 6.44 *et seq.*

<sup>108</sup> Paras 6.26 - 6.27 above.

<sup>109</sup> For example if the court excludes that partner in the circumstances considered in para 6.39 above.

<sup>110</sup> In Part 6 we also consult on s 33(2) (suffering share to be charged): para 6.49 *et seq.* If s 33(2) were to be extended to give the other partners an option to expel the partner concerned, the statutory provision reflecting the arrangements for an expelled partner could apply.

agreement,<sup>111</sup> the agreement should set out the appropriate timing of payment, but in default of this, the timings applicable to retirement would apply.

7.78 The provisions could apply whenever there is nothing to the contrary in an agreement and even if the dispute is being resolved in court, arbitration or by expert determination. Alternatively they could apply unless a different ruling were made by the court, arbitrator or expert. This would allow flexibility to meet the justice of each case.

7.79 Another option would be a general provision designed to ensure that all tribunals (courts, arbitrators and experts) consider instalments and order them where appropriate.

7.80 The final option is that the outgoing partner immediately becomes entitled to the full amount of the share and interest thereon until the date of payment.<sup>112</sup> This would reduce the insecurity to which the outgoing partner is exposed until he receives the whole value for his share to which he is entitled. Deferred payment or payment by instalments would only be available where the parties have agreed to this, whether in the partnership agreement or following the departure of the outgoing partner.

7.81 We invite views on the following alternatives concerning provision for payment by instalments which would apply in the absence of agreement to the contrary:

- (1) A uniform provision for instalments (our provisional view is against this);**
- (2) A provision for instalments linked to the reason for departure of the outgoing partner which could apply in all such cases or unless the tribunal makes a contrary ruling;**
- (3) A provision requiring tribunals to consider instalments and order them in appropriate cases; and**
- (4) An outgoing partner should become immediately entitled to the full value of the share.**

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<sup>111</sup> Para 6.54 above.

<sup>112</sup> This is the default position under RUPA: section 701. Section 701(h) provides for one exception: where a partner dissociates wrongfully (under section 602(b)) before the expiration of a definite term or the completion of a particular undertaking, the wrongfully dissociating partner is not entitled to receive any portion of the buyout price before the expiration of the term or the completion of the undertaking, unless the dissociated partner establishes to the satisfaction of the court that earlier payment will not cause undue hardship to the business of the partnership.

# **PART VIII**

## **WINDING UP DISSOLVED PARTNERSHIPS**

### **Introduction**

8.1 In Part 6 of this paper we discussed the duration of partnerships. In Part 7 we discussed the position of the outgoing partner where the partnership continues as between the remaining partners and is not dissolved as regards all the partners. In this Part we are concerned with the process of winding up the affairs of a partnership which is dissolved as regards all the partners. We are not concerned with the rules on bankruptcy in this Paper.<sup>1</sup> We are concerned only with what our terms of reference call “solvent dissolution”.

8.2 In many situations the partners have control over the duration of the partnership. In such situations there is nothing to stop partners from winding up the affairs of the partnership, so far as possible, before it is dissolved. They may be able to sell all the assets, pay all the debts, distribute all the surplus and then dissolve the partnership by unanimous agreement. There are advantages in proceeding in this way where it is possible; it gives rise to no legal problems requiring reform and we do not deal with it further. We are concerned in this Part with the more usual situation where the partnership is dissolved first and its affairs are wound up afterwards.

8.3 Winding up the affairs of a dissolved partnership can take different forms. In some cases it may be possible to dispose of the whole business as a going concern. In some such cases the acquirers may be a new partnership consisting of some of the partners of the dissolved partnership. In other cases the business may have to be broken up and the assets sold. In all cases the legal problem is that someone has to have all the powers and responsibilities necessary to complete the winding up.

8.4 Winding up is currently carried out in one of two ways: either by the former partners under the powers given to them for this purpose by section 38 of the 1890 Act or by a court under section 39, with the assistance of a receiver in England and Wales or a judicial factor in Scotland.

### **Winding up by the former partners**

#### ***Existing law: section 38***

8.5 Section 38 of the Partnership Act 1890 provides that:

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.

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<sup>1</sup> This is beyond our terms of reference. See para 1.1 above

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 has after the bankruptcy represented himself or knowingly suffered himself to be represented as a partner of the bankrupt.

### ***Assessment of existing law***

#### PARTNERSHIPS WITHOUT LEGAL PERSONALITY.

8.6 Section 38 does not appear to give rise to any serious practical problems so far as partnerships without legal personality are concerned. Prior to dissolution the rights, obligations and property are held by the partners and not by the firm as a separate entity. The effect of dissolution is that the authority of the partners, except a bankrupt partner, continues but only for the purposes of completing unfinished transactions and winding up the affairs of the firm. The other rights and obligations of the partners also continue for these purposes.

8.7 At present the authority of the former partners under section 38 extends only “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”. There is a question whether this would extend to entering into a new trading contract even if that were highly expedient to enable the business to continue so that it could be sold as a going concern. It has been suggested to us that it would be useful if section 38 were amended to make it clear that it is lawful for the business of a partnership to be carried on so far as is necessary or expedient for the beneficial winding up of the firm, if all the partners agree that this may be done. It is arguable that such an amendment is unnecessary. The former partners can confer express authority on any or all of their number to enter into new contracts, and continue the business temporarily, on behalf of all of them. There is nothing unlawful in doing so.

#### PARTNERSHIPS WITH LEGAL PERSONALITY.

8.8 Section 38 gives rise to very serious problems in relation to partnerships with legal personality. These problems are currently acute in Scotland and would have to be faced in England and Wales if it were to be decided that legal personality should be conferred on some or all partnerships. The difficulty is that rights and property may be vested in the firm as a legal person. Once the firm is dissolved there is no longer any person to hold the rights and property. When an individual dies, rights and property pass to an executor. There is no provision in the 1890 Act for any similar transfer to the former partners by operation of law. There is not the same problem in relation to liabilities. The partners, while the firm existed, already had a joint and several subsidiary liability for the obligations of the firm. This liability can be converted into a primary liability when the firm disappears.<sup>2</sup> Nor is there the same problem in relation to power to bind each other in transactions necessary for the winding up. There is nothing to stop the former partners authorising each other, expressly or impliedly, to do what is necessary or expedient on behalf of them all. However, in relation to rights and property there is a vacuum.

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<sup>2</sup> See paras 10.54 – 10.57 below.

8.9 Older Scottish authorities attempted to fill this vacuum by treating the firm as continuing “in a sense” after dissolution.<sup>3</sup> It was gone, yet not gone. Modern judges have been uneasy with this approach and have preferred to say that the firm does not continue after dissolution but that the former partners have the rights necessary for winding up.<sup>4</sup> The courts have not, given the inadequate state of the statute law, been able to explain how rights and property pass from the firm to the former partners.

8.10 The two leading Scottish cases are *Inland Revenue v Graham’s Trustees*<sup>5</sup> and *Lujo Properties v Green*.<sup>6</sup> Both cases concerned leases to partnerships and both illustrate the difficulties in applying section 38 to a firm with a legal personality.

8.11 In *Graham’s Trustees*, the House of Lords held that the partnership in question was dissolved on the death of a partner and, accordingly, a non-assignable lease to the firm fell, since there was no longer a tenant. Delivering the leading judgment in the House of Lords, Lord Reid said:

In my opinion, section 38 does not make the surviving partners parties to the firm’s contracts and so keep those contracts alive. That would involve a radical change in Scots law. But I see no difficulty in holding that this section does require unfinished operations to be completed under the conditions which would have applied if the contract had still existed.<sup>7</sup>

8.12 In *Graham’s Trustees* this had the effect that while the partnership and lease had ended on the death of Mr Graham, the only rights and duties of the remaining (former) partners regarding the land were those of occupation for the purpose of winding up the agricultural business of the former partnership. Section 38 conferred no rights of possession, and certainly no right of tenancy, upon the former partners. In the words of Lord Upjohn:

It was suggested that section 38 might in some way be invoked to continue the lease to the partnership, although it had come to an end with the death of the deceased by operation of law. This I do not understand. The lease came to an end by reason of the fact that on his death the legal persona of the partnership ceased to exist. It was then and there completed and put an end to: there was nothing upon which section 38 could operate.<sup>8</sup>

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<sup>3</sup> See Bell, *Comm.* II, 527 and 533; *Paul v Taylor* (1826) 4 S 572; *Dickson v The National Bank of Scotland Ltd* 1917 SC (HL) 50, 52 – “for certain purposes a partnership continues notwithstanding dissolution”. In *Stewart v Stewart* (1835) 14 S 72 it was held, somewhat bizarrely, that a partnership which had been dissolved some ten years previously still owned the partnership property.

<sup>4</sup> See in particular the remarks of Lord Hunter in *Inland Revenue v Graham’s Trustee* 1971 SC (HL) 1, 4 where he pointed out that this view of the law avoided “the logical difficulty of asserting that the partnership continues in existence after it has been dissolved.” See also *Lujo Properties Ltd v Green* 1997 SLT 225 where Lord Penrose concluded that the view that the partnership survived dissolution was no longer acceptable.

<sup>5</sup> 1971 SC (HL) 1.

<sup>6</sup> 1997 SLT 225.

<sup>7</sup> *Inland Revenue v Graham’s Trustees*, *op cit*, at p 21.

<sup>8</sup> *Ibid*, at p 27.

8.13 *Lujo Properties* was remarkably similar to *Graham's Trustees* but concerned an assignable lease.<sup>9</sup> A firm of solicitors was the tenant under the lease. It was dissolved and a judicial factor was appointed, whereupon the landlords raised an action seeking declarator that the former partners of the firm were liable for the rent for the remaining duration of the lease. Following a very thorough examination of the relevant authorities<sup>10</sup> Lord Penrose concluded that the assignability of the lease was crucial. Being assignable, the lease was an asset of the partnership "available for realisation in the winding up of the firm"<sup>11</sup> notwithstanding the fact that the partnership as tenant had ceased to exist. Accordingly, Lord Penrose held that:

If section 38 applies to a contract it must apply to the extent of maintaining as enforceable against the former partners the obligations of the firm prior to dissolution. The provision does not innovate upon those obligations except by identifying a different obligant.<sup>12</sup>

8.14 Given the gap in the statute law, no court could explain how the rights under the lease passed from the former partnership, now non-existent, to the former partners, who were admittedly not the tenants. Lord Penrose merely commented that it was:

perhaps unnecessary to find an acceptable characterisation of the relationship which exists after dissolution of the partnership and before assignation.<sup>13</sup>

He also said that:

the rationalisation of the continuing rights and obligations appears to me to be of much less significance than the fundamental recognition of the fact that those rights and obligations continue.<sup>14</sup>

8.15 It is clear that section 38 is inadequate for partnerships with legal personality.

### **Possible reforms**

#### PARTNERSHIPS WITHOUT LEGAL PERSONALITY

8.16 The existing law seems reasonably satisfactory. However, as doubts have been expressed, we provisionally propose that section 38 be amended to provide specifically that after dissolution, if they all agree, the former partners can carry on the partnership business with a view either to disposing of it as a going concern or to the beneficial winding up of the partnership.

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<sup>9</sup> Both counsel for the pursuers and defenders based principal contentions on the *ratio* of *Graham's Trustees* and over two pages of the reported case is devoted to Lord Penrose's appraisal of the earlier case. See *Lujo Properties v Green*, *op cit*, at pp 228 - 230.

<sup>10</sup> *Campbell v Calder Iron Co* (11<sup>th</sup> December 1805, FC); *Walker v McKnights* (1886) 13 R 599; *Marshall v Marshall* (23<sup>rd</sup> February 1816, FC); Erskine, *Institutes*, III, iii 27.

<sup>11</sup> *Lujo Properties v Green*, *op cit*, at p 237G-H.

<sup>12</sup> *Ibid*, at p 239L.

<sup>13</sup> *Ibid*, at p 237B.

<sup>14</sup> *Ibid*, at p 236H.

8.17 We invite views on the following propositions:

**(1) Section 38 (winding up affairs of dissolved partnership by former partners) does not require fundamental change so far as partnerships without legal personality are concerned.**

**(2) However, section 38 should be amended to make it clear that the 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, and that the former partners may confer such authority on any or all of their number.**

#### PARTNERSHIPS WITH LEGAL PERSONALITY

8.18 Section 38 is clearly inadequate as it stands for partnerships with legal personality. What is required is a method of enabling the former partners to hold, or take over by operation of law, the property and rights of the dissolved partnership but only for the purposes of winding up its affairs and completing unfinished transactions. There are two options. The first is to revive the idea that the partnership, and its legal personality, continue for this limited purpose after dissolution. The second is to provide expressly in the Act that the property and rights of the dissolved partnership pass, by operation of law at the moment of dissolution, to the former partners for the purposes of winding up the affairs of the dissolved partnership and completing its unfinished transactions. The former partners could be regarded as trustees for this purpose. They already have liabilities, as former partners, for the obligations of the dissolved firm.

8.19 The option of deeming the partnership to continue for the purpose of the winding up has the advantage that during the period of winding up the partnership (retaining separate legal personality) continues to own property and subsists as the principal creditor and debtor, with the partners continuing to act as the agents of the partnership. This avoids the need to transfer the property and rights of the partnership to the partners to allow winding up. It also has the advantage of keeping continuing contracts with third parties alive and thereby avoiding the problems highlighted in *Graham's Trustees and Lujo Properties*.<sup>15</sup>

8.20 There are theoretical difficulties with this option. There is the logical difficulty of regarding the partnership as gone and yet not gone at the same time. There is the difficulty that there may be only one partner, or no partners, left during the winding up process. It may be odd to say that a partnership continues in such circumstances. There is the difficulty of knowing when the partnership does come to an end. The winding up process may drift on indefinitely. In some cases there will be closing accounts and a recognisable end to the winding up period. In other cases there may be no recognisable end at all. The partnership may continue forever.

8.21 However, we think it unlikely that this will cause any serious practical problems. During the winding up, the partners need to dispose of the partnership assets, collect the debts and pay the creditors. Debts and obligations owed by or to the partnership will only

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<sup>15</sup> See paras 8.10 - 8.15 above.

continue to exist or to be enforceable for a limited time.<sup>16</sup> If partnership property is not disposed of during winding up it would be advantageous for the partnership to continue so that the property continued to have an owner and did not revert to the crown.

8.22 A variant of this option is adopted by RUPA. Section 802 states:

(a) Subject to subsection (b), a partnership continues after dissolution only for the purpose of winding up its business. The partnership is terminated when the winding up of its business is completed.

(b) At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners, including any dissociating partner other than a wrongfully dissociating partner, may waive the right to have the partnership's business wound up and the partnership terminated.

8.23 Where the partners decide, during the course of the winding up, that they wish the partnership to continue it may resume business as if the dissolution had never occurred.<sup>17</sup> The rights of third parties arising before they knew, or were notified, of the decision to halt the winding up and continue the partnership or arising from the dissolution itself<sup>18</sup> are afforded some protection.<sup>19</sup> Similarly, any rights of a third party arising out of conduct in reliance on the dissolution are protected. For example, a loan called up on dissolution remains called up. A lease that is terminated by the dissolution remains terminated.

8.24 The second option – of transferring property and rights to the former partners by operation of law as trustees for the purposes of the winding up – has the advantage of avoiding logical difficulties and of providing a clear termination point for the dissolution of the partnership. It builds on the conclusion reached by the House of Lords in *Graham's Trustees* and followed by the Court of Session in *Lujo Properties* that a dissolved partnership ceases to exist, but provides the legal machinery necessary to give practical effect to that conclusion. So far as obligations are concerned the former partners would be liable as individuals and not as trustees.<sup>20</sup> There would, and should, be no suggestion that their liability would be confined to the value of the trust property held for the purposes of the winding up.

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<sup>16</sup> In Scotland, most obligations will prescribe within 5 or, at most, 20 years (although obligations to make reparation in respect of death or personal injuries do not prescribe but have a limitation period of 3 years). See the Prescription and Limitation (Scotland) Act 1973. In England and Wales the limitation periods for claims vary between one and twelve years, with a "longstop" of fifteen years: Limitation Act 1980. The Law Commission is currently reviewing limitation of actions: see Limitation of Actions, Consultation Paper No 151.

<sup>17</sup> Section 802(b)(1) states: "The partnership resumes carrying on its business as if dissolution had never occurred, and any liability incurred by the partnership or a partner after the dissolution and before the waiver is determined as if dissolution had never occurred."

<sup>18</sup> In the comment to section 802 in the annotated version of the UPA 1994 ("RUPA"), (Uniform Laws Annotated, Volume 6, 1995) it is suggested that the rights of a third party arising out of conduct in reliance on the dissolution are protected, absent knowledge or notification of the waiver.

<sup>19</sup> Section 802(b)(2) states: "The rights of a third party accruing under section 804(1) or arising out of conduct in reliance on the dissolution before the third party knew or received a notification of the waiver may not be adversely affected."

<sup>20</sup> See paras 10.45 – 10.52 below.

8.25 We have seen that one of the main problems on dissolution is its effect on long-term contracts, such as those covering leases, insurance and employment. We envisage that under this second option contracts entered into by the partnership prior to its dissolution would continue during the winding up until terminated by the partners as trustees. It would, of course, be open to the parties to the contract to stipulate that it terminated on dissolution of the partnership, or that either party had the right to terminate it in that event.

8.26 Although this option may appear to be logically sound, it could create potentially serious problems relating to real or heritable property. Title to such property can only pass through registration. If the partnership ceases to exist on dissolution, it will be unable to execute the documents necessary to effect the transfer. The property would become ownerless and ultimately revert to the Crown.

8.27 Our provisional view is that option one - deeming the partnership to continue for the limited purposes of winding up - is preferable to option two. The problems which option two would create regarding the transfer of property significantly outweigh the problem of determining the precise date of the partnership's termination.

8.28 We invite views on the following propositions:

**(1) Section 38 of the 1890 Act is inadequate in relation to partnerships having a separate personality.**

**(2) In relation to such partnerships the dissolved partnership should be deemed to continue for the purposes of winding up its affairs and completing unfinished transactions.**

## **Winding up by court**

### ***Existing law***

8.29 On the termination of a partnership any partner is entitled under section 39 to apply to the court to have the partnership wound up. The mechanisms differ as between England and Wales on the one hand and Scotland on the other.

#### ENGLAND AND WALES

8.30 In England and Wales the winding up will proceed under the supervision of the court in any case where a partner is represented by a personal representative or trustee in bankruptcy, or if any dispute arises between the partners. Such a partnership action normally has two stages. First, the judge decides at trial matters such as the existence of the partnership and its terms. A dissolution is normally ordered. This requires one party to bring in an account which may include a profit and loss account to the date of dissolution, a balance sheet at dissolution, and a post dissolution account.<sup>21</sup> The other party then serves notice of any objection he has. In theory this should identify the issues and enable the court to give directions for their speedy resolution. This is rarely so in practice.

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<sup>21</sup> For the difficulties with this, see Part 7.

8.31 A receiver may be appointed but:

the receiver's function is not to wind up the partnership, as a liquidator winds up a company, but merely to get in and preserve the assets and pay the partnership debts, while the Court takes the usual partnership accounts and enquiries and supervises the dissolution. If assets are not in danger, there is generally no purpose in appointing a receiver, who (except by consent) has no power to determine the rights of the partners *inter se*.<sup>22</sup>

8.32 The receiver has no power to carry on the business. Only a manager, under the direction of the court, may do this.<sup>23</sup> A receiver may, however, be appointed a manager as well.<sup>24</sup> Although an insolvent partnership may be wound up as an unregistered company,<sup>25</sup> and an administrator or liquidator appointed with powers equivalent to their registered company counterpart,<sup>26</sup> there is no equivalent for the winding up of a solvent partnership.<sup>27</sup>

8.33 The procedure for winding up a partnership is similar to the old procedure for winding up an estate under a full administration order. The court assumed full control of the administration. This had three main consequences:

- (1) none of the trustees' powers could be exercised without the authority of the court;
- (2) the court could only act on a party's application; and
- (3) the court required many matters to be formally proved even if they were undisputed.

8.34 The effect of these characteristics was that the court could not act as an initiator. It was constrained by the system. The delay and expense were notorious. These features were behind the passing of the Judicial Trustees Act 1896. Full administration orders of this kind are now almost completely obsolete, except for partnerships. It is not difficult to understand why. Whatever the merits of an adversarial system in deciding disputes between parties, it is ill-suited to a largely administrative process, like winding up a partnership.

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<sup>22</sup> Supreme Court Practice 1997, Note 30/1/15. Although this note has not been included in the CPR, it remains an accurate summary of the position.

<sup>23</sup> See the comment of Lord Lindley quoted at para 23-149 in *Lindley & Banks*.

<sup>24</sup> The appointment of a receiver (or a receiver and manager) should normally be regarded as a remedy of last resort: see *Lindley & Banks*, para 23-149 and the approach taken by the Court of Appeal in *Toker v Akgul* [1996] 6 CL 466.

<sup>25</sup> Under the Insolvency Act 1986 as amended by the Insolvent Partnerships Order 1994, SI 1994/2421.

<sup>26</sup> Namely administrators under Insolvency Act 1986, s 14(1), Sched 1 (modified by the Insolvent Partnerships Order 1994, SI 1994/2421, art 6, Sched 2, paras 1, 8 and 10, as amended by SI 1996/1308); and liquidators in compulsory winding up under Insolvency Act 1986, s 167 (1), Sched 4 (modified by the Insolvent Partnerships Order 1994, SI 1994/2421, art 7, Sched 3, paras 1 and 10, as amended by SI 1996/1308).

<sup>27</sup> An unregistered company cannot be wound up under Insolvency Act 1986 voluntarily (see s 221(4)).

8.35 The inherent problems with the procedure as applied to partnerships remain. Thus to give just one example:<sup>28</sup> in 1984 a receiver and manager was appointed over a partnership business. This was bitterly resented by the defendants. The partnership business was eventually sold by the receiver. However, it had been impossible to wind up the receivership. The defendants had constantly brought applications challenging the receiver's conduct, his accounts, and his remuneration. Nearly every order was appealed. The taking of accounts was ordered in 1984, but did not proceed far. The defendants did not recognise that it was a separate proceeding from the receivership; one of their complaints was that the receiver had not ascertained the balances due to them. While the defendants attacked the receiver, the plaintiff lost interest in the action. Eleven years after the appointment of the receiver and manager the defendants were still challenging the conduct of the receivership, it seemed likely that there would be no funds left for the partners and that the receiver would make a loss.

8.36 A practical consequence of this sort of experience is that many partnership actions are avoided or settled at an early stage. Parties are warned of the likely procedural difficulties and costs.<sup>29</sup> Actions to wind up a solvent partnership are relatively rare, so comparatively few practitioners are familiar with the procedure. In time this becomes self-perpetuating. Even when they do take place, the receiver's legal costs and remuneration sometimes exceed the partnership's assets.

#### SCOTLAND

8.37 In Scotland, a judicial factor may be appointed to wind up the affairs of a dissolved partnership.<sup>30</sup> A judicial factor is a manager appointed by the court to do a certain task. The technique is widely used in a variety of situations.<sup>31</sup> Judicial factors are regulated by statute<sup>32</sup> and are under the supervision of the Accountant of Court. The power to appoint a judicial factor to wind up a dissolved partnership is derived from a combination of section 39 of the 1890 Act, which enables any partner of a dissolved partnership to apply to the court to wind up the business and affairs of the firm, and the ordinary law on judicial factors.

8.38 The court enjoys a wide discretion as to the circumstances in which a judicial factor may be appointed.<sup>33</sup> In general, if there is a partner who can capably and fairly undertake the winding up, the court will not appoint a judicial factor, as the partner is considered to be in the best position to undertake the task.<sup>34</sup> However, if there is no fit partner left, or the

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<sup>28</sup> This case was quoted by the Chief Chancery Master, J M Dyson, in a letter to Mr Justice Rattee on 16 March 1995 and subsequently included as an attachment to a letter from Mr Justice Rattee to the Law Commission on 10 May 1995.

<sup>29</sup> Settling or avoiding disputes is, of course, desirable, but it is a perverse logic which welcomes the inaccessibility of the judicial system in encouraging this.

<sup>30</sup> See *Gatherer* (1893) 1 SLT 401; *Thomson* (1893) 1 SLT 59; *Paterson* (1894) 1 SLT 564; *Robertson* (1902) 10 SLT 417; *Carabine v Carabine* 1949 SC 521.

<sup>31</sup> In rare cases a judicial factor may be appointed to manage temporarily the affairs of an undissolved partnership. See, for example, *McCulloch v McCulloch* 1953 SC 189.

<sup>32</sup> The Judicial Factors Acts 1849 to 1889, as amended.

<sup>33</sup> See *Dickie v Mitchell* (1874) 1 R 1030, 1033, per Lord President Inglis.

<sup>34</sup> See dicta of Lord President Inglis in *Nicoll v Reid* (1877) 5 R 137, 140.

rights of one of the partners are endangered by the actions of another, the court will act. Appointments have been made in the following situations: where all the partners were dead;<sup>35</sup> where one partner was too old and the other unfit to manage the business;<sup>36</sup> where one partner continued the business instead of winding it up following a dissolution, to the jeopardy of the other partner's rights and interests;<sup>37</sup> where one partner was guilty of gross misconduct;<sup>38</sup> where one partner was physically incapacitated;<sup>39</sup> where one partner was mentally incapacitated;<sup>40</sup> and where it was necessary to protect the firm's assets until dissolution.<sup>41</sup> Interim appointments are competent but rare.<sup>42</sup>

8.39 Judicial factors of dissolved partnerships are usually given "the usual powers" on their appointment. In theory a judicial factor is a manager, not an owner. Property does not vest automatically in a judicial factor. Sometimes the court appointing a judicial factor will purport to vest the property of the dissolved partnership in the factor but the theoretical basis and efficacy of such an order may be doubtful. A court cannot normally, without statutory authority, transfer property from one person to another just because it is expedient to do so. Because judicial factors are managers with "the usual powers" rather than officers vested with special statutory functions and powers, they often feel vulnerable and prefer to seek the agreement of all the partners, or the authority of the Accountant of Court or the court, before taking important steps which might be challenged by an aggrieved former partner. This leads to delay and expense and, given that the partners are often in dispute, to unnecessary difficulties.

8.40 There appears to be a doubt in the existing law as to whether rights against judicial factors prescribe in the normal way.<sup>43</sup> This doubt is not confined to partnership cases and we do not think that it would be appropriate to consider it in this paper.

### ***Assessment of existing law***

8.41 The existing law as to solvent winding up is unsatisfactory in both jurisdictions. The basic problem is the lack of an officer (whatever called) who could take over the property and rights of the dissolved partnership and exercise adequate powers to wind up the affairs of the dissolved partnership in an independent way. Preliminary consultations and

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<sup>35</sup> *Dixon v Dixon* (1832) 6 W & S 229.

<sup>36</sup> *Dickie v Mitchell*, but note that this was not an actual partnership.

<sup>37</sup> *Carabine v Carabine* 1949 SC 521; *Allan v Gronmeyer* (1891) 18 R 784.

<sup>38</sup> *MacPherson v Richmond* (1869) 6 SLR 348, where the partner had persistently overdrawn from his capital account, had absented himself from the business for a prolonged period blaming his partners' refusal to allow him to withdraw further capital, and had refused to carry out his usual duties upon his return.

<sup>39</sup> *Eadie v MacBean's Curator Bonis* (1885) 12 R 660, but note that the appointment was refused here because the partnership contract did not stipulate that the incapacitated partner should give his personal services to the business.

<sup>40</sup> *Cleghorn* (1901) 8 SLT 409.

<sup>41</sup> *McCulloch v McCulloch* 1953 SC 189.

<sup>42</sup> See *McCulloch v McCulloch* 1953 SC 189, 192.

<sup>43</sup> See *Bank of Scotland v Laverock* 1992 SLT 73; *Beltmoss Quarry Company* (unreported) 1994. The doubt seems to be caused by the fact that for some purposes judicial factors are treated as trustees. A judicial factor is not, however, a true trustee. Normally the judicial factor manages, but does not own, the relevant property.

interviews revealed dissatisfaction with the existing process in both countries.<sup>44</sup> Expense and delay were common complaints. In so far as expense and delay are caused by the inherent difficulties of the situation they are unavoidable. Partnership disputes are often bitter. The affairs of dissolved partnerships are often complicated and tangled. Accounts may be incomplete. Information may not be readily available. The law cannot make complicated situations simple. What it can do is to ensure that the officers responsible for the winding up have adequate powers.

8.42 As long ago as 1960, the Harman Report<sup>45</sup> identified the problems in the English procedure and pointed to a possible remedy:

... it is said that no-one has ever worked out a partnership account to its conclusion. This may be true, but arises rather from the nature of a partnership account than from a failure of the law. In most partnership cases, the assets are in the hands of the defendant, who has excluded the plaintiff from them. In such a case, the only effective remedy is the appointment of a receiver. This, however, at the present time is often a lame expedient. The liquidation of limited companies and of the estates of bankrupts is a far speedier matter. In our opinion the remedy is to assimilate the winding up of a partnership to that of a company or a bankrupt's estate. The receiver should from the date of decree for dissolution be clothed with all the powers of a liquidator in a compulsory winding-up or of a trustee in bankruptcy. The partnership property should be vested in him either by a rule or by a vesting direction included in the order making the appointment, and he should have the right to realise it forthwith and without application to the Court. He should also have the powers of a liquidator for settling lists of creditors and debtors. Once the remaining assets have been realised the partners are not likely to be long in agreeing how to divide them, even if any issue concerning this has not been, as it often is, decided at the hearing of the action.<sup>46</sup>

8.43 The Review Body on the Chancery Division of the High Court, reporting in 1981, wrote that this recommendation of the Harman Committee "seems an eminently sensible one".<sup>47</sup>

### ***Proposals for a new system***

#### GENERAL

8.44 We believe that the fundamental requirements of a new system for winding up solvent partnerships in England and Wales and in Scotland are the same. There has to be a legal framework to enable an independent officer to act vigorously. The property and rights of the dissolved partnership should be vested in the officer who should have wide powers

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<sup>44</sup> The Scottish Law Commission is particularly grateful for the assistance given by the Accountant of Court in this connection.

<sup>45</sup> Report of the Committee on Chancery Chambers and the Chancery Registrars' Office, 1960, Cmnd 967, para 95(2).

<sup>46</sup> The Harman Committee's recommendation has been given effect in relation to insolvent partnerships which are treated as unregistered companies for the purpose of winding up.

<sup>47</sup> Report of the Review Body on the Chancery Division of the High Court (1981) Cmnd 8205 p 46, para 146(vi).

and adequate discretion. The officer should have the responsibility not only to realise the assets and settle the liabilities of the dissolved partnership but also to determine the financial rights and liabilities of the former partners among themselves. The system in general could be similar to that used in a members' voluntary winding up of a company.

#### NAME OF OFFICER

8.45 Whether the officer should continue to be called a receiver in England and Wales and a judicial factor in Scotland, or given a new name, is a secondary consideration. However, there would be advantages in having a new name. The powers which we envisage would go beyond merely receiving and managing. We therefore proceed on the assumption that there would be a new kind of officer, whom we provisionally call the partnership liquidator.

#### CHANGING TO PROCEDURE FOR INSOLVENT WINDING UP

8.46 It may happen, and frequently does at present, that an apparently solvent partnership turns out to be insolvent when its affairs are investigated by an independent officer. We are not concerned in this paper with insolvent winding up. Nevertheless some mechanism must be available to enable the appropriate insolvency procedure to be initiated. We provisionally suggest that the partnership liquidator should be obliged to report to the court, with a view to a change to the procedure for insolvent partnerships, if of the opinion that the partnership will be unable to pay its debts within 12 months of his appointment.

#### PARTNERSHIP PROPERTY

8.47 To be effective, the partnership liquidator needs to have full power to deal with the partnership assets. We have already considered options for the treatment of the partnership, and the consequences for partnership property, during the winding up of the partnership.<sup>48</sup> Whether a partnership is deemed to continue during winding up or terminates on commencement of winding up, partners will retain their powers to deal with the partnership property. We suggest that, where there is a partnership liquidator appointed, those powers should be suspended and full powers given to the liquidator instead. This would be similar to the situation in the members' voluntary winding up of a company.<sup>49</sup>

#### POWERS AND DUTIES

8.48 The partnership liquidator should have an obligation to pay the dissolved partnership's debts, to ensure the most efficient realisation of its assets and to distribute any surplus among the partners in accordance with the partnership agreement or section 44 of the 1890 Act. The partnership liquidator should be regarded as the statutory agent of the former partners for the purposes of the winding up but might be given express power, without the need for the sanction of the court or the approval of the former partners, to:

- (a) bring or defend legal proceedings judged by the partnership liquidator to be necessary or expedient for the winding up;

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<sup>48</sup> See paras 8.16 - 8.28 above.

<sup>49</sup> Insolvency Act 1986, s 92(2) - on the appointment of a liquidator all the powers of the directors cease, except so far as the company in general meeting or the liquidator sanctions their continuance.

- (b) sell or transfer any of the dissolved partnership's property;
- (c) borrow against the security of the dissolved partnership's assets; and
- (d) do all other things necessary for winding up the partnership's affairs and distributing its assets.

#### NEED FOR APPROVAL IN CERTAIN CASES

8.49 When the firm is wound up, partners may have to make a contribution in the circumstances set out in section 44 of the 1890 Act. This should continue to be the case. A partnership liquidator should not be able to compromise the obligation of any one partner to contribute to make up, for example, for a deficiency in the firm's capital, unless the partnership liquidator has obtained the prior unanimous approval of the partners.

8.50 Similarly partners have a clear interest in any compromise or arrangement by the partnership liquidator of potential claims against the partnership. It would, therefore, seem right that the power to make such a compromise or arrangement needs the prior approval of all the partners.

8.51 It might be advantageous if the partnership liquidator were able to continue the business for the beneficial winding up of the partnership. The practicability of this might, however, differ markedly between a trading and a professional firm. The personal relationship between a client and a professional partnership cannot easily be transferred to a partnership liquidator. If this power is available, should it be exercisable without the prior sanction of all the former partners?<sup>50</sup> If the partnership liquidator acts as agent of the former partners and has power to enter into new obligations, the former partners would be exposed to unlimited liability as a result of the decisions of the partnership liquidator. It could be argued that it is only right that the former partners should bear any trading losses of the partnership liquidator since they would take the gains. Furthermore, a partnership liquidator, as a licensed insolvency practitioner, is unlikely to engage in risky trading; and if losses are incurred that are attributable to the negligence of the partnership liquidator these would be recoverable. Nevertheless, situations might arise where losses arise from business decisions which the former partners would not have taken, but which fall short of negligence on the part of the partnership liquidator. We believe that it would not be acceptable to expect any former partner to run the risk of unlimited liability without the ability to exercise some kind of control over the management of the business. To require the approval of all the former partners allows any of them to have power over the direction of the winding up. Nonetheless, the consent of only a majority could force a former partner with well-founded doubts to assume the risk of the partnership liquidator's activities. We suggest that the power to carry on the business for the beneficial winding up of the firm should require the prior unanimous approval of the former partners and that any former

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<sup>50</sup> This is currently the position in a members' voluntary winding up of an unlimited company, although the use of this power is rare. It is also available in the administration of an insolvent partnership in England and Wales. This is only natural as the purpose of the administration order is to secure the survival of the partnership as a going concern, so that there is more advantageous realisation of partnership property than would have been achieved by a winding up. The court must first be satisfied that the partnership is unable to pay its debts.

partner should subsequently be able to apply to the court to withdraw the authority. If the winding up continues for more than a year, the partnership liquidator will in any event have to lay accounts before the former partners. This would give them a formal opportunity to consider whether to withdraw any authority previously given.

8.52 We suggest therefore that in each of the following situations the partnership liquidator should be required to obtain the prior unanimous approval of the partners:

- (a) making any compromise or arrangements with creditors;
- (b) compromising any liability a partner may have to contribute in accordance with section 44 of the 1890 Act; and
- (c) carrying on the business for its beneficial winding up.

#### ACCOUNTABILITY

8.53 The powers of the partnership liquidator have to be balanced and controlled by adequate mechanisms to protect the rights of the creditors and former partners. We suggest therefore that:

- (a) a former partner or creditor should have the right to apply to the court to determine any question arising in the winding up;
- (b) the discretion of the court to order an account in all cases be retained and that a former partner should have the right to apply to the court for an account;
- (c) the partnership liquidator should be bound to lay accounts before the former partners annually and when the winding up is complete;
- (d) there should be notification requirements similar to those applying in a members' voluntary winding up of a company.

#### DISCLAIMING

8.54 The liquidator of a company can disclaim onerous property.<sup>51</sup> Onerous property is any unprofitable contract, and any other property which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act.<sup>52</sup> A disclaimer operates to release the company from liability, but, except so far as is necessary for this purpose, does not affect the rights or liabilities of any other person.<sup>53</sup> A person whose property is disclaimed is treated as a deemed creditor to the extent of the loss or damage which they suffer. Disclaimer is final. The court will not interfere with a

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<sup>51</sup> For the power to disclaim in company law in England and Wales, see Insolvency Act 1986 ss 178 - 182. For similar provisions in the law of bankruptcy in England and Wales, see ss 315 to 321.

<sup>52</sup> Insolvency Act 1986, s 178(3).

<sup>53</sup> Insolvency Act 1986, s 178(4). Where property is disclaimed, it will escheat to the Crown or (as the case may be) to the Duchy of Cornwall or of Lancaster.

liquidator's discretion to disclaim unless the liquidator has acted in bad faith or perversely.<sup>54</sup> In Scotland, common law rules in relation to companies, and a combination of such rules and the Bankruptcy (Scotland) Act 1985<sup>55</sup> in relation to individuals, achieve a broadly similar result. A trustee in sequestration or the liquidator of a company may adopt a contract which is beneficial to the bankrupt or company.<sup>56</sup> The trustee or liquidator must do so within a reasonable time or will be held to have abandoned it, giving rise to a claim in damages against the bankrupt or the company.<sup>57</sup> By not adopting a contract the trustee or liquidator in effect disclaims it.<sup>58</sup>

8.55 A disclaimer is similar to the repudiation of a contract. However, if a contract is repudiated, the innocent party can choose whether to accept the repudiation. There is no such option for a disclaimer. To give a liquidator a power to disclaim would, therefore, make the liquidator more powerful than the partners replaced. It would also put the partnership in a more advantageous position than a sole trader who would not have this power. Partners who have onerous property could decide to put the firm into dissolution and have a liquidator appointed, who could then disclaim the property. Partners can moreover choose to move property in and out of the partnership. Whether, for example, a lease is partnership property can potentially change from one day to the next.<sup>59</sup> The landlord has no control over this. If the lease is held outside the partnership (as, for example, a surgery in a medical partnership often is), then the lease could not be disclaimed, unless all the partners were bankrupt. It might be anomalous to have a power to disclaim a lease if it is held as a partnership asset, when no such power would be available if it is not.

8.56 If there is no power to disclaim, the liquidator of a partnership holding, say, an uneconomic lease would have to negotiate an end to the liability. This may prove to be impossible. The liquidator might only be able to sub-let the tenancy, remaining liable for the shortfall for, say, 15 years. This does not assist the orderly winding up of a business with long-term unprofitable obligations. The power to disclaim would facilitate the end of the partnership. The landlord or other creditor in a long term contract ought not be disadvantaged by this: there would be a claim for damages for any loss resulting from the disclaimer. The partners' financial position would be substantially the same, irrespective of whether a contract were disclaimed or left to continue.

8.57 We seek views on whether a general power to disclaim ought to be available to the partnership liquidator in relation to onerous property and whether in the case of contracts (including leases) any power to disclaim should apply only to those entered into after the

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<sup>54</sup> *Re Hans Place Ltd* [1992] BCC 737. And see Insolvency Act 1986, s 181.

<sup>55</sup> Section 42 of the Bankruptcy (Scotland) Act 1985 empowers a permanent trustee to adopt a contract of the bankrupt where he considers the adoption would be beneficial to the administration of the debtor's estate. A party to a contract can request in writing that the trustee adopt or refuse to adopt the contract. If the trustee fails to respond to the request within 28 days (or to obtain an extension of the time limit) he is deemed to have refused to adopt the contract.

<sup>56</sup> *Gray's Trustees v The Benhar Coal Co* (1881) 9 R 225; *Asphaltic Limestone Concrete Co v Glasgow Corporation* 1907 SC 463. Gloag, *Contract* (2nd ed 1929) p 426.

<sup>57</sup> *Crown Estate Commissioners v Liquidators of Highland Engineering Ltd* 1975 SLT 58; *Anderson v Hamilton & Co* (1875) 9 R 355.

<sup>58</sup> This is how Gloag (*op cit*) presents the matter at p 426.

<sup>59</sup> See *Lindley & Banks*, para 18-43 et seq.

relevant legislation came into force.<sup>60</sup> On exercise of the power to disclaim, any party suffering loss or damage would have a remedy against the partnership (if it continues during dissolution) or against the former partners.<sup>61</sup> We have not had an opportunity to discuss this issue with the Crown Estate, the Duchies of Cornwall and Lancaster or the Treasury Solicitor, the authorities concerned with disclaimed property. Their views will be sought as part of the consultation process.

8.58 The existence of a power to disclaim might lead to a practice of taking partners bound as individuals as well as partners, in which case they would be the principal obligants. This is already common in some situations. Alternatively the partners as individuals might be taken bound as sureties or guarantors, in which case their liability would be secondary in nature. Again this is already common. We see no reason why third parties should not seek to protect themselves by such means.<sup>62</sup>

#### OTHER PROVISIONS

8.59 The above account of a possible new system is only an outline. Other provisions might well be required. In general we consider that any other provisions should be modelled on the rules for a members' voluntary winding up of a company.

#### ***Invitation for views***

8.60 We invite views on the following provisional proposals and questions for a new system for winding up dissolved partnerships under court supervision in England and Wales and Scotland:

- (1) There should be a new system for winding up the affairs of solvent dissolved partnerships under court supervision, the key feature of the new system being the appointment of an officer with powers and duties modelled on those of the liquidator in a members' voluntary winding up of a company.**
- (2) A former partner or creditor should have the right to apply to the court to determine any question arising in the winding up.**
- (3) A former partner should have the right to apply to the court for an account.**
- (4) Suggestions are invited for an appropriate name for the officer. Possibilities include: receiver (England and Wales) or judicial factor (Scotland); partnership liquidator; partnership administrator; dissolution manager; and partnership manager. (We use "partnership liquidator" provisionally in the remainder of these proposals).**

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<sup>60</sup> The corresponding provisions for companies apply only in England and Wales but preliminary consultations by the Scottish Law Commission showed a demand for such a power in relation to Scottish partnerships.

<sup>61</sup> See paras 8.16 - 8.28 above for the discussion on the continuation of a partnership during the winding-up period.

<sup>62</sup> See *Hindcastle v Barbara Attenborough Associates Ltd and Others* [1997] AC 70 and *Re Park Air Services PLC (Christopher Moran Holdings Ltd v Birstow and Ruddock)* [1999] 2 WLR 396 (HL).

- (5) The partnership liquidator should be under a duty to report to the court if of the opinion that the debts of the former partnership could not be paid within 12 months of appointment, with a view to initiating the appropriate insolvency procedure.**
- (6) The partnership liquidator should have full powers to deal with the assets of the partnership, the rights of the partners to deal with the partnership property ceasing on his appointment.**
- (7) The partnership liquidator should be regarded as the statutory agent of the former partners for the purposes of the winding up but should be given express power, without the sanction of the court or the approval of the former partners, to:**
- (a) bring or defend legal proceedings judged by the partnership liquidator to be necessary or expedient for the winding up;**
  - (b) sell or transfer any of the dissolved partnership's property;**
  - (c) borrow against the security of the dissolved partnership's assets; and**
  - (d) do all other things necessary for winding up the partnership's affairs and distributing its assets.**
- (8) In each of the following situations the partnership liquidator should be required to obtain the prior unanimous approval of the former partners:**
- (a) making any compromise or arrangements with creditors;**
  - (b) compromising any liability a former partner may have to contribute in accordance with section 44 of the 1890 Act; and**
  - (c) carrying on the business for its beneficial winding up.**
- (9) Should the partnership liquidator be able to disclaim onerous property? If so, in the case of contracts, including leases, should the power to disclaim apply only to those entered into after the relevant legislation came into force?**
- (10) Are any other special provisions required?**
- (11) In general, would it be appropriate to base any other special provisions which might be required on the rules for the solvent winding up of a company?**

### ***Alternative Dispute Resolution***

8.61 In the case of an application for a winding up by the court under section 35 of the 1890 Act, where there is a dispute between the former partners, a possible reform to the system could be the introduction of a 'cooling-off' period, with the involvement of a mediator at an early stage to work with the partners to help them conduct the winding-up without recourse to the courts. Given that the majority of partnership cases involve small firms where an irretrievable breakdown in communication has occurred, some of which are family firms and may also involve family disputes, the involvement of a mediator may provide a suitable mechanism for effecting a winding up. Such an approach has the great advantage of attempting to prevent, rather than cure, many of the problems in the current systems. It must be acknowledged, however, that many disputes will ultimately end up in

court, and the more formal procedure adopted. Nevertheless, any method of avoiding such scenarios would be a desirable option to be pursued.

8.62 In England and Wales the Civil Procedure Rules give the Court the power to refer parties to an alternative dispute resolution (“ADR”) procedure.<sup>63</sup> The rules on costs provide an incentive for parties to take the prospect of using these procedures seriously,<sup>64</sup> by enabling the court to take into account the parties’ conduct before and during the proceedings when it makes orders for costs.<sup>65</sup> For these rules to be applied in partnership disputes with maximum effect, it will be necessary to ensure the possibility of using ADR is drawn to the parties’ attention at the earliest possible opportunity. The Chancery Guide goes some way to achieving this by requiring that legal representatives should bring the party’s attention to the possibility of using ADR.<sup>66</sup>

8.63 In Scotland, there is no power contained in the rules of court for the Court of Session or the Sheriff Court to refer parties to an alternative dispute resolution procedure and we are not aware of any proposals to introduce such a power in the near future. It is of course open to parties to elect to proceed by way of ADR instead of going to court in the first instance. As the introduction of a power to refer to ADR is relevant to an area of law much wider than our current remit, we do not propose to introduce such a power solely in relation to partnership disputes.

### **Winding up by a person appointed by the former partners**

8.64 We considered whether there could be advantage in a third system whereby the former partners might appoint a partnership liquidator, without recourse to the court, to undertake the winding up. It could be argued that no special statutory provision is necessary for this purpose. There is nothing to stop the former partners, in the exercise of their powers under section 38 of the 1890 Act, from engaging an accountant or solicitor to conduct the winding up for them and conferring any necessary powers. If they are not unanimous on this point it is arguable that an application to the court would be preferable to allowing the wishes of a minority to be overridden. Against this, however, it could be argued that a majority of the former partners ought to be able to take a decision which, by avoiding court proceedings, might save considerable expense. A modification would be to allow a specially qualified majority, say a majority both in number and in value of entitlements on distribution, to appoint a partnership liquidator. This would avoid the objection that a minority of partners, entitled perhaps to 90% of the partnership’s profits, capital and assets, could be tied to an administrative process which (in terms of costs) would bear most heavily on them.

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<sup>63</sup> CPR, r 1.4(2)(e).

<sup>64</sup> CPR, r 44.3(2)(b) allows the court to depart from the general maxim on costs, set out in CPR, r 44.3(2)(a), that costs are borne by the unsuccessful party.

<sup>65</sup> CPR, r 44.3(4)(a) states when considering which costs order to make the Court may take into account the conduct of all the parties. CPR, r 44.3(5)(a) - (c) further defines what type of ‘conduct’ the Court may consider. It includes conduct before and during proceedings, including following any pre-action protocols; the reasonableness of raising, pursuing or contesting particular allegations or issues; and the manner in which particular allegations or issues are pursued or defended.

<sup>66</sup> Chancery Guide, para 17.4.

8.65 If a system of partnership liquidators appointed by the former partners themselves were to be introduced it would seem to be appropriate for the liquidator to have similar powers and duties to those of a court-appointed partnership liquidator. It is not so clear, however, that the assets of the dissolved partnership should vest in the liquidator. If the former partners are in agreement on the procedure their co-operation in property disposals could perhaps be assumed. If they are not in agreement it could appear harsh to allow a majority of the former partners, even if it is a specially qualified majority, to divest a minority of the former partners of their property without any recourse to a court.

8.66 We are not convinced that special provision for a liquidator appointed by the former partners is necessary but we invite views on the following questions:

- (1) In addition to provision for winding up by the former partners under section 38 and provision for winding up by a partnership liquidator appointed by a court, should there be provision for the winding up of a dissolved partnership by a partnership liquidator appointed by the former partners without recourse to the court?**
- (2) Should a majority of the former partners be able to impose such a partnership liquidator on the others?**
- (3) If so, should any special majority be required?**
- (4) Should a partner-appointed liquidator, if such a system were introduced, have the same powers and duties as those of a court-appointed liquidator?**
- (5) Should the assets of the dissolved partnership vest in a partner-appointed liquidator for the purposes of the winding up?**

### **Substantive rights of former partners**

#### ***Existing law***

8.67 Section 44 of the 1890 Act provides that:

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.

### **Example**

8.68 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 firm's capital of £18,000. In addition, Y advances £2,000 by way of a loan to the partnership. On dissolution of the partnership, the total assets of the firm are £10,000. £2,000 is owed to creditors.

8.69 The payment of outside creditors and Y's advance leaves surplus assets of £6,000. There has, therefore, been an overall loss of £12,000 capital (the difference between the surplus assets and the firm's capital). This must be made up by the partners in the same proportion in which they share profits.

8.70 Profits are divisible equally, so X, Y and Z must each contribute £4,000. In the final analysis, X receives £5,000 (£9,000 capital less £4,000 contribution to loss), Y receives £4,000 (£6,000 capital contribution plus £2,000 advance<sup>67</sup> less £4,000 contribution to loss), and Z has to contribute £1,000 (the difference between the £4,000 contribution and the £3,000 capital due).

### **The rule in *Garner v Murray***

8.71 Where there has been an overall trading loss and one of the partners is insolvent, the process becomes more complicated.<sup>68</sup> If the required contribution of the insolvent partner exceeds the balance on that partner's capital account, there will be a deficit in the assets available for distribution. In *Garner v Murray*,<sup>69</sup> Joyce J held:

Section 44 is plain. I do not find anything in that section to make a solvent partner liable to contribute for any insolvent partner who fails to pay his share. Subsection (b) of s 44 proceeds on the supposition that contributions have been paid or levied. Here the effect of levying is that two partners can pay and one cannot. It is suggested on behalf of the plaintiff that each partner is to bear an equal loss. But when the Act says losses are to be borne equally it means losses sustained by the firm. It cannot mean that the individual loss sustained by each partner is to be of an equal amount. There is no rule that the ultimate personal loss of each partner, after he has performed his obligations to the firm, shall be the same as or in any given

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<sup>67</sup> As discussed above, the advance is returned in priority to the capital contributions.

<sup>68</sup> See generally *Lindley & Banks*, para 25-45 *et seq*; Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand* (7th ed 1996) 260 *et seq*.

<sup>69</sup> [1904] 1 Ch 57.

proportion to that of any other partner. I have to follow the Act, and I see no difficulty in doing so in this case. The assets must be applied in paying to each partner rateably what is due from the firm to him in respect of capital, account being taken of the equal contribution to be made by him towards the deficiency of capital.<sup>70</sup>

8.72 This has become known as the rule in *Garner v Murray*. The deficiency, caused by the inability of the insolvent partner to contribute the full share due, is borne by the solvent partners in proportion to their capital entitlements. It appears to have been based on the premise that it would be unjust to require partners to contribute to a shortfall not relating to sums they have withdrawn.<sup>71</sup>

8.73 Taking the above example, with Z insolvent, the total assets available for distribution after the payment of debts and advances would be £14,000. This is made up of surplus assets of £6,000 plus the notional contributions of £4,000 from each of X and Y. This is divided 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).

8.74 The application of the rule is less clear where the capital account of the insolvent partner is overdrawn at the date of dissolution or after debiting that partner's contribution to the lost capital.<sup>72</sup> There appear to be two schools of thought on the treatment of overdrawings.<sup>73</sup> The first is simply to ignore them for the purpose of the rule; the other is to treat them as a loss, which must be shared between all the partners.

8.75 Although the question arose on the facts in *Garner v Murray* itself, the solution is not expressly set out in the reported judgments. The preferred view, which appears to be based on the actual terms of the order, is that the overdrawn account is treated as an uncollectable debt of the firm. This is counted with trading losses as part of the firm's overall loss.<sup>74</sup> One report of the judgment referred to the insolvent partner as being "indebted to the firm" with the overdrawings "treated as irrecoverable". In calculating the shortfall, the report referred to "[t]he assets (treating [the insolvent partner's] debt as irrecoverable) ...".<sup>75</sup>

8.76 There is logic behind this. A deficit in a partner's capital account could be treated as a 'debt' owed to the other partners. If this debt cannot be recovered, resulting in an overall deficiency in the firm's assets, why should this not be treated as any other debt? More particularly, why should an overdrawn account be treated differently from the capital account itself?<sup>76</sup> However, this produces tension with the notion that partners should not contribute to capital they have not withdrawn.

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<sup>70</sup> [1904] 1 Ch 57, 60.

<sup>71</sup> See *Lindley & Banks*, para 25-48.

<sup>72</sup> As in *Garner v Murray* itself.

<sup>73</sup> See *Lindley & Banks*, para 25-47.

<sup>74</sup> See Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand*, *op cit*, at p 261.

<sup>75</sup> (1904) 52 WR 208.

<sup>76</sup> Section 24(1) of the 1890 Act makes no such distinction: partners must contribute equally to the losses of capital.

8.77 The rule does not cover a ‘catastrophic loss’<sup>77</sup> situation where assets are insufficient to meet the claims of outside creditors. In such a case, the solvent partners must contribute in their loss sharing ratios until the external liability is satisfied.<sup>78</sup>

8.78 Although the rule in *Garner v Murray* is not as internally consistent as may be claimed, we are not aware of its application giving rise to major practical difficulties or perceived injustice. In the absence of these considerations, we should hesitate before proposing any change to this area of partnership law.

***Invitation for views***

8.79 We invite views on the operation of section 44 in general and on the rule in *Garner v Murray* in particular:

**(1) Does section 44 of the 1890 Act (Rules for distribution of assets on final settlement of accounts) operate in a satisfactory way?**

**(2) In particular, does it operate in a satisfactory way in a case where one former partner is insolvent and where the so-called rule in *Garner v Murray* applies?**

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<sup>77</sup> See Higgins & Fletcher, *The Law of Partnership in Australia and New Zealand*, *op cit*, at p 262 - 263.

<sup>78</sup> They may, of course, lodge claims against the insolvent partner’s estate in bankruptcy for amounts paid to meet his share of partnership liabilities.

# **PART IX**

## **PARTNERSHIP AND AGENCY**

### **Introduction**

9.1 In this Part we discuss agency in the partnership context. Partnerships, being either groups of persons (under English law) or legal persons (under Scots law) have to act through agents. They may appoint agents who are not partners, in which case the normal law on agency applies. They may use the partners as agents. The 1890 Act contains rules on partners as agents and it is these rules with which we are concerned in this Part. We deal later with the related, and overlapping, topics of the liabilities of the partnership and the partners in various circumstances<sup>1</sup> and the execution of deeds by the partnership.<sup>2</sup> Here we are concerned with the power of the partner to bind the partnership or, in English law, the other partners.

### **The basic rule on partners as agents**

#### **Section 5**

9.2 Section 5 of the 1890 Act provides that:

Every partner is an agent of the firm and his other partners<sup>3</sup> 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.

9.3 The main part of section 5 of the 1890 Act provides for the normal rules of agency to apply to partnerships. An act of a partner on behalf of the firm within the scope of the partner's actual authority binds the firm.<sup>4</sup> An act of a partner on behalf of the firm in the course of carrying on the partnership business in the usual way also binds the firm: the partner acts with implied or apparent authority. An act of a partner done without actual or apparent authority, and not binding on the firm, may become binding on the firm if it is subsequently ratified.

9.4 The limit of a partner's implied authority is set by the usual course of the particular business carried on. It is this and not the nature of the individual's involvement which is normally decisive in establishing whether the partner acted with authority.

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<sup>1</sup> See Part 10.

<sup>2</sup> See Part 19.

<sup>3</sup> Previous versions of the Partnership Bill referred only to a partner being an agent *of his other partners* for the purpose of the business of the partnership, while the side-note referred to this as the 'power of a partner to bind the firm'. It was only when the Bill was extended to apply to Scotland where the firm had separate personality that the clause was amended so that a partner was also an agent of the firm.

<sup>4</sup> This is the case irrespective of whether the act was done in the course of carrying on the partnership business in the usual way.

9.5 Section 5 appears to be generally satisfactory, apart from the point discussed in the next paragraph. It does not seem to have given rise to difficulty in practice. It does not, of course, prevent a partner who has authority, express or implied, to act in a particular matter from making it clear that a particular transaction within the scope of that authority is in fact being undertaken in a private capacity or in some other capacity.<sup>5</sup> A partner in a firm could, for example, make it clear to a regular supplier that a particular transaction was being entered into in a private capacity.

9.6 One defect in section 5 is that it is not adapted to the situation, which exists at present within the United Kingdom and which might continue to exist, where some partnerships have legal personality and some do not. In the case of those which do not have legal personality the reference to the partner being an agent for the firm is inappropriate because the firm is the whole group of partners, including the partner acting. So a partner acting as agent for the firm is acting in part as agent for himself, which is a legal impossibility. In the case of partnerships which do have legal personality the reference to the partner acting as agent for the other partners is inappropriate. It is the partnership (or firm) which carries on the business and the partner acts as agent for the firm. The way in which section 5 is framed is suitable for neither the one case nor the other and this has given rise to differences of opinion between experts.<sup>6</sup>

9.7 We invite views on the following provisional proposals:

**On the assumption that some partnerships will, and some will not, have a separate legal personality, section 5 of the 1890 Act should be amended on the following lines:**

- (a) Where a partnership does not have a separate legal personality the basic rule should be that the partners are agents of the other partners;**
- (b) Where the partnership does have a separate legal personality the basic rule should be that the partners are agents of the partnership.**

9.8 We have considered whether it would be of assistance to have in statutory form some basic rules setting out when a partner would bind the firm, but which are not linked to how the particular business of a firm is usually carried on.<sup>7</sup> There could, for example, be a list of acts that are commonly within a partner's authority. The difficulty, however, is that what is 'usual' in one business may not be 'usual' in another.<sup>8</sup> What is usual also changes

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<sup>5</sup> See, for example, *Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1985) 155 CLR 541 (where it was held that in fact the partner had no authority in the particular transaction).

<sup>6</sup> *Major v Brodie* [1998] STC (Ch D) 491.

<sup>7</sup> Clause 25 of the 1879 Partnership Bill set out a number of acts that (subject to what is now s 5 of the 1890 Act) would bind the firm. These included buying and selling goods, paying debts, drawing a cheque on the bankers of the firm in the firm name and hiring a servant and agent if the business was one for which servants or agents were necessarily or usually employed. Clause 26 set out further acts which would bind the firm but were only of relevance to trading partnerships, for example borrowing money on the credit of the firm and pledging goods of the firm for that purpose.

<sup>8</sup> See *McDonic v Hetherington* (1997) 142 DLR (4th) 648, 656: "a factual issue cannot be decided by resort to a 'rule' taken from previous cases." See also Lord Lindley's comment at *Lindley & Banks*, para 12-11: "no answer of any value can be given to the abstract question - Can one partner bind his firm by such and such an act? unless, having regard to what is usual in business, it can be predicated of the act in question either that it is one without

over time. What was ‘usual’ in the nineteenth century may not be ‘usual’ at the beginning of the twenty-first century.<sup>9</sup> We would welcome views but our preliminary view is that such a list would not be helpful.

## **Supplementary rules**

### **Section 6**

9.9 Section 6 of the 1890 Act provides that:

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.

9.10 The words “and all the partners” at the end of the main part of this section are curious. In English law the firm is simply all the partners. So the extra words at the end of the provision add nothing. In Scots law the only important point is that the firm, as a separate legal person, should be bound. The rest flows from that. Again the provision seems to be suitable for neither situation.

9.11 We invite views on the following provisional proposal:

**The reference to “all the partners” at the end of section 6 of the 1890 Act should be deleted as unnecessary and, in some cases, inappropriate.**

9.12 We are not aware of any other difficulties with section 6 but would welcome comments.

### **Section 7**

9.13 Section 7 of the 1890 Act provides that:

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

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which no business can be carried on, or that it is one which is not necessary for carrying on any business whatever. There are obviously very few acts of which any such assertions can be truly made. The great majority of acts, and particularly all which give rise to doubt, are those which are usual in one business and not in another.” See further *Dubai Aluminium Company Ltd v Salaam and others*, *The Times* 21 April 2000 per Aldous LJ (quotation taken from transcript) “[d]ecisions of judges as to what was in the ordinary business of a particular partnership may not be of guidance as to what was in the ordinary business of another partnership.”

<sup>9</sup> See eg *United Bank of Kuwait Ltd v Hammoud* [1988] 1 WLR 1051, 1063F. See also *Dubai Aluminium Company Ltd v Salaam and others*, *The Times* 21 April 2000. In the latter case Aldous LJ gave the example that solicitors in 1890 did not provide a full range of financial services whereas some do today. Thus the buying and selling of shares would not in 1890 be held to be in the ordinary course of business of a firm of solicitors, but the contrary could be true today depending upon the facts.

he is in fact specially authorised by the other partners; but this section does not affect any personal liability incurred by an individual partner.

9.14 This section seems to have given rise to no problems in the United Kingdom although it was discussed in an early New Zealand case which turned on the meaning of “apparently not connected with the firm’s ordinary course of business”.<sup>10</sup> The phrase “specially authorised by the other partners” is, however, slightly troublesome. First the word “specially” seems unnecessary and potentially confusing. Secondly, in the case of a partnership with a separate legal personality the authorisation should come from the firm.

9.15 We invite views on the following provisional proposals:

**(1) Section 7 of the 1890 Act should be amended to reflect the fact that, in a firm with legal personality, the authorisation should come from the firm.**

**(2) There should be no need for the partner to have been “specially” authorised. The question should simply be whether the partner was in fact authorised.**

### **Section 8**

9.16 Section 8 of the 1890 Act provides that:

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.

9.17 The general rule of agency law is that a principal can only restrict an agent’s authority by giving notice of this to third parties. However, before the 1890 Act, there was a conflict in partnership law between the dicta of Lord Ellenborough in *Gallway v Mathew*<sup>11</sup> and *Smithson and Alderson v Pope*<sup>12</sup> and Sir James Martin CJ in *Montefiore v Smith*<sup>13</sup> who based his decision on a statement by Lord Lindley in his extra-judicial capacity as a text-book writer.<sup>14</sup> The dispute was whether a distinction could be drawn between notice of an agreement that a partner would not do a certain act and notice that the firm would not be liable if the partner did that act. According to Lord Lindley, writing before the 1890 Act, only in the latter case would the firm escape liability.

9.18 Section 8 of the 1890 Act was intended to clarify this. In the view of the current editor of *Lindley & Banks*, there is still some doubt whether the third party must have notice that the partner is prohibited from doing an act so as to bind the firm or whether mere notice of the prohibition is sufficient.

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<sup>10</sup> *Kennedy v Malcolm Bros* (1909) 28 NZLR 457.

<sup>11</sup> (1808) 10 East 264; 103 ER 775.

<sup>12</sup> (1808) 1 Camp 404, n (a); 170 ER 1001.

<sup>13</sup> (1876) 14 SCR (NSW) 245.

<sup>14</sup> Quoted in full in *Lindley & Banks*, para 12-149, n 81.

9.19 We do not believe that there is much room for doubt if section 8 is read together with section 5. If a partner has no authority to act on behalf of the firm and a third party knows this, the firm is not bound. Indeed in these circumstances section 8 adds little to section 5. We do not believe that in this connection section 8 needs amendment.

### **Section 15**

9.20 Section 15 of the 1890 Act provides that:

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.

9.21 It is doubtful whether this provision is necessary but it seems to give rise to no difficulty and we suggest no change.

### **Section 16**

9.22 As a matter of agency law, the knowledge of an agent who has actual or ostensible authority to receive communications on behalf of the principal will be treated as that of the principal.<sup>15</sup> Section 16 of the 1890 Act recognises this general principle:

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.

Again this seems to have given rise to no difficulty and we suggest no change.

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<sup>15</sup> *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, 702, per Hoffmann LJ. Hoffmann LJ considered that the court *could* infer that an agent who had a duty to communicate to the principal did precisely that, but that this was a rebuttable inference of fact.

# PART X

## LIABILITY FOR PARTNERSHIP OBLIGATIONS

### Introduction

10.1 In this Part we consider the liabilities of the partners and the firm for partnership debts and obligations and for wrongs, dealing first with the situation of the partnership which continues unchanged<sup>1</sup> and proceeding to the liabilities of incoming partners and of outgoing or former partners.<sup>2</sup> We then consider the liability of those firms which have separate legal personality for the obligations of predecessor firms. Finally we look at some miscellaneous points on liability, including liability by holding out.<sup>3</sup>

10.2 We make several suggestions for minor changes to the 1890 Act, taking into account that some partnerships covered by the Act have a separate legal personality and that more might have a separate legal personality if options for change suggested earlier were to be adopted.

### Liability of partners for debts and obligations of the firm

#### *Existing law*

##### GENERAL

10.3 Partners have unlimited liability for the firm's debts and obligations. In English law, partners are jointly liable with one another for the debts and obligations of the firm incurred during their membership. In Scots law, they are jointly and severally liable.<sup>4</sup> The matter is regulated by section 9 of the 1890 Act which provides:

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.

10.4 The effect of joint liability in English law is that all the partners are liable for the performance of the whole promise. One partner can be sued and found liable for the whole debt, with a right to recover a proportionate contribution from the other liable partners. As the previous procedural differences have largely been removed,<sup>5</sup> the position is substantially

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<sup>1</sup> These matters are dealt with in ss 9 to 13 of the 1890 Act.

<sup>2</sup> These matters are dealt with in s 17 of the 1890 Act.

<sup>3</sup> This is dealt with in s 14 of the 1890 Act.

<sup>4</sup> In Scotland, because the firm has a separate legal personality, the liability of the partners is subsidiary. We consider this at paras 10.5 – 10.7 below.

<sup>5</sup> The general rule used to be that all those jointly liable should be joined as defendants to an action *Kendall v Hamilton* (1879) 4 App Cas 504, 544, *per* Lord Blackburn. If this did not happen, proceedings could be stayed until all such people jointly liable were joined in the action. Moreover, judgment against one joint promisor used to bar an action against the others, even if the judgment was not satisfied. *King v Hoare* (1844) 13 M& W 494, 505 - 506; 153 ER 206, 210; *per* Parke B. These consequences no longer follow: CPR, Part 19; Civil Liability (Contribution) Act 1978, s 3. The consequences of releasing one of the co-debtors are common to both types of

similar in English law if the liability is joint and several.<sup>6</sup> In Scotland, on the other hand, the difference between joint liability and joint and several liability is substantial. A joint debtor is liable only for a proportionate share of the debt.<sup>7</sup> A debtor who is liable jointly and severally is liable for the whole debt, with a right of relief from the co-debtors. The wording of section 9 therefore achieves substantially the same result in both English law and Scots law. In both legal systems each partner is potentially liable for the whole debt in a question with the creditor, with a right of contribution or relief against the other partners.

## SCOTLAND

10.5 Section 9 does not distinguish between the liability of a partner where the partnership does not have a separate personality and the liability of a partner where, as in Scotland, it does. In fact, however, the nature of the partner's liability is different. At present, in Scotland, the liability of the partners for the debts and obligations of the firm is a subsidiary liability.<sup>8</sup> This stems from the fact that the firm is a legal person and can therefore incur its own debts and obligations, for which it has primary liability:

A partner of a company<sup>9</sup> is not a joint and several obligant in the ordinary sense for a debt due by the company of which he is or has been a partner. The debt is the debt of the company, and the company is the primary obligant.<sup>10</sup>

Although section 9 of the 1890 Act does not state that, where the partnership has a separate personality, the partners' liability is subsidiary, the Scottish courts have assumed that the old rule continues.<sup>11</sup> Lord President Cooper in *Mair v Wood*<sup>12</sup> 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.

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liability see *North v Wakefield* (1849) 13 QB 536; 116 ER 1368; *Deanplan Ltd v Mahmoud* [1993] Ch 151; *Jameson v Central Electricity Generating Board* [1999] 2 WLR 141. See also Law of Contract: Report on Contribution (1977) Law Com No 79, paras 42 - 43 and Rick Munro, "The release of co-debtors under individual voluntary arrangements" *Insolvency Law & Practice* (1998) vol 14, no 4, p 230.

<sup>6</sup> It may remain the case that it is felt desirable that all those who are jointly liable (as opposed to those who are jointly and severally liable) be parties to any proceedings. However the ability of the court to order that parties be added to proceedings, under Part 19 of the CPR, means that (whether liability is joint or joint and several) the failure to join a party when proceedings are commenced is unlikely to have any impact, beyond costs or interest sanctions, if it is deemed appropriate for the party to be added to the proceedings at a later date.

<sup>7</sup> See *Coats v Union Bank* 1929 SC (HL) 114.

<sup>8</sup> Bell, *Comm. II*, 508.

<sup>9</sup> The word "company" was often used in Scotland before the 1890 Act to denote the partnership or firm.

<sup>10</sup> *Neilson v Wilson* (1890) 17 R 608, 618, *per* Lord Shand. Lord Shand dissented as to the result in this case but that does not affect the passage quoted.

<sup>11</sup> See *Mair v Wood* 1948 SC 83, 86, *per* Lord President Cooper.

<sup>12</sup> 1948 SC 83, 86.

10.6 Because the partners' liability is secondary to that of the firm, it cannot be enforced until the firm has failed to meet the obligation.<sup>13</sup> It has been held that a creditor of the firm must constitute the claim against the firm before going against the partners.<sup>14</sup> In this context 'constituting' the claim appears to mean raising a court action against the firm and obtaining decree.<sup>15</sup> In practice the partners are commonly sued in the same action. It is not necessary to enforce the decree against the firm before enforcing it against the partners. Therefore the point at which the partners usually become liable for the firm's debts is when decree is granted against the firm.<sup>16</sup> Although it is sometimes said that the partners are in the position of cautioners or guarantors for the firm, that is just a rough way of indicating the subsidiary nature of their liability. It cannot be assumed that all of the ordinary rules applying to cautioners apply in this context.<sup>17</sup>

10.7 The enforcement of decrees is covered by section 4(2) of the 1890 Act which provides that, in Scotland:

... 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.

Where a decree against the partnership alone is to be enforced against a partner it is up to the messenger-at-arms or sheriff officer enforcing the decree to ascertain that the person charged is in fact a partner.<sup>18</sup>

### **Possible reforms**

#### CHANGING THE NATURE OF THE LIABILITY

10.8 It might be argued that a partner's liability to a third party should be for a proportionate share of the debt, calculated by reference either to the number of partners or to the partner's interest in the firm. We would not, however, support such a change. Given the informality and lack of regulation of partnership arrangements as between the partners,

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<sup>13</sup> Bell, *Comm. II*, 508.

<sup>14</sup> See *Mair v Wood* 1948 SC 83, 86, *per* Lord President Cooper. Although Bell states that "[t]he demand must be made first against the company, or the company must have failed to pay, or have dishonoured their bill, before the partner can be called on" (*Comm. II*, 508), he does not state that decree against the firm is necessary.

<sup>15</sup> The meaning of 'constitution' of a debt is nowhere defined, but in the cautionry context, it means obtaining decree. As the liability of partners in partnership law is analogous to that of cautioners, it seems that constituting a debt against a firm means obtaining decree against the firm. This was the view accepted in *Mair v Wood* 1948 SC 83, 86 and in *Highland Engineering Ltd v Anderson* 1979 SLT 122, 124. See, however, *Neilson v Wilson* (1890) 17 R 608 where, in the context of rules on joint and several liability, "constitute" appears to have a different meaning.

<sup>16</sup> However, if a document is registered in the Books of Council and Session for preservation and execution, the third party can use summary diligence against either the firm or the partners immediately. We suggest later that this rule should not apply in the case of dissolved partnerships. See paras 17.15 and 17.17 below.

<sup>17</sup> See Bell, *Comm. II*, 508 (partners do not have the "benefit of discussion" – ie the right to insist that the creditor did diligence against the principal debtor before proceeding against the cautioner - which proper cautioners used to have before the Mercantile Law Amendment (Scotland) Act 1856). A current difference is that a partner's subsidiary liability is joint and several whereas in a proper cautionry each of several co-cautioners is bound only for a proportionate share.

<sup>18</sup> *Drew v Lumsden* (1865) 3 M 384. See Graham Stewart, *Law of Diligence* (1st ed 1898) p 296.

and the difficulty for third parties in knowing what these arrangements are at any time, we think that the fairer solution is that of the present law where the creditor can proceed against any partner, leaving it to the partner to seek relief from the other partners. It seems appropriate that the risk of insolvency of a partner is borne by the other partners and not by the third party. The other partners are best placed to monitor their fellow partners and assess the prospects of the business.

10.9 It seems anomalous, however, that the liability of a partner should be only joint in English law and not joint and several. Even although, as noted above, the results in both cases are substantially similar, it would be procedurally better for third party creditors, and more consistent with other provisions in the Act, if liability were to be expressed as joint and several. In other respects, including liability for wrongs, liability under the Act is joint and several.<sup>19</sup> There is a case for applying one liability regime to all partnership liabilities, whether or not contractual.

10.10 We invite views on the following provisional proposal:

**The liability of a partner, under section 9 of the 1890 Act, for debts and obligations of the firm should be joint and several and not, as is presently the case in England and Wales, joint.**

10.11 The special rules at the end of section 9 on the liability of a deceased partner's estate also seem anomalous. These special rules are in two parts. The first part provides that the estate is liable severally as well as jointly.<sup>20</sup> We have suggested that liability should be joint and several in all cases. If that suggestion were accepted, the section could be simplified accordingly and one anomaly removed. The second part provides that the estate's liability for partnership debts is, in English law, subject to the prior payment of the deceased partner's separate debts. The partnership debts and obligations are postponed to the deceased's separate debts. This postponement of partnership creditors may be of comfort to a deceased's estate, but it presents anomalies. Liability for wrongful acts and omissions is joint and several. This remains so after the partner's death, but this liability is not postponed to the prior payment of the partner's separate debts. If the liability is both contractual and tortious, the effect of section 9 is avoided. It would be more coherent to have one rule which postpones *any* partnership claim or postpones *no* partnership claim. Judgment for the whole of a partnership debt can be levied against a living partner without regard to the existence of any of the partner's other creditors. We cannot see why the fact that the partner dies one day before judgment is given should alter this.

10.12 We invite views on the following provisional proposal:

**Section 9 of the 1890 Act should be amended to remove the anomalous postponement to separate creditors mentioned, in the context of the liability of a deceased partner's estate, at the end of the section.**

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<sup>19</sup> See s 10 (liability for wrongs and misapplication of money or property).

<sup>20</sup> *Re Doetsch, Matheson v Ludwig* [1896] 2 Ch 836. The statement in s 9 that the estate is liable "so far as [the debts and obligations] remain unsatisfied" has not been interpreted to mean that the assets of the other partners must first have been exhausted, and only that as a matter of fact the debts or obligations have not been met.

## POSITION WHERE PARTNERSHIP HAS SEPARATE PERSONALITY

10.13 It seems clear that the Act should provide for the situation where the partnership has a separate personality. This would be useful at present, in order to make the Act reflect the position in Scotland, and would be even more necessary were some or all English partnerships to be given separate legal personality.

10.14 It can be taken for granted that the partnership itself will be liable for its own obligations. That is a simple consequence of conferring separate personality. The difficulty is to determine the precise nature of the partners' liability.

10.15 The first issue is whether the partners' liability should be subsidiary, the primary liability being that of the partnership. It might be thought that a simple solution would be to make the partners jointly and severally liable along with the partnership. A creditor could sue the partnership and/or any or all of the partners, without restriction. This solution would have the merit of preserving the rights of creditors notwithstanding any introduction, in English law, of separate personality for some or all partnerships. A creditor would still be able to proceed directly against any partner, without bothering about the partnership. It would, however, give the wrong impression of the nature of the respective liabilities of the firm and the partners. It would give the impression that in a four-partner firm there were five obligants, each being liable, as between themselves, only for a one-fifth share.<sup>21</sup> This solution would also give the misleading impression that if a partner paid the whole of a partnership debt the partner's right of relief against the partnership would only be for part of the debt. In fact the partner should have a right of relief against the partnership for the whole amount of the debt. It would also be rather misleading to give the impression that if the partnership paid, it would have a right of relief against the partners. In fact, if it paid that would be the end of the liability of the partners. The more natural and accurate approach is to say that the partnership is the primary obligant and that the partners' liability is subsidiary.

10.16 The next question is whether the creditor should be required to take certain steps against the partnership first, before proceeding against a partner.<sup>22</sup> There are two important policy considerations. First, creditors should not be required to take unnecessary steps. A creditor should be able to obtain satisfaction by means of one action and one set of enforcement proceedings and, in any case where it appears that the assets of the partnership are likely to be insufficient, it should be possible for the enforcement proceedings to be directed against a partner. Secondly, partners should be protected from unnecessary proceedings against them in a personal capacity in relation to partnership debts. The partnership is the business vehicle and the primary obligant. The whole assets of a partner may be sunk in the partnership. It is more principled, and will generally be less wasteful of time and effort, for routine proceedings to be directed against the partnership, at least at the initial stages. In practice a creditor would probably seek payment first from the firm, the primary debtor. In the case of a firm well able to pay its debts there would be no reason to do anything else. It is reasonable that partnership assets should be liable in the first place to satisfy partnership debts.

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<sup>21</sup> This would not necessarily produce the wrong result in the end of the day, because each partner would ultimately be liable for a quarter of the partnership's debt, but it would be a confusing and complicated way of proceeding.

<sup>22</sup> See para 18.3 below.

10.17 The existing Scots law balances these two policy considerations by requiring the action to be against the partnership, the primary debtor, although it is possible and customary also to sue partners in the same action,<sup>23</sup> but by then allowing the decree, even if obtained only against the partnership, to be enforced directly against a partner. There is no requirement to exhaust remedies against the partnership assets before proceeding to enforcement against a partner's own assets. So far as we are aware this system has given rise to no problems or complaints. Current English procedural rules allow a judgment in the name of a firm to be enforced against partnership assets, but impose various criteria, at least one of which must be satisfied before a judgment in the name of a firm can be enforced against the assets of individual partners.<sup>24</sup>

10.18 The American RUPA balances the policy considerations in a different way. First it provides that:

An action may be brought against the partnership and any or all of the partners in the same action or in separate actions.<sup>25</sup>

So far this is not so different from the Scottish solution. Then, however, it provides that a judgment against the partnership is not by itself a judgment against a partner and that a judgment against a partnership may not be satisfied from a partner's assets unless there is also a judgment against a partner.<sup>26</sup> This is different from the Scottish solution in that it makes a decree against the partner, which can be obtained in the same action or in a later action, necessary before there can be execution against the partner. However, the practical results will be the same under both systems because in Scotland it is customary to include partners in the initial action. Where RUPA differs significantly from the Scottish solution is in providing that a creditor of the partnership cannot generally levy execution against a partner's own assets unless remedies have been exhausted against the partnership's assets.<sup>27</sup> There are exceptions. The creditor can, for example, proceed directly against the partner's assets if the partnership is bankrupt, or if the partner has so agreed, or if a court grants permission on certain grounds, such as clear insufficiency of the partnership assets.<sup>28</sup>

10.19 Under both the Scottish approach and the RUPA approach a creditor of the partnership can, in appropriate cases, obtain satisfaction out of a partner's own assets by means of one action and one set of enforcement proceedings. Both recognise that the partner's obligation is subsidiary. RUPA, however, applies this principle more strictly by requiring remedies against the partnership to be exhausted before execution can be done against a partner's own assets. In Scotland a decree against the firm, or against an individual partner obtained in the same or a later action, can be enforced directly against the partner without doing diligence against the assets of the partnership, even if the partner is unaware of the decree. The Scottish solution is more favourable to creditors. In particular, it

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<sup>23</sup> We suggest later that the Act should make it clear that the partners can be sued in the same action. See paras 17.14 and 17.17 below.

<sup>24</sup> CPR, Sched 1, RSC O 81, r 5(1) & (2); see para 18.3.

<sup>25</sup> Section 307 (b).

<sup>26</sup> Section 307 (c).

<sup>27</sup> Section 307 (d).

<sup>28</sup> Section 307 (d)(2) - (4).

places the creditor who has proceeded first against the partnership alone, perhaps in ignorance of the partnership's precarious financial state, in a stronger position because the creditor can proceed immediately to enforce the judgment against a partner without having to seek the court's permission or to raise a separate action against the partner. On balance, our provisional view is that a creditor should not have to exhaust enforcement remedies against the assets of the partnership before enforcing the judgment against the assets of a partner.

10.20 We invite views on the following provisional proposals and question:

**(1) The Partnership Act should specify the nature of the partners' liability for partnership obligations in those cases where the partnership has a separate legal personality.**

**(2) In such cases, the partnership should have the primary liability and the partners' liability should be subsidiary.**

**(3) Creditors of the 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.**

**(4) A partner satisfying the whole or part of a claim against the partnership shall have the right to be indemnified by the partnership, failing which, to the extent that that partner has paid more than their due proportion, they shall have the right to a pro rata contribution from the other partners.**

**(5) A creditor should be permitted to enforce a judgment obtained against a partnership directly against the assets of a partner without it also being necessary to obtain a judgment against that partner.**

**(6) On the assumption that the creditor has obtained an appropriate judgment, do consultees agree that the creditor need not be required to exhaust enforcement remedies against the assets of the partnership before enforcing the judgment against the assets of a partner?**

## **Liability for wrongs**

### ***Existing law: sections 10 to 12***

#### LIABILITY OF THE FIRM

10.21 Section 10 provides:

Where, by any wrongful act<sup>29</sup> 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

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<sup>29</sup> In *Dubai Aluminium Company Ltd v Salaam and others*, *The Times* 21 April 2000 the Court of Appeal (Turner J dissenting on this point) held that the reference to "any wrongful act or omission" in s 10 encompassed all wrongful acts or omissions; it therefore included accessory liability in equity. Aldous LJ considered that the question as to whether an act is within the actual or apparent course of a particular business is primarily a

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.<sup>30</sup>

10.22 Section 11 provides:

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<sup>31</sup> 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.<sup>32</sup>

Section 11 extends the scope of section 10. It applies even where a partner is not acting in the ordinary course of the firm's business or with the authority of co-partners when the money or property is misapplied.

10.23 Both section 10 and section 11 apply at present, and could apply in the future, equally to firms with legal personality and firms without legal personality. In the case of a partnership without legal personality "the firm" simply means the partners, who are liable jointly and severally.<sup>33</sup>

#### LIABILITY OF THE PARTNERS

10.24 Section 12 of the 1890 Act provides:

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.

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question of fact. He took the view that there is "no principle of law that a solicitor does not have implied or apparent authority to constitute himself a constructive trustee."

<sup>30</sup> Section 10 establishes that the firm is liable for a fraud committed by a partner in the ordinary course of the business of the firm. A fraud is, of course, a wrongful act and if it is undertaken in the ordinary course of the partnership, the firm will be liable: see, eg, *Scarborough Building Society v Howes Percival CA* (unreported) 5 March 1998. However, it is necessary to prove an actionable fraud. The combination of a false statement innocently made with knowledge of another of the true facts is not fraud: there has been no true deceit: see *Armstrong v Strain* [1952] 1 KB 232.

<sup>31</sup> *New Mining & Exploring Syndicate Ltd v Chalmers & Hunter* 1912 SC 126 is an example of a case where it was held that s 11 was inapplicable because the money was not received in the course of the business.

<sup>32</sup> Liability under s 11(a) and (b) is not mutually exclusive. See *Rhodes v Moules* [1895] 1 Ch 236. For the rationale of s 11(b) see *Bass Brewers Ltd v Appleby & another* [1996] PNLR 385, 396. See also *McDonic v Hetherington et al* (1997) 142 DLR (4th) 648; and HY Yeo, "Liability of partner for misconduct of fellow partner" (1998) *Company Lawyer* vol 19, no 6, p 171.

<sup>33</sup> 1890 Act, s 12.

This section would become unnecessary if, as we have suggested above, liability for the firm's obligations in general were to be joint and several.

### ***Possible reforms***

10.25 The only question on which we seek views is whether it should continue to be the case that a partnership is not liable for loss or injury caused to a partner by the wrongful act or omission of another partner.<sup>34</sup> This rule seems anomalous, particularly in those cases where the partnership has a separate legal personality. It is difficult to see any policy justification for it. The partnership will carry the insurance and, it might be thought, the partnership ought to be liable.

10.26 We invite views on the following provisional proposal:

**It should no longer be the law that a partnership is not liable for loss or injury wrongfully caused by one partner, acting with authority or in the ordinary course of the firm's business, to another partner.**

### **Improper employment of trust property for partnership purposes**

#### ***Existing law: section 13***

10.27 Section 13 of the 1890 Act provides that a partner who acts as a trustee and who improperly employs trust property in the business or on the account of the partnership does not make the co-partners liable.<sup>35</sup> This does not affect the liability of a partner who has notice of a breach of trust.<sup>36</sup> The section also does not operate to prevent the proper use of a tracing remedy against property in the possession or under the control of the firm.<sup>37</sup>

10.28 In *Bass Brewers Ltd v Appleby & another*<sup>38</sup> Millett LJ explained the difference between liability under section 11 and under section 13:

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

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<sup>34</sup> As noted above, s 10 of the 1890 Act provides that the firm is liable for loss or injury wrongfully caused by a partner to any person "not being a partner in the firm". See *Mair v Wood* 1948 SC 83; *Blackwood v Robertson* 1984 SLT (Sh Ct) 68.

<sup>35</sup> At first instance in *Dubai Aluminium Company Ltd v Salaam and others* [1999] 1 Lloyd's Rep 415, 470, Rix J held that s 13 was limited to circumstances where the partner accepts the responsibility of being a trustee. He considered that the section assumed that the individual trusteeship was not something undertaken in the ordinary course of business, otherwise it would not be consistent with s 11 (see *Lindley & Banks* para 12-136). Section 13 did not deal with the situation where a partner, *not* being a trustee, conducts himself as an accessory to a breach of trust. This could, however, constitute a wrongful act under s 10: see n 29, para 10.21 above. On appeal Aldous LJ approved these conclusions.

<sup>36</sup> 1890 Act, s 13(1).

<sup>37</sup> 1890 Act, s 13(2).

<sup>38</sup> [1996] PNLR 385, 397.

capacity, such as trustee,<sup>39</sup> 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.

### **Possible reform**

10.29 We suggest no alteration of substance to section 13. To cater for partnerships with separate legal personality it might be useful, however, to make it clear not only that the other partners are not liable in the circumstances mentioned but also that the partnership is not liable.

10.30 We therefore invite views on the following provisional proposal:

**To cater for partnerships with separate legal personality, section 13 of the 1890 Act should provide not only that the other partners are not liable but also that the partnership is not liable.**

### **Holding out**

#### **Existing law: section 14**

10.31 A person who is not a partner may be liable to third parties as though a partner. Section 14 provides:

(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,<sup>40</sup> is liable as a partner<sup>41</sup> to any one who has on the faith of any such representation given credit<sup>42</sup> 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.

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<sup>39</sup> Section 13 refers to "a partner, being a trustee ...".

<sup>40</sup> The firm does not need to be an actual one: see *D & H Bunny Pty Ltd v Atkins* [1961] VLR 31.

<sup>41</sup> The person is liable as a partner, namely is estopped or personally barred from denying being a partner. Estoppel or personal bar does not make the person a partner, and so if there is only one other 'partner' there will as a matter of law be no firm, and for example, nothing to be wound up: see *Re C & M Ashberg*, *The Times* 17 July 1990.

<sup>42</sup> This has not been given a restrictive meaning, and probably covers any transaction with the firm: see the High Court of Australia judgment in *Lynch v Stiff* [1943] 68 CLR 428 and *Lindley & Banks*, para 5-52. There is no UK authority on this matter. The point was left unargued before the Court of Appeal in *Nationwide Building Society v Lewis and Another* [1998] 2 WLR 915 after the Court indicated (at p 920) that as the common law doctrine of estoppel was wider than s 14(1) and the plaintiff was not basing his case on s 14(1) alone, the construction of the statutory language was unnecessary.

10.32 Section 14 is a statutory application of the doctrine of estoppel<sup>43</sup> or, in Scotland, personal bar.

### **Possible reforms**

10.33 It is not entirely clear when it could be said that a partner “knowingly suffers himself” to be represented as a partner. In *Lindley & Banks* the current editor poses the following problem:<sup>44</sup>

Will a person who has not authorised others to hold him out as a partner but who, knowing that they are in fact holding him out, makes no attempt to stop them incur any liability under the section? Will he knowingly suffer himself to be held out if he merely protests? Must he go further and advertise his true position or apply for an injunction? In view of the imprecision inherent in the section, prudence would seem to dictate the immediate commencement of proceedings if the objections are ignored.<sup>45</sup>

10.34 Although the rule could undoubtedly be difficult to apply in marginal cases we are not satisfied that amendment of the provision would improve the position and make no suggestion for change.

10.35 A further difficulty concerns the interaction of holding out with section 36. Section 36 enables those dealing with a partnership after a change in its composition to treat all apparent members of the old firm as still being members of the firm until notified of the change.<sup>46</sup> For example, if a partner retires and follows the notice provisions of section 36, a creditor who has received actual notice cannot argue that a person has held himself out as a partner. Logically, therefore, the mere use of his name in the firm name would not appear to constitute holding out.

10.36 However, on the basis of some pre-1890 case law, it is arguable that the continued use of that name may render the retiring partner liable on the basis of holding out, even if he has given proper notice of his retirement.<sup>47</sup> This contrasts with the clarity of section 14(2) which applies in the case of the death of a partner and which provides that the continued use of the old firm name or of the deceased’s name as part thereof shall not, *of itself*, constitute holding out.

10.37 It seems to us that section 14(2) is too narrow in applying only to the case of the death of a partner. Exactly the same problem – continued use of the name of the firm or of the name of the outgoing partner as part of the firm name – could arise in other situations where a partner ceases to be a member of a partnership.<sup>48</sup> The rules ought in our view to be

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<sup>43</sup> See *In re Fraser, ex parte Central Bank of London* [1892] 2 QB 633, 637; *Hudgell Yeates & Co v Watson* [1978] QB 451, 470; *Bass Brewers Ltd v Appleby & another* [1996] PNLR 385 and *Nationwide Building Society v Lewis* [1998] 2 WLR 915, 919.

<sup>44</sup> *Lindley & Banks*, para 5-47.

<sup>45</sup> Footnotes omitted.

<sup>46</sup> See paras 10.49 - 10.53 below.

<sup>47</sup> See *Lindley & Banks*, paras 5-56 - 5-61.

<sup>48</sup> See, for example, *In re Fraser, ex parte Central Bank of London* [1892] 2 QB 633.

the same whether the partner dies or retires or is expelled or otherwise ceases to be a partner. In the interests of clarification, we therefore invite views on the following provisional proposal:

**Section 14(2) (the effect of the continued use of a firm name or of a deceased partner's name as part of a firm name) should apply not only to a deceased partner but also to any other outgoing partner.**

### **Liability of incoming partner**

#### ***Existing law: section 17(1)***

10.38 The general rule on the liability of an incoming partner is provided by section 17(1) of the 1890 Act which provides:

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.

10.39 The important word in this provision is “thereby”. The new partner does not become liable for existing obligations merely by being admitted but that does not prevent the new partner from agreeing to be liable. Such an agreement may be inferred where, for example, the incoming partner does not contribute any capital to the new firm.<sup>49</sup> The effect of such an agreement will depend on its terms and on the other parties to it. Usually any such agreement would be only with the other partners (or, in Scotland, with the firm<sup>50</sup>) and would not involve the new partner in any direct liability to creditors. It may, however, be entered into with the creditors also and may amount to an assumption of direct liability by the new partner.<sup>51</sup> It appears that the courts in England<sup>52</sup> used to infer from slight evidence the agreement of an incoming partner to be liable to a creditor for the obligations of the old firm but this is no longer the case.<sup>53</sup>

10.40 The question of whether an incoming partner is liable for pre-existing debts of a firm is a separate (although related) question from whether the new firm created by the introduction of the new partner is liable for the debts of the old firm. We discuss that question, which has given rise to a substantial body of case law, later.<sup>54</sup>

#### ***Possible reform***

10.41 The principle of section 17(1) seems sound. The provision is well-adapted to the situation where a new partner is admitted into a partnership which continues as a legal person. In such a case the partnership would continue to be liable for obligations incurred before the admission. Any capital contributed by the new partner would be available to

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<sup>49</sup> *Miller v Macleod* 1973 SC 172.

<sup>50</sup> Whether the same continuing firm (if that is possible) or a new firm which has taken over the old firm's debts. For the doubts as to whether there a firm can continue after the admission of a new partner, see paras 2.34 – 2.35 above.

<sup>51</sup> See *Lindley & Banks*, para 13-28; Miller, pp 278 – 279.

<sup>52</sup> But not Scotland. See Miller, pp 278 – 279.

<sup>53</sup> See *Lindley & Banks*, paras 13-29 – 13-30.

<sup>54</sup> See paras 10.62 - 10.69 below.

meet the partnership's liability. The new partner's personal liability<sup>55</sup> would, however, arise only in relation to obligations incurred after the admission. That seems to us to be a satisfactory solution and we make no suggestion for change.

### **Liability of outgoing partner for obligations incurred before leaving firm**

#### ***Existing law: section 17(2) and (3)***

10.42 Section 17(2) and (3) of the 1890 Act provide:

(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.

#### ***Possible reforms***

10.43 The rules in section 17(2) and (3) seem basically sound. It seems clear as a matter of policy that a partner should not be able to escape from obligations owed to a third party by the simple expedient of leaving the partnership. The provisions can apply to a partnership with a continuing legal personality. In such a case, if the partnership continued as a legal entity after the retirement, the retiring partner's liability would continue to be a subsidiary one.

10.44 It is a defect in section 17(2) and (3) that they apply only to a retiring partner and not to a partner who leaves a partnership in some other way. We invite views on the following provisional proposal:

**Section 17(2) and (3) of the 1890 Act (on the liability of a retiring partner) should apply to all outgoing partners.**

10.45 It may be difficult to determine whether a debt or obligation was incurred before or after a partner left a firm<sup>56</sup> but we are not convinced that any amendment of the provisions could remove the difficulty. The date when an obligation is incurred is partly a matter of the general law on obligations and partly a matter of fact.

10.46 It is, in English law,<sup>57</sup> unclear what, if any, consideration a retiring partner provides in section 17(3). Novation involves the formation of a new contract. Consideration should move therefore from the promisee. A difficulty arises when X and Y are in partnership and X retires. X, Y and the creditors of the firm all agree that X will cease to be liable and that Y

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<sup>55</sup> See para 10.15 above, where we have suggested that this liability should be clearly recognised as a subsidiary liability.

<sup>56</sup> *Oakford v European and American Steam Shipping Company* (1863) 1 H & M 182; 71 ER 80; *Court v Berlin* [1897] 2 QB 396; *Welsh v Knarston and Others* 1972 SLT 96, 97; 1973 SLT 66, 71(not, however, decided on s 17(2)).

<sup>57</sup> This is not a problem in Scots law.

will be solely liable. *Chitty on Contracts*<sup>58</sup> notes that, although it seems that X cannot be sued, it is hard to see what consideration X provides.<sup>59</sup> *Lyth v Ault*<sup>60</sup> is cited as authority for consideration lying in the fact that it might be easier to enforce against a single debtor, than against several, all of whom are solvent. It is stated that this is “a possible, if invented consideration”.<sup>61</sup> *Lindley & Banks* quote approvingly Lord Lindley’s comments that:

An express agreement by the creditor to discharge a retired partner, and to look only to a continuing partner, is not [necessarily] inoperative for want of consideration;<sup>62</sup> [and]

the proposition that a creditor of a firm cannot, for want of consideration, abandon his right against a retiring partner, and retain it against the others, unless they give some fresh security, has been shown to be erroneous, and is now exploded.<sup>63</sup>

10.47 The better view seems to be that the retiring partner can be released.<sup>64</sup> All the authorities which might cast doubt are pre-1890. Section 17(3) of the 1890 Act refers to the discharge of a retiring partner by an “agreement” between the retiring partner, the members of the new firm and the creditors. In order to resolve the uncertainty about consideration under English law we suggest that the statute should be amended to provide that “agreement” in section 17(3) does not mean a “contract” supported by valuable consideration.<sup>65</sup> We invite views on the following provisional proposal:

**Statutory effect should be given to the proposal that in English law an agreement whereby a partner retires from the partnership and is released from further liability is not a contract which needs to be supported by valuable consideration.**

### ***Indemnity to outgoing partner***

10.48 Often a retiring partner is indemnified by the remaining partners against the partnership’s debts and obligations.<sup>66</sup> This is a matter for agreement between the outgoing partner and the continuing partners, and does not have any immediate impact on a creditor, who is not a party to the agreement. We have dealt with the introduction of an indemnity as a default rule.<sup>67</sup> The effect of the indemnity on a third party is not and, in our view, does not need to be, regulated by statute.

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<sup>58</sup> *Op cit*, para 3-132. This text is also included in G H Treitel, *The Law of Contract*, (10th ed 1995) p 143.

<sup>59</sup> Also see Prime & Scanlon, *op cit*, pp 148-149; and Charles Drake, *op cit*, pp 138 - 139.

<sup>60</sup> (1852) 7 Ex 669; 155 ER 1117.

<sup>61</sup> *Chitty on Contracts*, *op cit*, paras 3-132 and 3-008.

<sup>62</sup> Para 14-105. Also see n 77 of that paragraph for an explanation why ‘necessarily’ is in square brackets.

<sup>63</sup> Para 14-113. *Lyth v Ault* is referred to here.

<sup>64</sup> If a creditor expressly agrees not to hold a retiring partner liable, but nonetheless sues the retiring partner, the creditor may be estopped if the retiring partner has been prejudiced by relying upon the promise.

<sup>65</sup> See, for example, the decision in *Feeney v Firbeck Main Collieries Ltd* [1926] 2 KB 218 that ‘agreement’ under s 14 of the Workmen’s Compensation Act 1923 did not mean that consideration was necessary.

<sup>66</sup> An indemnity is normally implied where the remaining partners take over the outgoing partner’s share. See *Lindley & Banks*, para 10-207, *Gray v Smith* (1889) 43 Ch D 208.

<sup>67</sup> See paras 7.27 - 7.29 above.

## Liability of outgoing partner for obligations incurred after leaving firm

10.49 Normal agency principles dictate that a partner's apparent authority will continue until it is revoked and notice of revocation is given to any third party with whom the partner deals.<sup>68</sup> A continuing partner may therefore bind the firm and impose liability on a partner who has retired from the firm unless the retired partner has given effective notice of his retirement.<sup>69</sup>

10.50 Section 36 of the 1890 Act covers the notice provisions which should be complied with to bring an end to a partner's agency, and thereby end liability for future debts and obligations. It provides:

(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] [Edinburgh] [Belfast] Gazette ... 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,<sup>70</sup> or who becomes bankrupt,<sup>71</sup> 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 death, bankruptcy, or retirement respectively.

10.51 In *Tower Cabinet Co Ltd v Ingram*<sup>72</sup> "apparent" was held to mean apparent to the person who dealt with the firm. A creditor must have knowledge that the retiring partner was a partner at the date of retirement.<sup>73</sup> If a person was known by a creditor to be a partner before retirement, then actual notice of retirement must be given if the creditor has had previous dealings with the old firm.<sup>74</sup> If the creditor has had no previous dealings but still knew of a partner's membership of the old firm, notice in the Gazette is sufficient.

10.52 The provisions in section 36, resting as they do on established agency principles, are sound in theory. However, the burdens of compliance are significant. In *Hammerhaven Pty Ltd v Ogge* the Court of Appeal of the Supreme Court of Victoria held that for the purposes

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<sup>68</sup> *Bowstead & Reynolds on Agency* (16th ed 1996) para 10-025.

<sup>69</sup> Also see the possibility of liability under the principles of holding out (1890 Act, s 14) discussed in paras 10.31 – 10.37 above.

<sup>70</sup> It is a settled principle of agency law that the death of the principal ends the authority of the agent. See *Bowstead & Reynolds on Agency, op cit*, para 10-027. In Scotland, where partnerships have separate legal personality, the partner is the agent of the partnership which is the principal. See paras 2.9 and 2.14 above.

<sup>71</sup> On bankruptcy the principal's estate vests in a new principal, the trustee in bankruptcy: see *ibid*, para 10-027. For Scots law, see n 70 above.

<sup>72</sup> [1949] 2 KB 397, (CA).

<sup>73</sup> This was held to be the effect of s 36(1) and s 36(3) in *Tower Cabinet Co Ltd v Ingram* [1949] 2 KB 397. It is possible to interpret the reference in s 36(1) to 'apparent' to mean what is apparent to the public at large.

<sup>74</sup> See *Hammerhaven Pty Ltd v Ogge* [1996] 2 VR 488.

of the Victorian equivalent to section 36(1)<sup>75</sup> the alteration of a letterhead should not be treated as constituting actual notice, unless attention is clearly drawn to such a change.<sup>76</sup>

10.53 From a pragmatic perspective the need for an apparent partner to give notice in the Gazette gives protection to a relatively limited number of prospective creditors. It is unlikely that prospective customers of a firm routinely check the Gazette to keep track of the comings and goings of a firm with which they had no previous contact. We recognise that notice in the Gazette is not in fact an efficient way of providing notice of a partner's retirement. However, notice in the Gazette makes sense legally. It is a simple way of publicly broadcasting the end of an agency relationship. A creditor might not know of the retirement, but has the means of finding out. It is doubtful if any alternative system of public notice, for example, publication in a more widely read journal, would offer any further tangible practical benefit. With the development of e-commerce another option might be to require notice of the retirement to be displayed on the partnership's website. We invite views but make no suggestion for change.

## **Liability of former partner of dissolved partnership**

### ***Existing law***

10.54 The liability of former partners of a dissolved partnership is governed by section 38 of the 1890 Act which we consider more fully elsewhere.<sup>77</sup> In the present context the relevant words are:

After the dissolution of a partnership the ...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...

10.55 The word "continue" means that if a partner was not liable for a particular obligation before the dissolution (for example, because of the effect of section 17(1) on the liabilities of an incoming partner) then that partner will not be liable after dissolution.

10.56 The effect of section 38 on the partners' liabilities has been considered in two Scottish cases, *Inland Revenue v Graham's Trustees*<sup>78</sup> and *Welsh v Knarston*<sup>79</sup> In *Graham's Trustees* there was a dispute over whether a lease survived the dissolution of the tenant partnership on the death of one of the partners. It was held that the lease came to an end.<sup>80</sup> Lord Reid in the House of Lords considered that the question of how the partnership could be wound up was dealt with by section 38. He stated that:

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<sup>75</sup> Partnership Act 1958, s 40(1).

<sup>76</sup> Cf *Lindley & Banks*, para 13-73 where it is submitted that compliance with the Business Names Act 1985 should often ensure that notice of a change in the firm is given to its customers. Miller, pp 307 - 309, suggests that a change in the name of a firm puts a customer on inquiry but the removal of a partner's name from a firm's letterhead of itself will not give rise to an inference of actual notice.

<sup>77</sup> See Part 8 above.

<sup>78</sup> 1971 SC (HL) 1.

<sup>79</sup> 1972 SLT 96; 1973 SLT 66.

<sup>80</sup> See paras 8.10 – 8.15 above for a fuller discussion of this case.

... the surviving partners have the right and duty to complete all unfinished operations necessary to fulfil contracts of the firm which were still in force when the firm was dissolved.<sup>81</sup>

Once a partnership has been dissolved, partners are liable to fulfil any obligations of the partnership which still exist following the dissolution.

10.57 *Welsh v Knarston* was concerned with the liability of partners for a delict committed after the (technical) dissolution of a partnership. A firm of solicitors failed to raise an action on behalf of their clients within the prescribed time limit. The firm was dissolved after it had been instructed to act but before the expiry of the period for raising the action. The effects of section 38 were considered in this case by Lord Stott in the Outer House, who approved the dictum of Lord Reid in *Graham's Trustee*.<sup>82</sup> In Lord Stott's opinion, the obligation to complete transactions in section 38 included obligations such as those to pursue the clients' claim.

### **Possible reforms**

10.58 The policy of section 38 is clearly correct in so far as it provides for the continuing liability of the partners of a dissolved partnership. It would be unacceptable if creditors could be deprived of their rights by the simple dissolution of the partnership with which they had contracted. We suggest no change in this basic rule. In any event, it will be possible for there to be an agreement between the old and new partners and the creditors that the new partners will be liable in place of the old partners. If the business is to be taken over by another person or group or entity and the intention is that former partners who are not to be involved in the continuing business are not to be liable for accrued obligations then it will be up to them to obtain an indemnity from those carrying on the business. That is a matter between the former partners and the person or persons taking over the business. It will not affect the rights of creditors.

10.59 It may be for consideration whether the rule on the continuing liability of former partners should be detached from section 38 and expressed separately, leaving section 38 to cover the authority of the former partners to wind up the business. The rule on the continuing liability of former partners for partnership debts and obligations after the partnership has been dissolved is an important rule which should not be submerged in a provision dealing with something else. That, however, is a question of arrangement and drafting which can be solved at a later stage.

10.60 It is necessary to consider whether any adaptation of the basic rule in section 38 is necessary to cater for partnerships with a separate legal personality. The basic rule must remain that the former partners continue to be liable for the former firm's obligations, to the same extent that they were liable before the dissolution. However, if it were to be decided that the liability of the partners was, while the partnership existed, a subsidiary one, then it

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<sup>81</sup> 1971 SC (HL) 1, 21.

<sup>82</sup> 1972 SLT 96, 97.

would be useful to make it clear that after the dissolution of the partnership as regards all the partners the liability of the former partners was no longer subsidiary but was primary. There would no longer be a partnership to have the primary obligation. This in turn has implications for the way in which litigation should be conducted in the case where a partnership has been dissolved.<sup>83</sup>

10.61 We invite views on the following provisional proposals:

**(1) It should remain the case that former partners continue to be liable for the obligations of a dissolved partnership.**

**(2) Where the dissolved partnership had a separate legal personality, and the liability of the partners was subsidiary to that of the partnership, it should be made clear that the liability of the former partners ceased to be subsidiary and became primary when the partnership was dissolved.**

### **Liability of partnership for another partnership's obligations**

10.62 A problem which has frequently arisen in practice is whether a partnership<sup>84</sup> is liable for the obligations of another partnership whose assets and business it has taken over.<sup>85</sup> There is no difficulty in principle. X is not in general liable for Y's debts unless X has agreed, in a legally effective way,<sup>86</sup> to assume liability. The fact that X has acquired assets from Y is legally immaterial. If X has bought the assets then Y's creditors are no worse off because they can have recourse against the sale proceeds rather than the assets. If X has been given the assets and Y is solvent then Y's creditors are not prejudiced. They still have their rights against Y. There is no legal policy against donations by solvent persons. If Y was insolvent at the time of the gift, or became insolvent as a result of the gift or soon after the gift, there are rules in the law on bankruptcy and insolvency to protect Y's creditors by having the gift set aside.<sup>87</sup> So, in principle, a partnership which takes over the assets and business of another partnership should not be liable for the first partnership's debts unless it has agreed, in a legally effective way, to assume liability.<sup>88</sup> If it has so agreed then the liability should become a liability of the second partnership for which all the partners of the second partnership will, in principle, be liable in the usual way. However, the liability of a partnership for another partnership's obligations has been dealt with differently in England and Scotland.

### ***Application in Scotland***

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<sup>83</sup> See paras 17.10 – 17.11; 17.15 – 17.17 below.

<sup>84</sup> That is, in English law, a group of partners and, in Scots law, the partnership itself as a separate legal person.

<sup>85</sup> This question often arises where a new partner joins an existing firm, thus creating a new partnership. The question of whether the incoming partner is liable for pre-existing debts of the firm is dealt with by section 17(1) of the 1890 Act (considered above at paras 10.38 - 10.40).

<sup>86</sup> In a question with the creditor this means either that the creditor should be a party to the agreement or that an effective third party right should have been created in favour of the creditor, something which has been possible in Scots law but not in English law. See now, however, the Contracts (Rights of Third Parties) Act 1999.

<sup>87</sup> See the Insolvency Act 1986, ss 339 and 341 for the rules on transactions at undervalue in England and Wales; and the Bankruptcy (Scotland) Act 1985, s 34 for the rules on gratuitous alienations in Scotland.

<sup>88</sup> See, eg, *Henderson v Stubbs Limited* (1894) 22 R 51.

10.63 Courts in Scotland have taken a variety of approaches in deciding whether a partnership which takes over the assets of a business also takes over the liabilities of that business. It has been held, for example, that where a partnership, without a written contract, took over the business of an old partnership including all trade debts of creditors other than the one which was the subject matter of the action, the new partnership was liable for all the obligations of the old firm.<sup>89</sup> In another case where there was a partnership contract (which was acted upon) stating that the new firm was not liable for the debts of the old firm, it was held that nothing short of a direct undertaking or unequivocal dealings with the individual creditor could infer an undertaking of liability for a debt of the old firm.<sup>90</sup>

10.64 It has also been held that where a sole trader created a new firm on the assumption of a partner who did not contribute any capital to the partnership, the new firm was liable for the debts of the old business.<sup>91</sup>

10.65 From the case law, it seems that the courts in Scotland have focused on the circumstances surrounding the creation of the new partnership and the transfer of the assets of the former business to it, in deciding on the liability of the new partnership for the old firm's debts. Where the business taken over is substantially the same as the old firm, and where that business is continued without interruption, there appears to be a general presumption that the new partnership takes over the whole liabilities as well as the assets.<sup>92</sup> This presumption may be displaced.<sup>93</sup> The principle behind this presumption is that creditors should not be prevented from recovering a debt because all the assets of the firm which was liable have been taken over by a new partnership which is substantially similar, in terms of business and constitution, to the old firm.<sup>94</sup> While judges speak of applying a presumption, the courts in reality are deciding whether the new firm has agreed to assume the liabilities of the old firm. Such an agreement may be inferred from circumstances of the particular case or from a course of dealing.<sup>95</sup>

10.66 The case law is unclear as to whether the "agreement" or "undertaking" need be only within the partnership itself, or whether it must be between the new partnership and the creditor seeking to enforce the debt.<sup>96</sup> The only conclusion that can be drawn from the

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<sup>89</sup> *Heddle's Executrix v Marwick & Hourston's Trustees* (1888) 15 R 698.

<sup>90</sup> *Stephen's Trustee v Macdougall & Co's Trustee* (1889) 16 R 779. See also the company case of *Henderson v Stubbs Ltd* (1894) 22 R 51.

<sup>91</sup> *Miller v MacLeod* 1973 SC 172. The contribution of capital to the new partnership by an incoming partner is often a factor which the courts take into account in deciding whether an incoming partner is liable for the pre-existing debts of a firm. Because of the separate personality of the Scottish firm, the liability of the incoming partner must arise through the 'new' firm assuming the obligations of the old firm.

<sup>92</sup> *Miller v Thorburn* (1861) 23 D 359, 362.

<sup>93</sup> See, for example, *Thomson & Balfour v Boag & Son* 1936 SC 2, where a sole trader formed a partnership with his foreman, the latter having contributed a substantial sum of capital to the partnership.

<sup>94</sup> *Thomson & Balfour v Boag & Son* 1936 SC 2, 10, per Lord President Normand.

<sup>95</sup> Gloag, for example, treats the taking over of the assets of a business as a "fact from which the court may draw the inference that the new firm has agreed to be liable to the creditors of the old." Gloag, *Contract* (2nd ed 1929) p 267.

<sup>96</sup> See the anonymous article, Partnership Liability Questions, 1925 SLR 65, 69 - 73. Miller, p 274 also makes the point, that the theory that liability in cases such as *Miller v Thorburn* arises from an implied agreement cannot be maintained in light of the decision in *Henderson v Stubbs Ltd* (1894) 22 R 51 (see n 90 above) because the agreements implied in the earlier cases still did not involve the creditor.

case law is that the courts will look to the facts and circumstances surrounding each case to establish whether the partnership is continued on substantially the same basis as the old firm and, thus, whether the presumption of liability will apply.

### ***Application in England and Wales***

10.67 In England and Wales, there is no presumption, as appears to exist in Scotland, that where the whole business of a partnership is taken over by a different partnership, liabilities are transferred as well as assets. It was so held in the case of *Creasey v Breachwood Motors Ltd*<sup>97</sup> in which the court reviewed a number of Scottish authorities on this point and rejected them as not forming part of English law. Thus, in English law an incoming partner would not be bound by the earlier liabilities of the co-partner unless he agreed to be. Such an agreement will only be binding between the parties to it.<sup>98</sup>

### ***Assessment of existing law***

10.68 Where the partnership taking over the assets is practically the same as the partnership from which they are taken over, where the business is continued without interruption, and where the result is that the first partnership, if it exists at all, is left without assets, some continuity in liability for obligations is clearly desirable to protect the interests of creditors of the original partnership. We have concluded, however, that this is not a problem requiring special provision. The proposals for continuing personality made earlier would solve the problem in many cases.

10.69 Besides, the problem is not confined to partnerships. The same problem can arise whether the business vehicle whose assets are taken over, and the business vehicle which takes over the assets, are sole traders, partnerships or companies. It would be anomalous to include in the Partnership Act a special rule for the case where a partnership takes over the business of another partnership.

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<sup>97</sup> [1992] BCC 638.

<sup>98</sup> *HF Pension Trustees Ltd v Ellison* (unreported) 8th February 1999, Jonathan Parker J. A right of action under the agreement may, if the parties so intend, be conferred on a third party by virtue of the Contracts (Right of Third Parties) Act 1999.

# **PART XI**

## **PARTNERSHIP PROPERTY**

### **Introduction**

11.1 Sections 20 and 21 of the 1890 Act deal with partnership property in England and Wales. Section 22 was repealed in England and Wales by section 25(2) and Schedule 4 of the Trusts of Land and Appointment of Trustees Act 1996.<sup>1</sup> This Act does not apply to Scotland so that section 22 is still in force in Scotland. The main questions for consideration in this Part are whether the policy underlying these sections is satisfactory, and whether any changes are necessary to cater for a partnership with separate personality.

### **The existing law**

#### ***The statutory provisions***

11.2 Section 20 of the 1890 Act provides that:

(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 is necessary, for the persons beneficially interested in the land under this section.

(3) Where co-owners of an estate or interest in 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 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.

Section 21 supplements these rules 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.

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<sup>1</sup> The Trusts of Land and Appointment of Trustees Act 1996 came into force on 1 January 1997 in terms of SI 1996/2974. Where partners died prior to 1 January 1997 s 22 is preserved by s 25(2) so that their shares in the interest in land are treated as personal or moveable property.

Finally, section 22 provides that:

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.

11.3 These provisions reflect the pre-1890 English law.<sup>2</sup> They are not well-adapted to the Scottish position where the partnership has a separate legal personality.<sup>3</sup>

### ***Application in England and Wales***

11.4 The above statutory provisions do not cause any legal problems in England and Wales. A conveyance of a legal estate in land to a firm vests it in no more than four partners.<sup>4</sup> One consequence of this is that to obtain a direct right against all partners in large firms, landlords may either cause them to be sureties for the trustee partners' obligations or to be made contractual parties to a lease, even though the legal estate only vests in the first four.<sup>5</sup> If a firm sets up a company to hold land, it avoids the problems of transfer on a change in membership of the firm and any landlord's consent to such changes. Such complications would be avoided by conferring legal personality on English partnerships. The above provisions would require amendment if such reform were to be enacted.

### ***Application in Scotland***

11.5 As a legal person, the Scottish partnership is capable of owning moveable property such as cars, furniture, office equipment and intellectual property rights.<sup>6</sup> It can also hold title to a lease of heritable property.<sup>7</sup> A partnership cannot, under the present law, hold title to feudal property.<sup>8</sup> As a result, any land held by the partnership is held in trust, usually by some or all of the partners, for the partnership.<sup>9</sup> In practice, leases are also usually held in trust for the firm, and it is possible to hold moveable property in this way, although this is not thought to be common.<sup>10</sup> Property can also be partnership property even though it is not held explicitly in the name of the partnership or through trustees.<sup>11</sup>

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<sup>2</sup> For a full account of their operation and effect see *Lindley & Banks*, Chapter 18; Miller, pp 389 – 406.

<sup>3</sup> See Gretton, "Who Owns Partnership Property?" 1987 JR 163.

<sup>4</sup> Trustee Act 1925, s 34(2); Law of Property Act 1925, s 34(2).

<sup>5</sup> See *Lindley & Banks*, para 18-60.

<sup>6</sup> Section 70 of the Abolition of Feudal Tenure etc (Scotland) Act 2000, when it is brought into force, will make it clear that under the new rules on land ownership there is nothing to stop a partnership with legal personality from owning land in Scotland.

<sup>7</sup> *Dennistoun, Macnair and Co v Macfarlane* February 16, 1808 FC, Mor App "Tack" No 15.

<sup>8</sup> Bell, *Comm.* II, 508. But see the Scottish Law Commission's report on the *Abolition of the Feudal System* (Scot Law Com No 168, 1999); and para 11.11 below.

<sup>9</sup> Gretton, "Problems in Partnership Conveyancing" 1991 JLSS 232.

<sup>10</sup> Gretton, "Who Owns Partnership Property?" *op cit*.

<sup>11</sup> See para 11.8 below.

11.6 The result of the so-called 'heritage prohibition'<sup>12</sup> is that title to land is commonly taken in the name of trustees, with the partnership as beneficiary. Discontinuity of personality gives rise to different problems when trustees hold property. As we have seen, a change in the membership of the partnership can create a new firm which carries on the same business.<sup>13</sup> In such cases, unless the trust is carefully drafted, the trust beneficiary may disappear.<sup>14</sup> The trustees, assuming that they have power to do so, would have to convey the property to trustees for the new partnership. It is not easy to draft round this problem. The trust could be for the benefit of the firm or its successors but identifying the successors can be problematic.

11.7 Another potential problem with holding property through trustees is that they may omit to resign as trustees when they resign as partners.<sup>15</sup> (The trustees need not, but in practice usually will, be some or all of the partners.) The firm 'A, B and C and Co' may no longer be composed of A, B and C, but of D, E and F. In practice, what should happen is that A, B and C resign as trustees when they leave the partnership, and D, E and F (or some of them) are assumed as trustees.<sup>16</sup> However, the situation might arise where the partners are now D, E and F, but the former partners A, B and C remain as trustees, and are therefore required to execute deeds in relation to the property. There may be problems in tracing A, B and C, or they may all have died, in which case the trust would have lapsed and it would be necessary to petition the court for the appointment of new trustees.<sup>17</sup>

11.8 Property can be partnership property even though it purportedly belongs to one or more of the partners. Sections 20(1) and 21 of the 1890 Act deal with this by providing that property brought into the partnership or bought on its account is partnership property, and that property bought with the firm's money is deemed to have been bought on its account, unless there is a contrary intention. This is not of much assistance, because the question then becomes was the property bought on the partnership's account, and whether there is a contrary intention among the partners. This is a question of fact. So, for example, property held in a partner's name but entered into the partnership's books would be taken to be partnership property.<sup>18</sup>

11.9 Because the partnership is a legal person and owns property itself, the partners have no interest in the partnership property as such. Their interest is in the partnership, of which

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<sup>12</sup> See Styles, "Why Can't Partnerships Own Heritage?" 1989 JLSS 414. The term 'heritage prohibition' is misleading, as the partnership can own non-feudal heritable property, for example, leases.

<sup>13</sup> See para 2.4 above.

<sup>14</sup> Gretton "Problems in Partnership Conveyancing" *op cit*, p 234.

<sup>15</sup> Outgoing partners should resign as trustees by deed of resignation under section 19 of the Trusts (Scotland) Act 1921. Following this, they will no longer be infert – section 20, 1921 Act. A deceased partner automatically ceases to be a trustee, but a sequestrated partner would have to resign, and an insane partner would require to be removed under section 23 of the 1921 Act. The problem that occurs when outgoing partners fail to resign as trustees is also encountered in England and Wales.

<sup>16</sup> Under s 21 of the 1921 Act.

<sup>17</sup> Under s 22 of the 1921 Act.

<sup>18</sup> *Keith v Penn* (1840) 2 D 633.

they own a share.<sup>19</sup> This share is incorporeal moveable property, regardless of the nature of the partnership property.<sup>20</sup>

## **Possible reforms**

### ***Partnerships without separate legal personality***

11.10 For partnerships without separate personality, the concept of partnership property is necessary because there is no legal entity to which property and rights can belong. Sections 20 to 22 are drafted in a rather old-fashioned way, but the policy behind them has not caused significant problems. We do not propose any alteration to the policy of these sections, but they could be re-drafted in more modern language, fitting in with proposals for partnerships with a separate legal personality.

### ***Partnerships with a separate legal personality***

11.11 A different approach is necessary for partnerships with a separate legal personality. Here the partnership as a legal person can own property directly.<sup>21</sup> Section 70 of the Abolition of Feudal Tenure etc (Scotland) Act 2000, when it is brought into force, will make it clear that under the new rules on land ownership there is nothing to stop a partnership with legal personality from owning land in Scotland. We think that if partnerships with legal personality were to be introduced in England and Wales it should be made clear that such partnerships could own property directly or, as at present, through trustees<sup>22</sup> or nominee companies.

11.12 We have already suggested that partnerships should be capable of having a separate personality which continues despite changes in their membership.<sup>23</sup> This would mean that, where the partnership owned property directly, it would not be necessary to transfer the property every time there was a change in membership. This would be especially beneficial for real or heritable property, which would not require to be re-conveyed. Where property was held in trust for the partnership, there would be no problem in identifying the beneficiary.<sup>24</sup>

11.13 In the case of partnerships with separate personality which came to an end following a change in membership, the property would be dealt with as required by the situation. It

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<sup>19</sup> The proposition that partners have no interest in the partnership property but in the partnership of which they own a share is the same for England and Wales.

<sup>20</sup> Bell, *Comm.* II, 536. See further Part 18 'Enforcing Judgments'.

<sup>21</sup> The question of what happens to property owned by the partnership on dissolution is dealt with in Part 8. The tax implications of our property law proposals can only be ascertained once Inland Revenue has formed a view after considering the recommendations which will follow after consultation. However, as far as we are aware, we are not making proposals which would alter the tax position: see para 3.12 above.

<sup>22</sup> In Scotland the trustees would own the property and the partnership would have only a personal right against them. See *Inland Revenue v Clark's Trustees* 1939 SC 11.

<sup>23</sup> See Part 4 above. It does not matter for present purposes whether a continuing personality is conferred by the Partnership Act directly or acquired only by registration in a special register of partnerships.

<sup>24</sup> There would, however, be less need for property to be held through trustees as there would be no need to stop it becoming ownerless on a break in the firm's personality.

might, for example, have to be transferred to a new partnership which had taken over the business. Property held in trust might, in such a situation, be transferred to trustees for a new firm.

11.14 Allowing partnerships to own real or heritable property directly raises questions of third party protection, in particular how a third party would know whether the partnership selling the land was the same partnership which had bought it. We have already considered this in Part 4.<sup>25</sup> This is a general conveyancing issue; a purchaser would always want to see proof that the seller held good title.<sup>26</sup>

11.15 For partnerships with separate personality, there is no need for a definition of partnership property. A partnership which is an entity can hold property or be the beneficiary of a trust.<sup>27</sup>

11.16 There may be problems in identifying property which is held in trust for the partnership, but these will generally be problems of fact rather than of law. Property which is contributed to the partnership by a partner without transfer of title to the property is held in trust for the partnership by the partner. Similarly, property which is purchased by a partner or by an agent of the partnership (for example, a manager) for the partnership during its continuance will also be held in trust for it. This is a normal rule of agency law.<sup>28</sup> In both of these cases, there may be problems in establishing whether in fact the property was bought for or contributed to the partnership. However, if it is established that that was the case, then the law is clear - the partner or agent will hold the property in trust for the partnership.

11.17 A constructive trust in favour of a partnership can arise when a partner obtains some unauthorised benefit through being a partner,<sup>29</sup> or when a third party who is not in good faith acquires partnership property from a partner who has no right to transfer that property.<sup>30</sup>

11.18 We propose dealing with one further factual situation, which is also dealt with by the 1890 Act.<sup>31</sup> Property should be deemed to be bought for the partnership when it is bought with partnership money, subject to proof of a contrary agreement. If it is bought for the partnership, then it is held in trust by whoever purchased it.

11.19 It should also be made clear that the partners of a partnership with separate personality do not own a share in the partnership property directly. The partners own a share in the partnership and that share will, of its nature, be personal or incorporeal

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<sup>25</sup> Paras 4.38 – 4.40 above.

<sup>26</sup> See paragraphs 11.21 - 11.23 below for our proposals relevant to land transactions.

<sup>27</sup> There is no definition of company property in company law.

<sup>28</sup> Bell, *Comm. I*, 287; *Heritable Reversionary Co v Millar* (1892) 19 R 43. In England and Wales see *Burdick v Garrick* (1870) 5 Ch App 233.

<sup>29</sup> For example, in *McNiven v Peffers* (1861) 7 M 181, a partner renewed the lease of the partnership premises in his own name, without his partners' knowledge. He was deemed to hold it in trust for them.

<sup>30</sup> See *Huisman v Soepboer* 1994 SLT 682 and *Soar v Ashwell* [1893] 2 QB 390.

<sup>31</sup> Section 21.

moveable property. RUPA illustrates the type of rules necessary for this situation. Section 501 provides that:

A partner is not a co-owner of partnership property and has no interest in partnership property which can be transferred, either voluntarily or involuntarily.

Section 502 provides that:

The only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions. The interest is personal property.

### **Invitation for views**

11.20 We invite views on the following provisional proposals:

- (1) For partnerships without a continuing legal personality, the policy of sections 20 and 21 in England and Wales and sections 20 to 22 in Scotland of the 1890 Act should continue to apply.**
- (2) For partnerships with a continuing legal personality:**
  - (a) sections 20 to 22 should not apply;**
  - (b) it should be made clear that such partnerships can own property of any kind in their own name, and that property can be held in trust for them;**
  - (c) 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;**
  - (d) 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;**
  - (e) 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.**

### ***Transactions in Land***

#### REGISTERED PARTNERSHIPS IN ENGLAND AND WALES

11.21 Under our proposals in Part 20 the partnership would have a unique registration number. On initial registration the Land Registry would have to be able to ascertain either from the partnership deed or the certificate of registration who could bind the partnership from time to time. It would therefore be open to the partners to state on the partnership register either the names of the partners entitled to carry out land transactions or,

alternatively, a minimum number of partners that have to sign dealings with land.<sup>32</sup> If there were no provision in the register or in the deed then the presumption of due execution in Part 19<sup>33</sup> would apply.<sup>34</sup> We propose in Part 20 that a registered partnership should not be able to rely against other persons on a change in the name, office or membership of the firm unless this change has been registered. If the registered partnership were to register the names of those entitled to transact in land then there could be a similar prohibition on reliance on change in the absence of registration of the new names.

#### UNREGISTERED PARTNERSHIPS

11.22 Under RUPA there is a voluntary register of authority to transact in land. Any two persons can file a form claiming that they are partners in a particular firm and are authorised to execute a transfer of real property held in the name of the partnership. A transfer of real property executed by those registered with authority is conclusive in favour of a person who gives value provided the person has no knowledge that those executing are not partners. If those who filed the authority are not actually partners then they may be prosecuted for perjury. It is this last sanction which is intended to protect against false filing. There are disadvantages to partners in that they might feel they had regularly to check to see if anyone had fraudulently filed an authority. It may also be necessary to introduce measures such as those contemplated in Part 20<sup>35</sup> to ensure such voluntary filings are updated. If there were no voluntary filing then the only way an unregistered partnership could hold or transfer land would be by the current means of holding property in the name of trustees or a nominee company.

#### ***Invitation for views***

11.23 We invite views on the following provisional proposals:

- (1) For registered partnerships with legal personality it would be open to the partners to state on the partnership register either the names of the partners entitled to carry out land transactions or, alternatively, the minimum number of partners that have to sign dealings with land.**
- (2) For unregistered partnerships with legal personality there should be a voluntary register of authority to transact in land.**

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<sup>32</sup> See para 20.15 below.

<sup>33</sup> See paras 19.9 - 19.11 below.

<sup>34</sup> The Land Registry would also require some check as to the identity of the partners as a fraud prevention measure.

<sup>35</sup> See paras 20.31 - 20.37 below.

# **PART XII**

## **PARTNERS' FINANCIAL AND MANAGEMENT RIGHTS**

### **Introduction**

12.1 In this Part we deal with the law that governs partners' financial and management rights. These matters are covered in section 24 of the 1890 Act.

### **Partnership capital**

12.2 Partnership capital is the total of the sums contributed (and risked) by partners for the purpose of commencing or carrying on the partnership business. This is different from the actual assets of the firm. These are variable. The capital of the partnership is, or should be, a fixed agreed sum.<sup>1</sup>

12.3 Capital ought to be expressed in cash terms. If a partner contributes an asset the partners may ascribe to it a notional value, though too low a value may have inheritance tax implications.<sup>2</sup> Once brought in as capital, the asset will belong to the firm.<sup>3</sup> Capital can easily be written off. There is no statutory rule expressly governing this.

12.4 There is no need for the partnership to have a minimum capital base. In the absence of contrary agreement, the capital of the firm cannot be increased or reduced without the consent of all the partners.<sup>4</sup> A consequence of this is that a partner cannot withdraw capital while a partner of the firm.

### **Partnership profits**

12.5 One method of determining profit for partnership purposes is the excess of receipts over expenses. For tax purposes accounts must be prepared according to the correct principles of commercial accounting.<sup>5</sup> For the tax year 2000/2001 onwards, profits for tax purposes must be based on accounting standards adjusted as required or permitted by tax law.<sup>6</sup> This basis has been referred to by Inland Revenue as using the accountancy concept of 'true and fair', but only in so far as it affects the computation of taxable profits or losses; this does not mean that partnership accounts are required to give a true and fair view in the sense applicable to companies.

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<sup>1</sup> *Lindley & Banks*, paras 17-01 - 17-03. See the House of Lords decision in *Reed v Young* [1986] 1 WLR 649, 654; and the Court of Appeal judgment in *Popat v Shonchhatra* [1997] 1 WLR 1367, 1373.

<sup>2</sup> A contribution of capital will be treated for inheritance tax purposes as a transfer of value if the partner intends to confer a gratuitous benefit on any person: Inheritance Tax Act 1984, s 10(1). There will be no transfer of value if there is no intention to confer a gratuitous benefit, and the transaction is at arm's length between unconnected persons: *ibid*.

<sup>3</sup> See *Robinson v Ashton* (1875) LR 20 Eq 25.

<sup>4</sup> See *Heslin v Hay* (1884) 15 LR Ir 431; and *Bouch v Sproule* (1887) 12 App Cas 385, 405, *per* Lord Bramwell.

<sup>5</sup> *Gallagher v Jones* [1994] Ch 107.

<sup>6</sup> Help Sheet IR233 for Self-employment and Partnership Pages BMSD 12/99net.

12.6 Partners are free to disregard accounts prepared for tax purposes when ascertaining profits for internal division. This is a private matter. There are no prescribed rules for a partnership's internal accounts.<sup>7</sup> Partners can therefore prepare their own accounts on a 'cash' basis, that is crediting money received to the year of receipt and not the year it was earned. Indeed there is authority that, in the absence of agreement to the contrary, a 'cash' basis should be followed.<sup>8</sup>

12.7 Equally, whether assets are revalued depends on the accounting basis adopted by the firm. It is quite normal practice to measure the value of an asset at its written down book value. An incoming partner will therefore be entitled to a 'hidden' capital profit, unless it is expressly agreed that capital profits up to the date of admission belong to the former partners.<sup>9</sup> If there is a revaluation, the increase or decrease in an asset's value will represent a capital profit or loss which may be divided between the partners in their capital profit or loss sharing ratios.<sup>10</sup>

12.8 Disputes can arise over the most appropriate accounting treatment for an item, particularly when a partner leaves<sup>11</sup> or joins the firm. It is for consideration whether matters might be less contentious and more in line with partners' expectations if firms were obliged, like companies,<sup>12</sup> to compile their internal accounts to give a 'true and fair' view.<sup>13</sup>

12.9 If a partnership's internal accounts were prepared according to known standards, incoming partners would have a more transparent basis on which to make a judgment before becoming a partner. A standardised set of accounting principles would also aid the presentation of the partnership's financial statements to third parties, principally banks or other lenders.

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<sup>7</sup> Cf companies and Sched 4 to the Companies Act 1985. There is an exception for qualifying corporate partnerships provided by the Partnerships and Unlimited Companies (Accounts) Regulations 1993, SI 1993/1820. This applies (broadly) if members of the firm are limited companies or unlimited companies/ Scottish firms, each of whose members is a limited company. Annual accounts, an annual report and an auditor's report must be prepared as if the firm were a registered company.

<sup>8</sup> *Badham v Williams* (1902) 86 LT 191.

<sup>9</sup> See *Lindley & Banks*, para 17-05, and the 1890 Act, ss 24(1) and 44. However, the Scottish decision in *Bennett v Wallace* 1998 SC 457, 462 has cast doubt on this. It was decided in this case 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 only be entitled to a share in the increase in value of an asset.

<sup>10</sup> See *Robinson v Ashton* (1875) LR 20 Eq 25.

<sup>11</sup> We address what happens when a partner leaves a continuing firm (for whatever reason) in Part 7.

<sup>12</sup> The Accounting Standards Board ("ASB"), the successor to the Accounting Standards Committee ("ASC"), is responsible for establishing accounting standards for companies: see Companies Act 1985, s 256 and the Companies (Defective Accounts) (Authorised Person) Order, SI 1991/ 13. The standards developed by the ASC are known as Financial Reporting Standards ("FRS") and those adopted by the ASB (when it succeeded the ASC) are known as Statements of Standard Accounting Practice ("SSAP").

<sup>13</sup> Companies should compile their statutory accounts in accordance with accounting standards; if they depart from them, this must be noted and explained in the accounts: Companies Act 1985, s 236 and Sched 4, para 36A. As a general rule, accounts compiled in accordance with accounting standards will give a true and fair view. However, it is technically possible (although unlikely) that, in particular circumstances, compliance with the standards may not provide a true and fair view: see Andrew McGee, "The 'True and Fair' View Debate: A Study in the Legal Regulation of Accounting" (1991) 54 MLR 874.

12.10 We are not, however, in favour of prescribing mandatory accounting standards for partnerships. Partnership accounts are a private matter between the partners. Unlike the accounts of limited companies, partnership accounts are not intended to be public documents. The preparation of accounts on a 'true and fair' basis is linked to a company's limited liability and to the requirement for an auditors' report.<sup>14</sup> Partners prepare their accounts for their own private purposes. No other party has a legitimate interest in them. If partners wish to determine their profits by, for example, revaluing capital assets or adopting a 'cash' basis, that should remain a matter for their own judgment. Partnerships should not be put to the time and expense of preparing accounts in accordance with specified accounting standards, when the rationale for their doing so does not apply.<sup>15</sup>

12.11 It should also be noted that the application of accounting standards does not necessarily lead to greater certainty. The Companies Act requirement is to prepare a company's accounts to give a true and fair view, rather than *the* true and fair view. In general there remains considerable scope for judgment in compiling accounts.<sup>16</sup> It is often the case that accounting for work in progress is problematical for a professional partnership.<sup>17</sup> But the relevant accounting standard<sup>18</sup> will not resolve whether profit on all the firm's contracts should be recognised, or how much. Legitimate disputes would still remain.

12.12 This does not mean that a revised 1890 Act should have nothing to say on accounting standards. The 'default' position could be amended so that, in the absence of agreement to the contrary, partnerships should apply accepted accounting standards when drawing up their internal accounts. This is likely to be what the partners would expect, and might reduce later disputes on the basis of accounting for a particular item. If all the partners agreed, the firm could adopt a different basis. This would mean that accounting differences would remain between partnerships. This lack of harmonised treatment would be a necessary consequence of the need to preserve partners' freedom of contract. We invite views on the following provisional proposals:

- (1) Partnerships should not have a mandatory obligation to comply with specified accounting standards when compiling their internal accounts.**
- (2) A partnership's internal accounts should be required to comply with accepted accounting standards, unless partners agree otherwise.**

## **Equality is equity**

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<sup>14</sup> Companies Act 1985, s 235.

<sup>15</sup> And even for certain small and medium-sized companies, there are now exemptions from compliance with accounting standards and from an audit: see Companies Act 1985, Part VII, Chapter II.

<sup>16</sup> See Andrew McGee, *op cit*, and David Hole, "Withdrawal of the cash basis - sections 42 to 46 and Schedules 6 and 7" [1998] 5 BTR 405 on the lack of certainty over what constitutes a true and fair view.

<sup>17</sup> For example, whether to account for partners' (compared with other fee earners') work in progress. Under SSAP 9 partners' work in progress is not included because it is not a cost to the partnership. See also David Hole, *op cit*, on the computation of a partnership's work in progress for tax purposes.

<sup>18</sup> SSAP 9.

12.13 Section 24 of the 1890 Act provides that:

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.

12.14 The justification for this rule is that it is *prima facie* reasonable that partners value their respective inputs to the partnership as equal, whether they are made by way of cash, skill or otherwise. Any other basis founders on assessing *at the outset* what alternative value should be attached to each partner's contribution.

12.15 Before the decision of the Court of Appeal in *Popat v Shonchhatra*<sup>19</sup> there was uncertainty over the meaning of section 24(1) in relation to partners' capital contributions.<sup>20</sup> In the absence of any agreement, there was doubt whether partners were entitled to the proportion of the capital they contributed to the firm, if there were unequal contributions.<sup>21</sup>

12.16 The effect of the interpretation approved by the Court of Appeal is that partners are entitled to share equally in the firm's capital even though one partner has contributed £1 and another £1 million. We imagine that these two partners would be most surprised to learn that this was the correct legal analysis. We also imagine that the partner contributing £1 million would argue that the inequality of their capital contributions was sufficient evidence of a contrary agreement displacing the presumption of equality. In *Popat* Nourse LJ commented that:<sup>22</sup>

I am in no doubt that the slightest indication of an implied agreement between the partners that their shares of capital should correspond with their contributions to it will suffice to displace the provision that they are entitled to share equally. That could, in most cases, be expected to be the common sense of the matter.

12.17 A possible alternative approach to this issue is to amend section 24(1) so that partners are entitled to the return of their capital contributions in the same proportions as they were contributed, subject to any agreement to the contrary. Therefore, in the example in the preceding paragraph the partners would be entitled to the return of £1 and £1 million respectively. If a partner contributed an asset as capital, then that partner would be entitled to the value of the asset when it was brought in. However, the difficulty with this suggestion is that it would cause potential injustice to a partner who made a non-monetary contribution that could not be valued. If a partner A contributed (say) £10,000 in capital

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<sup>19</sup> [1997] 1 WLR 1367.

<sup>20</sup> See *Lindley & Banks*, paras 17-08 - 17-09.

<sup>21</sup> Section 44(b)(3) of the 1890 Act provides that each partner should get "rateably what is due from the firm to him in respect of capital". In our view this provision is not evidence that partners *own* capital in the proportions in which they contributed it. Rather it begs the question of what legally is "due" to the partner.

<sup>22</sup> *Op cit*, at p 1373.

while partner B contributed only skill, the result on dissolution would be that B would not be entitled to any of this £10,000.<sup>23</sup>

12.18 We invite views on the following questions:

**(1) Do consultees consider that in the light of the Court of Appeal’s decision in *Popat v Shonchhatra* there is a need to amend section 24(1) of the 1890 Act?**

**(2) If so, would they 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?**

### **Capital profits and losses**

12.19 If the market value of a partnership asset (which is not held as part of the firm’s trading stock) exceeds or is less than its acquisition cost, there will be a capital profit or loss. Partners are entitled to share equally in this profit,<sup>24</sup> subject to contrary agreement.

12.20 If there is a loss, partners must contribute to this equally, again subject to contrary agreement. It does not matter whether this loss is of a revenue or capital nature. This rule of equality will still apply even if there is a presumption that capital is to be owned in the same proportions in which it was contributed. Losses of capital are treated just like any other loss. In this respect, amending s 24(1) in the light of *Popat*<sup>25</sup> would make the law conform to what Lord Lindley considered it to be:

When it is said that the shares of partners are prima facie equal, although their capitals are unequal, what is meant is that losses of capital like other losses must be shared equally; but it is not meant that, on a final settlement of accounts, capitals contributed unequally are to be treated as one aggregate fund which ought to be divided between the partners in equal shares.<sup>26</sup>

If consultees do not favour such a reform, then capital will be treated as an “aggregate fund” in which the partners are entitled to equal shares.

### **Variable profit-shares and losses**

12.21 If partners share profits unequally, and nothing is said in their partnership agreement about losses, the inference will be that these are to be borne in the same

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<sup>23</sup> This is an illustration of the underlying rationale that, in the absence of agreement, partners should be assumed to value their contributions to the firm equally whatever form they take.

<sup>24</sup> The Court of Appeal made clear in *Popat* that profits in s 24(1) of the 1890 Act “clearly includes capital as well as revenue profits”: [1997] 1 WLR 1367, 1373. The entitlement of an incoming partner joining an existing firm may be limited to the increase in value since admission: see *Bennett v Wallace* 1998 SC 457 and n 9 to para 12.7 above.

<sup>25</sup> See para 12.17 above.

<sup>26</sup> Quoted in *Lindley & Banks*, para 19-21.

proportions.<sup>27</sup> This is a natural corollary, and no express statement in the 1890 Act is necessary to deal with this.

12.22 Matters are less certain if profit shares vary according to the partnership profits or a partner has some kind of preferential entitlement. It is not clear that a court would hold that a partner's entitlement to the first £2,000 of any profits means that that partner must bear the first £2,000 of any loss. The alternative would be to hold partners liable to bear losses equally.

12.23 As a general rule it would not be possible to apply a system for sharing profits in the same manner as losses. To take a simple example, how can a partner's entitlement to interest on capital (before profits are divided) be applied to losses?

12.24 One possibility would be for losses to be borne in the same way as the ultimate residue of assets is shared among partners under section 44 of the 1890 Act.<sup>28</sup> Preferential profit shares of an income nature only (for example, 'salaries') would be ignored. The relevant proportion would instead be the partners' entitlement to residual or capital profits.<sup>29</sup> The application of this rule might produce a greater degree of certainty than is currently the case.

12.25 We invite views on the following question:

**Should section 24 provide that, subject to agreement to the contrary, losses are borne in the same proportion as the ultimate residue of assets would be shared under section 44 of the 1890 Act?**

### **Partner's right to be indemnified**

12.26 As an agent a partner has a 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.

12.27 The section specifically refers to partners, and so does not cover persons who incur liability as a result of being held out as partners under section 14 of the 1890 Act. There is, however, no need to amend section 24(2) to extend it to a non-partner acting properly. Any

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<sup>27</sup> See *Re Albion Life Assurance Society* (1880) 16 ChD 83.

<sup>28</sup> See paras 8.67 – 8.79 above.

<sup>29</sup> See *Lindley & Banks*, para 25-42.

person acting as a duly authorised agent of the partnership in conducting the firm's business will have a right of indemnity under the general law.<sup>30</sup>

### **Other financial rights**

12.28 In the absence of agreement there is no right to interest on capital contributed to the firm. There is though an entitlement to simple interest at 5% on any payment or advance beyond the agreed capital contribution.<sup>31</sup> Section 24(3) of the 1890 Act provides that:

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.

Like the other provisions of section 24 this rule is subject to any agreement, express or implied, between the partners. This is not a particularly contentious aspect of partnership law, and we do not propose any major amendments to it. However, we do propose that the rate of interest should be a 'commercial' rate. We discuss in Part 7 what a commercial rate might be in connection with interest on an outgoing partner's share. We suggest there that this should be related to the Bank of England's base rate.<sup>32</sup> We think that the same rate of interest should apply to both statutory provisions and invite views on the following provisional proposal:

**The rate of interest, specified in section 24(3) of the 1890 Act, on a payment or advance by a partner beyond the partner's agreed capital contribution should be a "commercial" rate, related to the Bank of England's base rate, and not a fixed rate of five per cent.**

12.29 Section 24(4) provides that:

A partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him.

Section 24(6) provides that:

No partner shall be entitled to remuneration for acting in the partnership business.

Both rules are subject to any agreement, express or implied, between the partners. We suggest no amendment.

### **Management rights**

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<sup>30</sup> See *Halsbury's Laws*, Vol 1(2) (4th ed 1990 Reissue) para 113 *et seq*, and *Bowstead & Reynolds on Agency*, *op cit*, para 7-059. Such a right to indemnity may be excluded by the express terms of the contract of agency. Again it may be 'lost' if the agent is in breach of a common law duty of care owed to the principal.

<sup>31</sup> 1890 Act, s 24(5). This rate has been criticised, for example, by John Thurston, "Partnership Act 1890 - Time for reform" [1988] JBL, March 155.

<sup>32</sup> See paras 7.22 - 7.26 above.

12.30 Section 24(5) provides that, subject to agreement to the contrary:

Every partner may take part in the management of the partnership business.

12.31 The essence of partnership law is embodied in this right. Partners have undertaken to engage in business together for their mutual advantage, and a natural aspect of this is the right to intervene personally in the conduct of the partnership business. Partners have unlimited liability for all partnership debts and obligations; they must be able to influence the extent of their possible liability by engaging in the management of the business.<sup>33</sup> In keeping with the contractual nature of partnership this right is subject to the contrary agreement of the partners. We suggest no amendment.

12.32 In any business there will be disputes over the manner in which it is conducted. To pledge to run a business in good faith and for mutual advantage does not remove the likelihood of differences of opinion. The position, again subject to contrary agreement, is set out in section 24(8) of the 1890 Act:

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.

12.33 This is an entirely sensible provision. Deadlock would quickly arise if unanimity were needed for all decisions, however trivial. Partners must act in good faith<sup>34</sup> when exercising their management and voting prerogatives.<sup>35</sup> The majority should probably afford a minority the opportunity to express their views and, if they overrule them, they must do so in good faith.<sup>36</sup> The duty of good faith is particularly relevant to powers to dissolve a partnership. For instance, the exercise of a contractual power by a partner can still be in good faith even if the partner is thereby advantaged.<sup>37</sup>

12.34 It is a question of fact what constitutes an ordinary matter connected with the partnership business.<sup>38</sup> There is little case law bearing directly on the meaning of section

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<sup>33</sup> Cf limited partners under the Limited Partnerships Act 1907 who have no right to take part in the management of the limited partnership. If they do, they lose their limited liability protection.

<sup>34</sup> See Part 14 below.

<sup>35</sup> The 1879 Partnership Bill, unlike the 1890 Act itself, made this express. Clause 41(5) provided that: "All differences which arise as to matters in the ordinary course of the partnership business shall be decided by a majority of the partners; provided that the decision must be arrived at in good faith for the interest of the firm as a whole, and not for the private interest of all or any of the majority, and that every partner must have an opportunity of being heard in the matter." See s 34(7) of the Western Australia Partnership Act 1895 for a similar provision.

<sup>36</sup> See the obiter remarks of the Lord Chancellor in *Const v Harris* (1824) T & R 496; 37 ER 1191.

<sup>37</sup> *Sobell v Hooberman* (unreported) 1 April 1993, Mummery J. *Russell v Russell* (1880) 14 Ch D 471, where it was held that if a power is given to a single partner to be the sole judge of whether to dissolve the partnership (rather than to acquire a benefit), he may exercise it capriciously. There is no obligation on such a partner to act as a tribunal or to state the grounds on which he decides.

<sup>38</sup> A partner who wants to refer to the usual management practice in a particular trade or profession must adduce evidence of this.

24(8).<sup>39</sup> A well-drawn partnership agreement can provide greater precision. A partnership agreement may, for example, provide for a higher majority, for example 75% of the partners, or unanimity on the following matters:<sup>40</sup>

- (1) admission of a new partner;
- (2) merger;
- (3) waiving of restrictions on a partner;
- (4) variation of the partnership agreement;
- (5) fixing of partnership capital;
- (6) change of accounting date and basis;
- (7) reviewing drawings;
- (8) agreeing annual accounts;
- (9) agreeing reserves;
- (10) varying interest on advances;
- (11) acquisition or disposal of a business or a company;
- (12) acquisition or disposal of land;
- (13) change in pension provision and personal insurance; and
- (14) change in partnership premises.

12.35 Most of the above decisions are already subject to unanimous agreement, either under an express provision of the 1890 Act or under the general law. New partners can only be admitted with the consent of all the existing partners.<sup>41</sup> The partnership agreement can only be altered with the consent of all the partners.<sup>42</sup> Partnership capital can only be increased or decreased with the agreement of the partners.<sup>43</sup> A fixed term partnership can only be dissolved by all the partners and not by a majority.<sup>44</sup> If a merger requires either the dissolution of the old firm or the admission of numerous partners *en bloc*, this is already a matter for unanimity under existing partnership law.<sup>45</sup>

12.36 Statutory default provisions could not cover every management eventuality for all types of firm. It is only possible to provide general rules and the 1890 Act expresses these in an appropriate way. Nonetheless, there could be benefits in providing statutory guidance for relatively common management decisions where it is unclear whether the consent of all partners is required. It is unclear, for example, whether a decision to change partnership premises is an ordinary matter connected with the partnership business.<sup>46</sup> For many firms this will not involve a change in the nature of the partnership business, but much will turn

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<sup>39</sup> An example is *Highley v Walker* (1910) 26 TLR 685 in which it was held that the decision to employ a partner's son as an apprentice was an ordinary matter.

<sup>40</sup> See T Sacker, *Practical Partnership Agreements* (1st ed 1995); R C I'Anson Banks, *Encyclopaedia of Professional Partnerships* (1985); *Tolley's Professional Partnership Handbook* (3rd ed 1996).

<sup>41</sup> 1890 Act, s 24(7).

<sup>42</sup> 1890 Act, s 19.

<sup>43</sup> See para 12.4 above.

<sup>44</sup> 1890 Act, s 19.

<sup>45</sup> 1890 Act, ss 19 and 24(7).

<sup>46</sup> This is specifically dealt with in the Western Australia Partnership Act 1895. Section 34(9) provides that the consent of all existing partners is needed for a change in the place where the firm's business is carried on. Also see *Clements v Norris* (1878) 8 Ch D 129, 133 - 134 in which Jessel MR comments obiter that it is a matter for the mutual agreement between partners where to conduct the firm's business.

on the circumstances of each case. For example, for a restaurant to move from a tourist area to a quiet residential area might involve a change in the nature of the business.

12.37 One particularly troublesome matter where it is unclear whether the consent of all the partners is necessary is a decision to restrict a partner's authority without placing a similar restriction on all partners. In the current edition of *Lindley & Banks*, the lack of judicial authority in this area and the conflicting opinions of Lord Lindley himself<sup>47</sup> has led to the following analysis:<sup>48</sup>

1. A revocation which purports to exclude one or more partners from their rightful participation in the management of the partnership business cannot be effective.
2. Subject thereto, a majority of the partners may properly decide to introduce an express or implied limitation on the authority of each and every partner, if that can be justified as an ordinary matter connected with the partnership business. This may take the form of a resolution that certain acts will, in the future, require the concurrence of two partners, e.g., cheque signing, or an alteration in the way in which the partnership business is carried on which incidentally alters the scope of each partner's implied authority.
3. An attempt to place limitations on the implied authority of a single partner or group of partners would be unlikely to qualify as an ordinary matter and would, therefore, appear to be improper.<sup>49</sup>

12.38 We believe that to restrict the authority of one partner without placing similar limitations on the other partners is more likely than not to be an extraordinary matter. Obviously a partnership agreement may provide assistance on such issues. In its absence, should there be default rules? We believe that flexibility is best provided by allowing partners to run their business as they think fit, subject to their duty to act in good faith. Nonetheless there is arguably a cost to this flexibility. It may make sense to provide that, subject to agreement to the contrary, the consent of all the partners (including the partner affected) is needed to restrict the authority of one partner without at the same time restricting the authority of all the other partners.

12.39 We invite views on the following questions:

- (1) Should section 24(8) of the 1890 Act be amended so that, subject to agreement to the contrary, the consent of all the partners is 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?**
- (2) Should unanimity be required for any other decisions?**

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<sup>47</sup> *Lindley & Banks*, para 13-33.

<sup>48</sup> *Ibid*, para 13-34.

<sup>49</sup> Footnotes omitted.

12.40 It is for consideration whether some of the decisions which currently require unanimity should be moved into the category of decisions capable of being made by a majority. Existing requirements for unanimity may be inconvenient for firms above a certain size. Businesses may be frustrated by a stubborn minority who act in what they consider to be the best interests of the firm. For example in an 18 partner firm, 17 partners may wish to bring in a new partner to the firm. One partner objects.

12.41 There are arguments against relaxing the unanimity requirement for such decisions. The partnership is a joint concern conducted by all partners for the mutual advantage of all. A minority partner should not be unfairly prejudiced. It has been observed that striking the right balance between the majority's interest and the rights of the minority is "an art rather than a science".<sup>50</sup> Requiring a majority for an ordinary decision and unanimity for extraordinary ones regardless of the size of the firm produces a result which is both simple and consistent with the partnership relationship. To prescribe a system of special majority voting would involve arbitrary judgments about both the size of firms to which it is applicable and the size of the majority in such firms.<sup>51</sup> Additionally, the larger the firm the more likely it is to have an agreement covering precisely this sort of problem. Often the most appropriate management mechanism in these circumstances is the devolution of certain defined decisions to a committee consisting of only some of the partners.<sup>52</sup> We believe that these are matters best left to the firms themselves.

12.42 We invite views on the following provisional proposal:

**There should be no new statutory rules as to special majorities for votes on "extraordinary" decisions.**

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<sup>50</sup> Tony Sacker, *Practical Partnership Agreements* (1st ed 1995) p 14.

<sup>51</sup> For example, providing that the consent of all but one partner is required in 7-16 partner firms; 90% in 17-49 partner firms; and 85% for those firms with 50 or more partners.

<sup>52</sup> See *Tolley's Professional Partnership Handbook* (3rd ed 1996) p 14. The same points apply to prescribing a different majority (say 75%) for certain issues (eg changing partnership premises), and unanimity for others (eg admitting a partner).

# **PART XIII**

## **EXPULSION, SUSPENSION AND COMPULSORY RETIREMENT**

### **Expulsion of a partner**

13.1 In the 1890 Act there is no ‘default’ power to expel any partner. Section 25 of the Act provides that:

No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.

Partners often do confer a power of expulsion in their partnership agreements.<sup>1</sup> There is no doubt that such a power can be useful. We do not suggest any restriction on the freedom of partners to agree to an expulsion clause if they so wish.

13.2 If they do not, and it will be remembered that over 50% of firms do not have a partnership agreement, the partnership business is vulnerable to the actions of one discordant partner. If the partner does not agree to being bought out, the only option for these partnerships is to apply to the court for dissolution under section 35 of the 1890 Act. The grounds for dissolution include permanent incapacity of a partner, conduct by a partner calculated to prejudicially affect the carrying on of the business, wilful or persistent breach by a partner of the partnership agreement, conduct by a partner in matters relating to the partnership business such that it is not reasonably practicable for the other partners to carry on the business in partnership with the misbehaving partner and any other circumstances rendering it just and equitable that the partnership be dissolved.<sup>2</sup> At present, however, the court’s only option is to dissolve the partnership as regards all the partners.

13.3 We have already invited views on whether the court should have power under section 35 not only to dissolve a partnership as regards all the partners but also to expel a partner<sup>3</sup>. The question for consideration in this Part is whether there should be a default provision enabling a majority of the partners to expel a partner without having to take court proceedings.

13.4 A power to expel would be a strong power to give to a majority by operation of law. It would be expropriatory in nature at least so far as future profits are concerned.<sup>4</sup> It is arguably contrary to the essence of partnership as a relationship between equals and joint owners of a business. Partners do not stand in an employer-employee relationship.

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<sup>1</sup> See *Lindley & Banks*, para 10-94 (“it will be found in most well drawn agreements, although its true value may only be appreciated by the partners when circumstances have arisen for its exercise”). In the Scottish Law Commission’s study of partnership deeds, 55% contained an expulsion clause: see Appendix E.

<sup>2</sup> Section 35(b), (c), (d) and (f).

<sup>3</sup> See paras 6.37 - 6.42 above.

<sup>4</sup> As Sir W Page Wood V-C noted in *Blisset v Daniel* (1853) 10 Hare 493, 518; 68 ER 1022, 1033: “The retiring partner voluntarily renounces all the accruing profits coming to him. The bankrupt or insolvent partner in like manner becomes, by operation of the law, disentitled to any remaining profits. But the expelled partner has all future profits forcibly taken from him.”

13.5 On the other hand it can be argued that unnecessary court applications are undesirable and that partnerships, even those without any partnership agreements, should be enabled to resolve difficulties themselves. ‘Innocent’ partners may be understandably reluctant to have a public hearing to settle such matters as expulsion. This is one of the reasons why arbitration clauses are so common in partnership agreements. A statutory power of expulsion, in the absence of an agreement to the contrary, would be a mechanism for reducing the number of disputes reaching the court.<sup>5</sup>

13.6 It would be possible to provide that a statutory power of expulsion could only be exercised on certain specified grounds<sup>6</sup> and to require it to be exercised in good faith and in the best interests of the firm. It would also be possible to build in certain procedural safeguards, including a right to be heard.<sup>7</sup> The expelled partner would, of course, have a right to be paid out. We have already invited views on methods of valuing and paying an outgoing partner’s share.<sup>8</sup>

13.7 Our provisional view is, however, that even if appropriate safeguards and qualifications were built into the Act it would not be wise to give a majority, or even a special majority, of partners a statutory power to expel a partner. This is such a strong power<sup>9</sup> that, in our provisional view, it should be conferred by express provision in the partnership agreement or not at all.

13.8 This provisional view would, however, have to be reconsidered if the courts were not to be given a statutory right to expel on certain grounds. It is arguable that some power of expulsion, judicial or otherwise, is essential if problems caused by one unsatisfactory partner are not to be allowed to destroy the partnership as a going concern.

13.9 We invite views on the following provisional proposal and question:

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<sup>5</sup> The expelled partner might, however, contest the expulsion through the courts.

<sup>6</sup> Partnership agreements commonly provide a variety of grounds, many similar to those mentioned in section 35 of the 1890 Act (dissolution by a court). Grounds might include, for example, serious breach of duties, incapacity, conviction of certain types of offence, becoming bankrupt, assigning or charging a share in the partnership, conduct calculated to injure the reputation of the firm or likely to have an adverse effect on the business, or conduct contrary to the rules of a relevant professional association. Sometimes partnership agreements also include a general power to expel, if a partner is guilty of any conduct that would be a ground for dissolution by the court under section 35 of the 1890 Act.

<sup>7</sup> There is doubt in English law whether, beyond the duty to exercise the power in good faith, the rules of natural justice apply to expulsion clauses in partnership agreements. *Barnes v Young* [1898] 1 Ch 414; *Green v Howell* [1910] 1 Ch 495; *Kerr v Morris* [1987] Ch 90, 111. See Bernard Davies, “The Good Faith Principle and the Expulsion Clause in Partnership Law” (1969) 33 Conv (NS) 32. On the Australian law, see Keith Fletcher, “Partnership - multiple expulsions” (1998) 72 ALJ 506. In Scotland the rules of natural justice apply to the exercise of a contractual power of expulsion in a partnership or any other voluntary association. The most recent case is *Fairman v Scully and Others* 1997 GWD 29-1492 where Lord Hamilton, though not required to reach a decision on the matter, agreed with the concession of the parties that the rules of natural justice applied.

<sup>8</sup> See paras 7.30 – 7.81 above.

<sup>9</sup> Particularly if the partnership agreement contains enforceable restrictive covenants on outgoing partners.

**(1) If, as suggested earlier, courts were to have a power to expel a partner under section 35, there should be no other power of expulsion unless the partnership agreement expressly provides for it.**

**(2) If, contrary to our earlier suggestion, courts were to have no power to expel under section 35, should a majority of partners have a statutory power to expel and, if so, what grounds should be specified and what safeguards, if any, should be included?**

### **Suspension of a partner**

13.10 To the extent that investigations need to take place, there may be a delay in finally determining a partner's expulsion. In these circumstances it may be beneficial if a partner could be suspended. Such a power may be particularly apposite if a partner has been charged with criminal conduct. It could protect the firm from potential embarrassment. It may also reduce the chances of a partner, the subject of an expulsion resolution, seeking to gain readmission to the partnership by injunction or interdict.

13.11 A usual suspension clause<sup>10</sup> will preserve the suspended partner's financial rights. The suspended partner would not, however, be entitled to enter the partnership premises or take part in management matters. Given the purposes of such a power there is no need to specify reasons for its use. The requirement to act in good faith is probably a sufficient safeguard against misuse. The period of suspension is normally limited (for example to a period of four weeks). At the end of this, the partner is either expelled or readmitted. If readmitted, the partner could be given the opportunity to withdraw from the partnership relationship within a certain time.

13.12 There are difficulties with this kind of clause. The suspended partner will remain a partner, and so will continue to be exposed to unlimited liability for decisions taken. This is only partially offset by the corresponding right to share in the profits. Suspension will not in itself affect a partner's ostensible authority, and so potentially this could be exploited to destabilise the firm's business. The other partners could, of course, notify third parties of the temporary withdrawal of the suspended partner's authority.

13.13 Our provisional view is that the disadvantage of involuntary exposure to unlimited liability during a period of suspension is sufficiently pronounced to undermine the inclusion of such a power in the 'default' regime. We therefore provisionally propose that:

**There should be no power of suspension unless the partners expressly agree to one.**

### **Compulsory retirement**

13.14 Many partnership agreements have provisions for compulsory retirement, which are effectively 'no fault' expulsion clauses. Such a power is draconian, and while no doubt extremely useful in large firms, it is in tension with the essence of a partnership founded on

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<sup>10</sup> See, eg, R C F Anson Banks, *Encyclopaedia of Professional Partnerships* (1985) Precedent 1, Cl 21 (1).

mutual trust and confidence. Whether to have a compulsory retirement power should be a matter for the individual partnerships.

13.15 We invite views on the following provisional proposal:

**A compulsory retirement power should not be included as a “default” rule.**

# PART XIV

## PARTNERS' DUTIES

### Introduction

14.1 We discuss in this Part the fiduciary duties partners owe one another. These depend partly on sections 28 - 30 of the 1890 Act and partly on the common law. We consider whether there should be any amendments or additions to the statutory duties. We also discuss a possible statutory statement of the standard of care and skill required of a partner. In the next Part we discuss whether, where a partnership has a separate legal personality, the duties should be owed to the partnership, to the partners or to both.

14.2 The policy behind the imposition of fiduciary duties is 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>

This policy lies behind the notion of fiduciary duties in both English and Scots law although the background is different in the two countries.<sup>2</sup> Partners repose a mutual trust and confidence in each other that they will all engage in a particular business for their joint benefit. Partners stand therefore in a fiduciary relationship with each other. This was clearly recognised before the 1890 Act:<sup>3</sup>

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.

### The statutory duties: sections 28 to 30

14.3 Section 28 of the 1890 Act provides:

Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.

This section appears sound in theory and practice, and we propose no amendment to it.<sup>4</sup>

14.4 Section 29 of the 1890 Act provides:<sup>5</sup>

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<sup>1</sup> Finn, *Fiduciary Obligations* (1977), 3 - 4.

<sup>2</sup> There has been no distinction between common law and equity in Scotland.

<sup>3</sup> *Helmore v Smith* (1886) 35 Ch D 436, 444, *per* Bacon V-C.

<sup>4</sup> The section was considered and applied in *Ferguson v Mackay* 1985 SLT 94. The nature of the information that must be disclosed was discussed in depth by the Supreme Court of Victoria in *Hanlon v Brookes & Ors* (1996) ATPR 41-523. See also the cases referred to in that judgment.

<sup>5</sup> This reflects the pre-1890 English common law. Lord Lindley commented that: "Good faith requires that a partner shall not obtain a private advantage at the expense of the firm. He is bound in all transactions affecting

(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.<sup>6</sup>

(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.

Subsection (1) expresses a basic fiduciary duty and we suggest no amendment to it.<sup>7</sup> Section 29(2) expressly preserves the accountability of partners for private profits after the dissolution of a partnership but before its affairs have been completely wound up but only in one particular circumstance, namely dissolution by the death of a partner. The restriction is odd. There is no reason why the same rule should not apply whatever the reason for the dissolution. In fact the courts have held that this fiduciary duty subsists during the winding up of the partnership's affairs after a dissolution on other grounds.<sup>8</sup>

14.5 It has been suggested that this duty creates problems when a partnership breaks up and the former partners set up new businesses drawn from the client-base of the dissolved partnership. If the partners on dissolution are unable to agree the division of the business connection, they may have to compete with each other to win the business of the former clients. They may thus expose themselves to a claim for an accounting under section 29. To avoid such a claim the former partners might have to refrain from approaching the clients of the dissolved partnership and so allow competitors to win their business. We are not aware of the frequency or extent of this problem. If it is a significant problem a possible reform would be to give the court a discretion to grant relief where the partner has acted honestly and reasonably.<sup>9</sup> Our proposals to restrict the circumstances in which a partnership is dissolved should reduce the occurrence of this problem. We therefore do not propose any reform.

14.6 We invite views on the following questions:

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the partnership, to do his best for the common body, and to share with his co-partners any benefit which he may have been able to obtain from other people, and in which the firm is in honour and conscience entitled to participate." See *Lindley & Banks*, para 16-08.

<sup>6</sup> In English law the trust rule in *Keech v Sandford* (1726) Sel Cas T King 61; 25 ER 223 applies to partnerships so that a lease obtained personally by one partner as a result of being a partner will be held on a constructive trust for the firm (*Featherstonaugh v Fenwick* (1810) 17 Ves Jun 298). The Court of Appeal in *Don King Productions Inc v Warren and others* [1999] 3 WLR 276 held that the rule in *Keech v Sandford* now extended to the acquisition by a fiduciary of any property derived from property held as such a fiduciary (applying *Thomson's Trustee v Heaton* [1974] 1 WLR 605, 613 per Sir John Pennycuik V-C and *Chan v Zacharia* (1984) 154 CLR 178, 198 per Deane J).

<sup>7</sup> In *Aas v Benham* [1891] 2 Ch 244 it was held that the use of information obtained whilst a partner did not prevent a partner using it for the purposes of a business outside the scope of the partnership's. See also *Boardman v Phipps* [1967] 2 AC 46, 102 – 103 and generally Finn, *Fiduciary Obligations* (1st ed 1977) paras 539 *et seq*; and *Lindley & Banks*, para 16-28.

<sup>8</sup> *R W Pathirana v A Pathirana* [1967] 1 AC 233, 240; *Thomson's Trustees v Heaton* [1974] 1 WLR 605, 613; *Chan v Zacharia* (1984) 154 CLR 178, 197.

<sup>9</sup> See by way of analogy section 727 of the Companies Act 1985 and section 32 of the Trusts (Scotland) Act 1921.

**(1) Should the court be empowered to relieve partners from liability for breach of duty where they have acted honestly and reasonably?**

**(2) If so, should the power be available in all circumstances or only on dissolution of a partnership?**

14.7 Section 30 of the 1890 Act provides:

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.<sup>10</sup>

14.8 This is another classic fiduciary duty. Many partnership agreements go further and contain an express provision not to engage in any business, whether in competition with the partnership or not. The scope of a partner's duty under section 30 is, however, defined in relation to the partnership. A partner who can conduct a business wholly unrelated to the partnership business in the partner's 'spare' time is free to do so. We do not propose any change to this or any other change to section 30 but we would welcome views on the operation of this section.

### **The general duty to act in good faith**

#### ***No statutory statement***

14.9 The pre-1890 law, both English<sup>11</sup> and Scots,<sup>12</sup> recognised that partners owed each other a duty of "utmost"<sup>13</sup> or "exuberant"<sup>14</sup> good faith. Section 46 of the 1890 Act provides that the rules of equity and of common law applicable to partnership continue in force so far as they are consistent with the express provisions of the Act. No duty of utmost good faith is, however, expressly set out in the 1890 Act.<sup>15</sup>

#### ***Content of the duty***

14.10 In relation to powers of expulsion Lord Lindley noted that:

the Court will never allow a partner to be expelled if he can show that his co-partners, though justified by the wording of the clause, have, in fact, taken advantage

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<sup>10</sup> The Ontario Court of Appeal held in *Olson v Gullo* (1994) 113 DLR (4th) 42 that such a profit should be accounted to the firm as a partnership profit. The 'guilty' partner will, therefore, have an indirect interest in this. A partner who keeps some of the profit has benefited from the 'wrong', albeit to a much reduced extent.

<sup>11</sup> See *Const v Harris* (1824) T & R 496; 37 ER 1191.

<sup>12</sup> See Clark, I, 182; Bell, *Comm.* II, 508.

<sup>13</sup> The usual term in English law. See, for example, *Barnes v Youngs* [1898] 1 Ch 414, 418.

<sup>14</sup> A Scottish version, presumably reflecting the Latin *uberrima fides*. See, for example, Clark, I, 182.

<sup>15</sup> Earlier Partnership Bills did contain an express clause. Clause 46 of the 1879 Bill provided that: "Partners are bound to carry on the business of the partnership for the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives." As we have seen, the latter part of that clause was enacted as s 28 of the 1890 Act. It has also been enacted as s 9 of the Indian Partnership Act 1932.

of it for base and unworthy purposes of their own, contrary to that truth and honour which every partner has a right to demand on the part of his co-partners.<sup>16</sup>

The reference to taking advantage of a provision for base and unworthy purposes of their own gives some idea of the content of the duty of good faith. Not much more can be derived from the cases. References to good faith are more frequent than elucidations of it. Judges have suggested that a partner would be acting contrary to good faith if “attempting to turn the provisions of the articles of partnership unfairly to the disadvantage of his co-partner”<sup>17</sup> or if the motive for using an expulsion clause was “really to get an undue advantage over the other partner by purchasing him out on unfavourable terms”<sup>18</sup> or if there was “some improper motive”.<sup>19</sup> On the other hand it is clear that the duty of good faith does not require partners to act selflessly. The exercise of a power to dissolve a partnership by reason of the other partner’s incapacity to bear a fair share of the workload was held not to be in bad faith merely because one of the motives for it was a selfish desire to avoid being grossly overworked.<sup>20</sup> Partners who exercised an option to dissolve the partnership rather than buy out a retiring partner were held not to be in bad faith merely because that option was more financially advantageous to them.<sup>21</sup> It is also clear that the presence of other motives does not necessarily mean that an act taken properly for a legitimate motive is in bad faith. In the unreported case of *Kelly v Denmark*<sup>22</sup> the expelled partner had engaged in a tax fraud. This entitled the other partners to expel him. The fact that they had wanted to be rid of the expelled partner for some time was held not to be relevant, because the power of expulsion had been exercised properly in circumstances which fully justified it.

14.11 We have not seen any adequate explanation, or indeed any explanation at all, of the difference, if any, in this context between the practical effects of a duty of good faith and a duty of utmost or exuberant good faith. Most of the cases refer simply to good faith or bad faith.

### ***Applications of the duty***

14.12 The duty of good faith has been most discussed in relation to powers of expulsion or dissolution.<sup>23</sup> The two powers overlap in practice, particularly in the case of two-partner firms and it is unlikely that there is any difference in the application of the requirement of

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<sup>16</sup> Quoted in *Lindley & Banks*, para 10-99.

<sup>17</sup> *Green v Howell* [1910] 1 Ch 495, 501.

<sup>18</sup> *Ibid*, at p 504. See also the Scottish case of *Neilson v Mossend Iron Company* (1886) 11 App Cas 298, 309 where Lord Watson said obiter that the power to determine a partnership at will had to be exercised “in bona fide and not for the purpose of deriving an undue advantage”. This statement of principle was approved by Stirling J in *Daw v Herring* [1892] 1 Ch 284, 291. But see *Walters v Bingham* [1988] 1 FTLR 260 where Browne-Wilkinson V-C, without expressing any view whether the duty of good faith applied to a notice of dissolution, observed that the law of Scotland may differ from that of England in this respect.

<sup>19</sup> *Peyton v Mindham* [1972] 1 WLR 8, 14.

<sup>20</sup> *Ibid*.

<sup>21</sup> *Sobell v Hooberman* (unreported) 1 April 1993, Mummery J.

<sup>22</sup> 15 May 1996. This decision was criticised by John Northam, “Expulsion of a partner” (1996) 11 Commercial Lawyer 74.

<sup>23</sup> *Blisset v Daniel* (1853) 10 Hare 493; 68 ER 1022; *Barnes v Youngs* [1898] 1 Ch 414; *Green v Howell* [1910] 1 Ch 495; *Peyton v Mindham* [1972] 1 WLR 8; and *Kerr v Morris* [1987] Ch 90.

good faith to them.<sup>24</sup> There seems to be no reason, however, why the duty of good faith should not be applicable in relation to any exercise of a power conferred on one or some partners by the general law or by the partnership agreement. It is easy to imagine situations where management powers given to a small group of partners could be abused, in utmost bad faith, in order to disadvantage or even humiliate a particular partner.

### **Possible reforms**

14.13 The first question is whether the law on partnership should continue to have a duty of good faith. It might be argued that the duty is inherently vague and creates uncertainty and that in commercial relations courts should not be invited to probe the motives for actions which are legally justified. The 1890 Act already contains, in sections 28 to 30, provisions giving effect to an underlying requirement of good faith in those situations where it is most important and where the sanction for a breach of the duty is most practicable. To go beyond that, it might be said, is unnecessary. We have some sympathy with that argument. Nonetheless the duty of good faith in partnership relations has been regarded as part of partnership law for over a hundred years. It does not appear to have given rise to a great deal of difficulty in practice. We are not aware of any strong demand for its removal. In these circumstances our provisional view is that the duty should remain. We would, however, be interested in views on this question.

14.14 The next question is whether the duty should be expressed in the Act in relation to certain specific powers, for example the power to expel a partner.<sup>25</sup> This has been done elsewhere.<sup>26</sup> Our provisional view is against this course. It may be appropriate to have a statutory statement of the duty to confirm its existence in the context of a partnership with separate legal personality.<sup>27</sup> There is no good reason in our view for singling out certain powers when a whole range of powers, all with potentially serious consequences for a partner, could be used in bad faith. However, we invite views.

14.15 The next question is whether a general duty to act in good faith with regard to the other partners in any matters pertaining to the partnership should be expressed in the Act, without prejudice to the particular provisions in sections 28 to 30. We can see no advantage in referring to “utmost good faith” or “exuberant good faith”. There are arguments both ways. On the one hand it can be said that if the duty exists it can do no harm, and would make the law more readily apparent, to set it out in the Act. Partners and their advisers should be made aware in the Act itself of the existence of the duty of good faith.<sup>28</sup> They should not be left to search in the cases for authoritative guidance, perhaps in vain. They should not be exposed to the risk of litigation to determine whether, for example, the duty extends beyond the exercise of powers of expulsion. On the other hand it is arguable that no

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<sup>24</sup> See *Lindley & Banks*, para 24-13.

<sup>25</sup> On the assumption that such a power is conferred by the partnership agreement.

<sup>26</sup> See, for example, s 35(2) of the Western Australia Partnership Act 1895 which provides that: “where such power [of expulsion] is conferred, it *may be exercised only in good faith with a view to the benefit of the firm*, and the partner whom it is sought to expel must have an opportunity of being heard.” The 1879 Bill had an identical provision to this: see cl 42. See also s 33 of the Indian Partnership Act 1932.

<sup>27</sup> See Part 15 below.

<sup>28</sup> See John Thurston, “Partnership Act 1890 - Time for Reform?” [1988] JBL 155; and *Underhill's Principles of the Law of Partnership* (10th ed 1975) p 78.

advantage is to be gained by having in statutory form a broad statement of principle, which is admittedly rather vague, and which would be no easier for the courts to apply than the common law principle. Indeed it might be suggested that to express the principle in a statute would be to invite arguments over the proper interpretation of the words used and that this would be less desirable than allowing the principle to be developed on the basis of case law.<sup>29</sup>

14.16 The decision for or against replacing common law principles by statutory provisions is context specific. In the present context, where there already is a Partnership Act, the question is whether it would be more or less useful to include in it an important principle which is in the law but which is not reflected in the Act. If the principle were expressed widely (referring, say, to a duty to act in good faith in relation to the other partners in all partnership matters) there would be no reason to fear an ossification of the law. The important question, it seems to us, is whether or not there should be a duty of good faith in partnership relations. If it is decided that there should be, it seems that the balance of advantage is in favour of including it in the Act. This would accord with the Commissions' aim of making the law more accessible, whereas no obvious advantage would be gained from leaving it out. Our provisional view is in favour of such statutory statement.

### ***Invitation for views***

14.17 We invite views on the following questions:

- (1) Do consultees agree that there should continue to be a duty of good faith in partnership relations?**
- (2) If so, do consultees also agree that it should be set out in the Act, without prejudice to the particular provisions in sections 28 to 30?**
- (3) As an alternative to a general statement, should it be expressly provided that an obligation to act in good faith applies:
  - (a) when a partner is expelled; and**
  - (b) when a firm is dissolved?****
- (4) Are there any other specific circumstances in which partners should be expressly required to act in good faith?**

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<sup>29</sup> Similar arguments have been advanced by the Law Commission for not codifying the general law on fiduciary duties: see *Fiduciary Duties and Regulatory Rules* (1995) Law Com No 236, para 12.2. The Law Commissions discussed the merits of a full or partial codification of directors' duties and recommended a statutory statement in broad and general language of a director's main fiduciary duties and the duty of care and skill: *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (1999) Law Com No 261; *Scot Law Com No 173*, Part 4. Of course in partnership law there is already a codification of the main fiduciary duties between partners.

## **Duty not to act with culpable negligence?**

14.18 There is no express statement in the 1890 Act on the duty of care owed by a partner to the firm. The standard of care expected of a partner is unclear in both jurisdictions.<sup>30</sup>

### ***English law***

14.19 It appears from English case law that a partner's duty to the firm is to act without 'culpable' negligence.<sup>31</sup> However, there are also references to a partner's "want of reasonable care",<sup>32</sup> and to a partner simply being "guilty of negligence".<sup>33</sup>

14.20 It is not clear how much, if any, regard may be paid to the partner's own skills and attributes in English law. In *Winsor v Schroeder*<sup>34</sup> Woolf J referred to a partner's duty "to act honestly and in the interest of [the firm] without culpable negligence". However, he further held that the partner, a businessman, "was required not to act below the standards of a reasonable businessman in the situation in which he found himself".

14.21 In the New Zealand case of *Gallagher v Shulz*<sup>35</sup> the plaintiff, a passive partner, had entered into a partnership to develop her property with a property valuer, the defendant, who took charge of all the relevant work. Williamson J held that because the defendant partner had special qualifications, skills and experience, compared to the plaintiff, the standard to be applied to his conduct should be higher than the care he might show in his own affairs; instead he should show the skill and care which would be expected from a prudent valuer and experienced property developer:

A person who enters into partnership with an experienced and competent person is entitled to expect that person to keep good faith by showing a reasonable degree of competence which he is known to possess in conducting the partnership business affairs.<sup>36</sup>

### ***Scots law***

14.22 There is only limited authority in Scots law on the liability of partners to each other. Institutional writers and some cases support the notion that a partner is expected to show in relation to the firm "that diligence which he would shew in his own affairs".<sup>37</sup> More recently

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<sup>30</sup> See *Lindley & Banks*, para 20-10. It is clear that a partner who wilfully commits a fraudulent or an illegal act should shoulder the sole responsibility for the consequences: *Robertson v Southgate* (1848) 6 Hare 536; 67 ER 1276; *Campbell v Campbell* (1839) 7 Cl & Fin 166; 7 ER 1030.

<sup>31</sup> *Bury v Allen* (1845) 1 Coll 589, 604; 63 ER 556, 562; and *Thomas v Atherton* (1878) 10 Ch D 185, 199.

<sup>32</sup> *Thomas v Atherton* (1878) 10 Ch D 185, 202.

<sup>33</sup> *McIlreath v Margetson* (1785) 4 Dougl 278, 279; 99 ER 880.

<sup>34</sup> (1979) 129 NLJ 1266.

<sup>35</sup> (1988) 2 NZBLC 103.

<sup>36</sup> It may be possible for the partnership contract to be rescinded if there has been a misrepresentation of skill: 1890 Act, s 41.

<sup>37</sup> See *Mair v Wood* 1948 SC 83, 90; *Blackwood v Robertson* 1984 SLT (Sh Ct) 68. See also *Stair Memorial Encyclopaedia* I.16.7, Erskine III.iii.21 and Justinian Institutes III.xxv.9.

in *Ross Harper & Murphy v Banks*<sup>38</sup> Lord Hamilton has rejected that standard and has suggested that there should be an objective standard of care between partners. He stated that the standard should be that:

which requires the exercise of reasonable care in all the relevant circumstances. Those circumstances will include recognition that the relationship is one of partnership (which may import some mutual tolerance of error), the nature of the particular business conducted by that partnership (including any risks or hazards attendant on it) and any practices adopted by that partnership in the conduct of that business.

14.23 In this formulation, Lord Hamilton appears to favour an objective standard, but he qualifies that test by reference to the way in which the particular partnership carries on its business. As a result, an act by a partner could be viewed as reasonable in one set of circumstances but not in another. For example, where a partner in a firm of solicitors fails to spot an onerous condition in a title deed<sup>39</sup> this would, on the face of it, be a failure to take reasonable care. However, if the partner had been trained by the firm and had not been adequately trained as to how to examine title, the failure to spot an onerous condition may not amount to a failure to take reasonable care.

14.24 On this approach the duty owed by a partner to other partners may be different from that owed to a third party. Thus, where an act by a partner causes loss to a third party, it may be held that that partner did not exercise reasonable care with regard to the third party but, because of the nature of the partnership, the partner may be able to satisfy the duty of care owed to the other partners. In Lord Hamilton's approach, as in the earlier cases which adopted a subjective test, the court appears to be taking account of the peculiarities of the partnership relation.

### ***Options for reform***

14.25 We propose that there should be a statutory statement of a partner's duty of care. The concepts of 'culpable' (or 'gross' or 'serious') negligence are difficult and unclear. These concepts conflate the standard of care and its breach so that they become meaningless.<sup>40</sup> A statutory statement would result in more certainty, and should be more accessible. It would also bring to partners' (and their advisers') attention the full extent of their duties to each other. The principal difficulty is determining the standard against which the duty of care should be measured. There are two main options.

14.26 The first option is to adopt the rule that partners must be as diligent in partnership affairs as they would be their own affairs. This appears to have been the rule favoured by the Scottish courts prior to *Ross Harper & Murphy v Banks*.<sup>41</sup> The rationale for this rule is that in a partnership, founded on mutual trust and for each other's mutual benefit, the partners should not expect each other to have more diligence or skill than they actually have. If a

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<sup>38</sup> 2000 SLT 699.

<sup>39</sup> This was the case in *Ross Harper & Murphy v Banks* 2000 SLT 699.

<sup>40</sup> See *Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407, 427 - 428, per Romer J and *Houghland v R R Low (Luxury Coaches) Ltd* [1962] 1 QB 694, 697 - 698, per Ormerod LJ.

<sup>41</sup> 2000 SLT 699.

partner is not prudent, the fault lies with the other partners: they should have taken on a more able partner.<sup>42</sup>

14.27 Another approach would be to introduce an objective element into the standard of care in the way suggested in *Winsor v Schroeder*,<sup>43</sup> *Gallagher v Shulz*<sup>44</sup> and the recent Scottish case of *Ross Harper & Murphy v Banks*. This would also be consistent with the approach adopted for agents and directors of companies. The standard required of an agent is to exercise such care and skill as is reasonable in all the circumstances of the particular case.<sup>45</sup> An agent who is a member of a profession will be expected to exercise the degree of skill and care reasonably to be expected of a reasonably competent member of that profession.

14.28 Part of a company director's common law duty of care is to act in accordance with the actual knowledge, skill and experience possessed.<sup>46</sup> There is also a more objective strand to a director's common law duty, that is the duty to act with the skill and care of a reasonably diligent person having the general knowledge, skill and experience that may be reasonably expected of a person carrying out that director's duties.<sup>47</sup> This dual subjective/objective test for a company director is also similar to the approach adopted by the Model Trustee Code for Australian States and Territories<sup>48</sup> and the Trustees' Powers and Duties Bill.<sup>49</sup> This is an extension of the traditional English common law rule for trustees that "it is the duty of a trustee to conduct the business of the trust with the same care as an ordinary prudent man of business would extend towards his own affairs".<sup>50</sup> In Scots law also the standard of care imposed on a trustee is the objective standard of the ordinary

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<sup>42</sup> See *Stair Memorial Encyclopaedia*, I. 16. 7 and *Erskine*, III. iii. 21.

<sup>43</sup> (1979) 129 NLJ 1266.

<sup>44</sup> (1988) 2 NZBLC 103.

<sup>45</sup> See *Houghland v R R Low (Luxury Coaches) Ltd* [1962] 1 QB 694 and *Chaudhry v Prabhakar* [1989] 1 WLR 29. See generally *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (1999) Law Com No 261; Scot Law Com No 173.

<sup>46</sup> See *Insolvency Act 1986*, s214(4)(b), and Hoffmann LJ's view in *Re D'Jan of London Ltd* [1994] 1 BCLC 561, 563 that s 214(4) was an accurate statement of a director's common law duty of care. See generally *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, Draft Statement of Director's Duties, which refers to the "knowledge and experience which the director has".

<sup>47</sup> See *Norman v Theodore Goddard* [1992] BCC 14; *Re D'Jan of London Ltd* [1994] 1 BCLC 561; and *Insolvency Act 1986*, s 214(4)(a).

<sup>48</sup> Published by the Law School of the University of Queensland on the initiative of a number of Australian judges, practitioners and academics. It requires a trustee to "act with care, skill, prudence, and diligence having regard to (a) the nature, composition, and purpose of the trust, and (b) the skills which the trustee possesses or ought, by reason of his business or calling to possess."

<sup>49</sup> The Trustee Bill is presently in Parliament as a Government Programme Bill.

<sup>50</sup> *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515, 531, per Brightman J.

prudent man.<sup>51</sup> It is proposed to extend these common law duties by Clause 1(1) of the Trustee Bill which sets out a trustee's duty of care as follows:

Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular -

- (a) to any special knowledge or experience that he has or holds himself out as having, and
- (b) if he acts as a trustee in the course of a business or profession, to any special knowledge or experience that is reasonable to expect of a person acting in the course of that kind of business or profession.<sup>52</sup>

It applies to a trustee when exercising his powers of investment and his powers to acquire land; to employ and review agents; to appoint and review nominees and custodians; and to insure trust property.<sup>53</sup>

14.29 We believe that the rationale for the more objective test of a company director's common law duty of care does not extend to partnerships.<sup>54</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.<sup>55</sup> This would suggest that there ought to be more 'give and take', more flexibility for the conduct of a relationship, whose very essence is one of mutual trust and confidence. The very fact that mutual confidence is at the heart of the partnership relationship should perhaps determine the level of care expected of a partner in partnership affairs. 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.

14.30 On the other hand, an objective standard would be more in keeping with the tendency of case law in both English and Scots law. The trust and confidence which a settlor/truster places in a trustee may be no less than the trust and confidence which partners place in co-partners. It may be argued that it is appropriate that the law should impose an objective standard of care on a partner where co-partners have unlimited liability for the obligations into which that partner enters. In many modern partnerships which have a large number of partners or which may include corporations as partners a subjective standard may seem inappropriate. But we are only considering a default rule. It will be open to a partnership to agree a different standard of care. In addition if the standard is an objective one it may be necessary, in order to achieve justice, to qualify the standard by reference to the practices of the partnership and its responsibility for the training of the

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<sup>51</sup> *Raes v Meek* (1889) 16 R (HL) 31, 34, per Lord Herschell; *Tibbert v McColl* 1994 SC 178, 183.

<sup>52</sup> This provision was recommended in the Law Commissions Report on Trustees' Powers and Duties (1999) Law Com No 260; Scot Law Com No 172. See, in particular, the discussion about the duty of care in Part 3.

<sup>53</sup> The Trustee Bill, Sched 1.

<sup>54</sup> See Hoffmann LJ's observation in *Bishopsgate Investment Management Ltd (in liq) v Maxwell* [1993] Ch 1.

<sup>55</sup> In *Blackwood v Robertson* 1984 SLT (Sh Ct) 68 the sheriff commented that it seemed reasonable that, if the firm as a whole takes the benefit of exceptionally astute business dealings by one of the partners, it should also bear a loss caused by an occasional lack of astuteness.

partner in question.<sup>56</sup> We do not favour too prescriptive a formulation of the standard of care in a default code as that may inhibit the development of the law.

14.31 On balance we believe that an appropriate default rule is one which has regard to the knowledge, skill and experience that the partners have or purport to have. Thus if a firm has admitted a partner who has held himself out as possessing certain skills, it would be in accordance with the partners' reasonable expectations that he exercise such skills. We believe that this standard in many cases will achieve the same result as an objective standard which has regard to the business practices of the particular firm.

### ***Invitation for views***

14.32 We invite views on the following provisional proposal and question:

**(1) Do consultees agree 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?**

**(2) If consultees disagree with the provisional proposal in (1) above, should it be provided that, in the absence of agreement to the contrary:**

**(a) partners are expected to act in partnership matters with the care and skill that they would show in their own affairs; or**

**(b) partners are expected to act with such care and skill which would be exercised in the same circumstances 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?**

### **Duty to devote full or reasonable time and attention**

14.33 Partnership agreements often oblige partners to devote their full time and attention to the partnership.<sup>57</sup> In the absence of an express provision, a partner is not under a statutory or common law obligation to do so. Lord Lindley commented<sup>58</sup> that even where the services of the partners are "exceedingly unequal", the claim of the more diligent is left "to the honour of the other" and not to a court of law.<sup>59</sup>

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<sup>56</sup> As in *Ross Harper & Murphy v Banks* 2000 SLT 699. See paras 14.22 - 14.24 above.

<sup>57</sup> See T Sacker, *Practical Partnership Agreements* (1st ed 1995) and R C l'Anson Banks, *Encyclopaedia of Professional Partnerships* (1985) Precedent 11, clause 12(1).

<sup>58</sup> See *Lindley & Banks*, para 20-42, n 24.

<sup>59</sup> Contrast this with cl 41(4) of the 1879 Partnership Bill which provided that "Every partner must attend diligently to the business of the partnership, and shall not be entitled to any remuneration for acting in such business". And see the Western Australian Partnership Act 1895, s34(5) for a similar provision.

14.34 It may be possible, although difficult, to argue in a particular case that there is an implied obligation to devote a certain amount of time to the partnership. However, a term will only be implied if it is necessary to give efficacy to the intention of the parties.<sup>60</sup> If there is no express or implied obligation, partners may be left without a remedy against the underperforming partner. The diligent partners may be able to argue that there has been a breach of another clause in the partnership agreement. This may be extremely difficult to show.<sup>61</sup> They could also contend that the underperformance represents a breach of the duty of good faith, but much would turn on the particular circumstances. Finally, they may be able to seek a dissolution under section 35, probably on the 'just and equitable' ground, but they may be understandably reluctant "to emulate the heroic example of Samson who brought down the temple".<sup>62</sup> It is no wonder then that experts on partnership law consider that a clause specifying how much time each partner should devote to the partnership is "vital".<sup>63</sup>

14.35 This appears to be an unsatisfactory position. However, we do not believe that the answer to this lies in a statutory 'default' provision. It is difficult to provide one general rule on how much time a partner is obliged to devote to the firm's business. A statutory 'default' provision for a partner to devote full time and attention to the partnership may, for example, be inappropriate, and if generally applied, would be inflexible. Apart from a partner who primarily contributes capital to the firm as an investment, a partner may devote his name or goodwill or become less involved over time and may, for reasons acceptable to the other partners, devote less than full time and attention to the partnership.

14.36 An alternative is a duty to devote reasonable time and attention. The phrase 'reasonable time and attention' is easy to state, but it is not so easy to determine its actual meaning. Its lack of precision may encourage expensive litigation. The entire history of the partnership may need to be investigated: the parties' intention at the beginning of their relationship on what amount of time is 'reasonable' may have altered quite substantially during the course of the partnership.

14.37 We have already discussed the issue of expulsion and we consult on the possibility that section 35 be amended so that in addition to a dissolution as regards all the partners the court can order the buy-out by the remaining partners of a 'guilty' partner's share under s35(b) - (d) and (f).<sup>64</sup> We consider that, in appropriate circumstances, such an order could be made when one partner has demonstrated a consistent lack of commitment.<sup>65</sup>

14.38 We invite views on the following provisional proposal:

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<sup>60</sup> See *The Moorcock* (1889) 14 PD 64; and *Liverpool City Council v Irwin* [1977] AC 239.

<sup>61</sup> See *Lindley & Banks*, para 10-75.

<sup>62</sup> Drake, *Law of Partnership* (3rd ed 1983) p 174. *Lindley & Banks* also comment that this "will scarcely represent an attractive remedy": para 10-75.

<sup>63</sup> See *Lindley & Banks*, para 10-75; Drake, *op cit*, also argues that this should be combined with an expulsion clause: see pp 174 - 175.

<sup>64</sup> See paras 6.37 - 6.42 above.

<sup>65</sup> For example, under s 35(c), s 35(d) (not reasonably practicable to carry on business in partnership with 'guilty' partner) or s 35(f) (just and equitable). There would be no guarantee, of course, that such an order would be made.

**There should not be a statutory duty to devote full time and attention, or any other specified amount of time and attention, to the partnership.**

# **PART XV**

## **THE EFFECT OF A PARTNERSHIP'S SEPARATE LEGAL PERSONALITY ON PARTNERS' DUTIES**

### **Introduction**

15.1 In this Part we discuss the effect of separate legal personality on partners' duties. Two principal issues arise. First, to whom do partners owe their various duties? Secondly, who may enforce any duties which partners may owe to the partnership?

### **The existing law**

15.2 The creation of a partnership with separate legal personality means that partners may have duties to either or both of the partnership and their fellow partners. The existing law of partnership, which places partners in a fiduciary relationship with each other, reflects the view that mutual trust among the partners is an important aspect of the partnership relationship. The obligation to render true accounts and full information in section 28 of the 1890 Act is a duty owed by each partner to the other partners. On the other hand the duty to account for profit and the duty not to compete with the partnership, contained in sections 29 and 30 of the 1890 Act, are expressed as duties owed to the partnership. Where a partnership has a separate personality, that duty would be owed to the partnership as an entity.

### **Possible reforms**

15.3 If consultees favour the retention of a general duty of good faith in partnership relations<sup>1</sup> and a statutory statement of a partner's duty of care and skill,<sup>2</sup> it may also be appropriate to have a statutory statement that partners in making management decisions affecting the partnership are under a duty to act in good faith in the interests of the partnership. We consider that there may be a case for stating the following duties in a new partnership statute:

- (1) the duty of good faith in partnership relations;
- (2) the duty to give accounts and full information to other partners (section 28 of the 1890 Act);
- (3) the duty to account to the firm for profits (section 29 of the 1890 Act);
- (4) the duty not to compete in business against the firm (section 30 of the 1890 Act);
- (5) the duty to act in good faith in the interests of the partnership; and
- (6) the duty of skill and care.

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<sup>1</sup> See para 14.13 above.

<sup>2</sup> See para 14.25 above.

15.4 If consultees favour such a statutory statement, it will be necessary to decide to whom these duties are owed and who may enforce them. There are three main options.

15.5 The first option is that partners should owe all of the duties to the partnership and not to the other partners. This involves a strict application of the concept of legal personality: partners regulate their association in business by owing duties to the partnership alone. A partner would not be able to pursue a claim arising out of a breach of duty to the partnership unless he were able to raise a derivative action analogous to that available to a shareholder in company law.

15.6 The second option is that partners should owe duties to the partnership but certain duties such as the duty of skill and care and the duties to account for profits and not to compete with the firm would be owed both to the partnership and to other partners. The partnership alone would be able to sue for breach of a duty owed to it. Partners would be able to sue directly for obligations owed to them. There would be no derivative action. This option reflects the approach taken by RUPA.

15.7 The third option is that partners should owe to each other a general duty of good faith and duties to give accounts and information concerning the partnership. Other duties, such as the duty to account for profit, the duty not to compete in business against the partnership, the duty to act in good faith for the benefit of the partnership and the duty of skill and care would be owed to the partnership. This option would reflect the existing law more closely than the other options.

### ***Option 1***

15.8 The first option would have the benefit of clarity. Duties would be owed only to the partnership. There would be no conflict between duties owed to the partnership and those owed to other partners.<sup>3</sup> But it would have disadvantages which we consider significant. First, it would replace the obligation of good faith between partners which exists in the common law and which is seen as an important attribute of partnership. Secondly, it would be likely to preserve the derivative action in partnership law when there are proposals to replace it in company law.<sup>4</sup> The Law Commission in its *Report on Shareholder Remedies* explained that the derivative action in company law arose in England from the application of two principles, namely the “proper plaintiff principle” and the “majority rule principle”.<sup>5</sup>

15.9 Under this option a partnership with separate personality would alone have title to pursue claims for a wrong done to it by third parties and for breach of duties owed to it by the partners. This is consistent with the “proper plaintiff principle” that:

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<sup>3</sup> The DTI in its Consultation Paper “Limited Liability for Partnerships Regulatory Default Provisions Governing Relationships between Members” (February 2000) suggested that such conflicts were one of the reasons for not seeking to apply the duty of good faith between members of an LLP (para 21).

<sup>4</sup> See the Law Commission’s Report: Shareholder Remedies (1997) Law Com No 246; Cm 3769.

<sup>5</sup> Law Com No 246, para 6.1.

A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C.<sup>6</sup>

In Scotland title to sue is a matter of substantive law and not of procedure but the result in both jurisdictions would be substantially the same: the partnership, and not the individual partners, would have title to pursue remedies for wrongs done to it.

15.10 The courts are generally unwilling to be involved in disputes about the internal management of a company when the dispute can be settled by the majority of shareholders; this is shown in the majority principle rule. Partnership law is similar to company law in this field. Historically the courts have been reluctant to become involved in disputes concerning the internal management of a partnership.<sup>7</sup> If no statutory provision were made concerning title to sue in respect of the claims of partnerships with separate personality, it is likely that the common law rules, which in England have developed since *Foss v Harbottle*,<sup>8</sup> would be applied to partnerships with separate personality. This would be unfortunate.

15.11 In the Law Commission's *Report on Shareholder Remedies*,<sup>9</sup> to which the Scottish Law Commission contributed, we suggested that the common law on derivative actions was inaccessible and archaic. We recommended that a new derivative action procedure in England and Wales and a new statutory shareholder's action in Scotland replace it. It would not be desirable to preserve the common law on derivative actions in the reformed law of partnership. In place of a derivative action it would be possible to devise a provision to protect a partner akin to the protection of a minority shareholder in section 459 of the Companies Act 1985. We doubt that such a provision would be appropriate in the context of the general law of partnership but if consultees favour this option we would welcome their views on whether such a remedy should be included in a new Partnership Act.<sup>10</sup>

15.12 It would be possible to introduce measures to avoid the problems associated with derivative actions, and we are consulting on a measure under option 3 below. We consider however that the obligation of good faith between partners is at the root of the partnership relationship and that it should be preserved. Our provisional view therefore is that the first option should not be pursued.

## **Option 2**

15.13 The second option has the advantage of avoiding derivative actions by making provision for the circumstances in which a partner may sue another partner. RUPA

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<sup>6</sup> *Prudential Assurance Company Limited v Newman Industries Limited (No 2)* [1982] Ch 204, 210.

<sup>7</sup> See Lord Eldon in *Carlen v Drury* (1812) 1 V & B 154, 158; 35 ER 61, 62. Wedderburn "Shareholders' Rights and the Rule in *Foss v Harbottle*" [1957] CLJ 194.

<sup>8</sup> (1843) 2 Hare 461; 67 ER 189.

<sup>9</sup> Law Com No 246.

<sup>10</sup> The DTI initially expressed doubt as to the appropriateness of a s 459 remedy for LLPs. As a result of consultation, however, they now intend to apply s 459 in Schedule II of the regulations, modifying its application so that it can be excluded by a unanimous agreement between the members, and so that any person who joins the LLP at a later date is treated as having agreed any existing exclusion. See DTI Consultation Paper "Limited Liability for Partnerships Regulatory Default Provisions Governing Relationships between Members" (February 2000), paras 29 - 34; and see also DTI Summary of Responses, "Limited Liability for Partnerships Regulatory Default Provisions Governing Relationships between Members" (May 2000), p12.

provides that a partner owes a duty of loyalty and a duty of care both to the partnership and the other partners.<sup>11</sup> A partner, although unable to raise a derivative action, may thus sue another partner for breach of duties which are owed to the partner as well as to the partnership. But this approach has the drawback that an individual 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.<sup>12</sup> For example, a partner may enter into a transaction with a partnership and thus create a conflict of interest or a partner may innocently fail to disclose a profit which the partner has obtained from a transaction in which the partnership had an interest. The partnership may also have benefited from the transaction and the majority of the partners may in good faith decide to ratify the partner's actions or to waive any claim or resolve not to pursue the partner for a technical breach of fiduciary duty. If the duties were owed not only to the partnership but also to the individual partner, the partnership would not be able to waive or otherwise prevent a partner's claim for breach of the latter duty. This may be undesirable.<sup>13</sup>

### **Option 3**

15.14 The third option has the advantage that it is more consistent with the existing law than the other options. It would be possible to minimise uncertainty as to an overlap between duties owed to the partnership and duties owed between the partners by providing that certain duties were owed to the firm alone. These duties could include:

- (1) the duty to account for profits;
- (2) the duty not to compete in business against the partnership;
- (3) the duty to act in good faith in the interests of the partnership; and
- (4) the duty of care and skill.

Breach of any of these duties might give rise to loss to the partnership. An individual partner's loss resulting from breach of these duties would normally be measured by the loss in the value of his interest in the partnership. It may therefore be argued that it is appropriate that these duties should be owed only to the firm.

15.15 At the same time the duty of good faith in partnership relations would be a duty owed by a partner to other partners. If the duty were stated in general terms in a statute it

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<sup>11</sup> See s 405. The duty of loyalty involves a duty to account to the partnership for benefits which a partner derives from the conduct of partnership business, a duty to avoid conflicts of interest with the partnership and a duty to refrain from competing with the partnership. (See s 403.) At the same time the partnership is under a duty to provide partners with access to its books and records and partners are required to furnish their other partners with information concerning the partnership business and affairs. (See s 403.)

<sup>12</sup> The Scottish Law Commission, in its Report on the Law of the Tenement (1998) Scot Law Com No 162, para 6.22, recommended that in its proposed regime of internal governance the manager should owe duties both to the owners' association of a tenement and also to the individual proprietors. We consider that the majority rule principle that applies in partnership law and company law is not appropriate to the relationship between the manager of residential property in a tenement and individual owners: a manager's negligence may cause damage to the home of an individual proprietor without affecting the other proprietors.

<sup>13</sup> This approach nevertheless is consistent with RUPA's requirement of unanimity among partners for any contractual modification of fiduciary duties (s 103(b)(3)).

would allow the courts to develop the law and to apply it appropriately in particular circumstances. The duty in section 28 of the 1890 Act to give accounts and full information to other partners could remain a duty owed by partners to other partners or the duty could be imposed on both the partnership and the partners as in RUPA.<sup>14</sup>

15.16 If option 3 is preferred, it is necessary to consider whether a partner should be allowed to initiate litigation to obtain a remedy for wrongs done to the partnership.

15.17 It is within the implied authority of a partner to commence legal proceedings in the name of the partnership.<sup>15</sup> It is probably the law both in Scotland and in England and Wales that the majority of a partnership may disclaim an action raised by a partner in the name of the partnership.<sup>16</sup> To allow a partner to initiate litigation on behalf of a partnership by virtue of his interest in the partnership rather than under his authority as agent would not be a significant innovation if the partnership were able to disclaim the action as it can under the existing law. If consultees prefer this option, it could be provided that the individual partner's right to pursue claims on behalf of the partnership would be subject to the partnership ratifying the act complained of or waiving the claim or otherwise resolving not to pursue the claim. This would preserve the majority rule principle in circumstances where the other partners act in good faith in the interests of the partnership. Where an interested majority purported to block a claim to protect its own interest and did not act in the interest of the partnership as a whole, its actions would not be treated as the actions of a partnership and the partner would be able to pursue the claim.<sup>17</sup>

15.18 The third option has the further benefit that it preserves conceptual clarity. Certain duties which contribute to the well-being of the partnership as a business would be owed to the partnership alone. A partner could nevertheless raise an action to enforce those duties on behalf of the partnership but would be subject to the majority rule principle where the majority acted in good faith for the benefit of the partnership. At the same time this would enable a partner to obtain a remedy for the partnership where the majority abused their power, without having to dissolve the partnership.

15.19 This approach is unlikely to lead to a significant increase in partnership litigation. In normal circumstances a partner has implied authority to commence proceedings in the name of the partnership. A partner seeking to pursue litigation in the face of a disclaimer by the partnership would require to establish that the majority were not acting in good faith for the benefit of the partnership.

15.20 The principal disadvantage of option 3 is its complexity. Partners would owe certain duties to the firm and other duties to each other. There would be a potential for overlap between a partner's fundamental duty of good faith to other partners and the duty on partners to act in good faith for the benefit of the partnership in their management decisions.

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<sup>14</sup> See s 403 which imposes a duty on the partnership to provide access to books and records and a duty on the partners to furnish information.

<sup>15</sup> See *Lindley & Banks*, paras 14-69 - 14-70; Miller, p 213.

<sup>16</sup> Section 24(8); *Hutcheon & Partners v Hutcheon* 1979 SLT (Sh Ct 61); *Marquess of Breadalbane v Toberonochy Quarry Company* (1916) 33 Sh Ct Rep 154; *Re Sutherland & Partners' Appeal* [1994] STC 387 (CA), 390.

<sup>17</sup> The onus would be on the partner to demonstrate that the majority was not acting in the interests of the partnership.

It would be difficult to define the scope of these duties without making the law inflexible. It is not clear however that these disadvantages would give rise to serious practical problems.

### **Invitation for views**

15.21 We invite views on the following questions:

- (1) Do consultees agree that for a partnership with separate personality there should be provision defining the duties which a partner owes to the partnership and to the other partners respectively?**
- (2) Do consultees agree that a rule that a partner owes duties only to the partnership (option 1) is inappropriate?**
- (3) If a partner owes duties to the partnership and also to the other partners:**
  - (a) Do consultees agree that certain duties - the duty to account for profits, the duty not to compete with the partnership, the duty of skill and care and the duty to act in good faith for the benefit of the partnership - should be specified as being owed to the partnership alone while other duties - the duty of good faith in partnership relations and the duty to give accounts and full information to other partners - should be specified as owed by a partner to the other partners (option 3)?**
  - (b) In the alternative do consultees prefer the option that the duty of skill and care, the duty to account for profit and the duty not to compete with the partnership should be specified as owed to and enforceable by both the partnership and the other partners (option 2)?**
- (4) If option 3 in paragraph (3)(a) above is preferred, do consultees agree 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?**

# **PART XVI**

## **A MODEL AGREEMENT?**

### **Introduction**

16.1 Our terms of reference require us to consider the question of a model partnership agreement.<sup>1</sup>

### **The 1890 Act as a model agreement**

16.2 Much of the 1890 Act<sup>2</sup> is a standard set of contractual terms that apply to partners in the absence of contrary agreement. It contains a set of important default rules. We have already considered ways in which these default rules might be modernised and adapted to reflect current commercial reality. We have paid particular attention to modifications designed to reflect the normal desire of partners for more legal continuity in their business relationships than the 1890 Act currently provides. There will always be a need for default rules for those partnerships which do not adopt any a model agreement.<sup>3</sup>

### **A new model agreement?**

16.3 The question for consideration here is whether, in addition to the default rules in the 1890 Act, there should be a more detailed model agreement regulating other matters likely to require regulation in most partnerships. The model agreement would be available for adoption by partners if they so chose, with or without modification. Once adopted it could be varied, expressly or by implication from conduct, just like any other partnership agreement. It could include blanks on matters such as the firm name, its business, its premises, its bankers, its accountants, holiday entitlements, and so on, to be filled in to suit the needs of the particular partnership.

### **The argument for a model agreement**

16.4 The argument for a model partnership agreement is that such an agreement could regulate many detailed matters in a way which would be inappropriate in primary legislation. We are aware that if our proposals were to be implemented, many partnerships would wish to draw up new partnership agreements and if the model agreement regulated matters in a way which was appropriate for a large number of partnerships of various kinds then legal expense would be saved and many problems would be regulated in advance. A useful facility would be provided for partners and prospective partners. The facility would

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<sup>1</sup> See para 1.1 above. On the idea of a statutory 'model' partnership agreement analogous to Table A of the Companies Act 1985 see also our feasibility study published by the Department of Trade & Industry, 'Company Law Review: The Law Applicable to Private Companies' URN 94/529.

<sup>2</sup> In particular ss 19 - 34 and 42 - 44.

<sup>3</sup> It would be possible to put those provisions of the 1890 Act which regulate partners' rights and duties as between themselves into a schedule to make them easier for partners to adopt. It would be possible to provide for the schedule to be amended by statutory instrument. However, we are not convinced that there would be any great advantage in doing so. The rules apply if not disapplied. They do not need to be adopted. The 1890 Act has not required frequent amendment.

be optional and flexible. The mere fact that the attention of prospective partners was drawn to matters requiring to be specified in order to fill in blanks in the form would itself be useful.

### **The argument against a model agreement**

16.5 The argument against a model agreement is that it would be unrealistic to attempt to construct one model agreement containing provisions suitable for all firms, whatever their size and business. Partnership agreements vary greatly on such matters as holiday entitlements, the level and frequency of drawings, and whether there should be restrictive covenants when a partner leaves. Provisions vary with both the size and nature of the firm. What is suitable for a hundred partner law firm is unlikely to be appropriate for a two partner newsagents. If the model agreement option were pursued it might be necessary to produce a series of agreements which partnerships could adopt.

16.6 Although, in the context of company law, Table A<sup>4</sup> has proved extremely useful to businesses, a model partnership agreement would need to cover a wider range of issues than are covered by Table A. The company as a business vehicle has clearly defined structures and procedures. This allows Table A to deal effectively with issues affecting companies (such as share capital, procedure at general meetings, payment of dividends and provisions relating to directors). A model partnership agreement would have to regulate partners' rights and duties as between themselves, dealing for example, with issues of ownership, profit sharing, resignation and valuation of an outgoing partner's share. Drawing up such a model agreement would necessarily involve making arbitrary decisions between the competing rights of partners.

### **Invitation for views**

16.7 We recognise that some firms might benefit from a model partnership agreement. Nevertheless, our provisional view is that, if the default rules in the 1890 Act are modernised as suggested earlier in this Paper, there would be less of a need for any officially approved model agreement. Further, the problems of formulating a model agreement that addressed fully the needs of all types of partnership would, we think, be difficult to overcome.<sup>5</sup> There is nothing to prevent commercial firms from producing model agreements if they so wish and if they think there is a market for them.<sup>6</sup>

16.8 However, we invite views on the following question:

**Do consultees agree that the problems in formulating a model partnership agreement that addressed fully the needs of all types of partnership would militate against such an idea?**

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<sup>4</sup> Companies (Tables A to F) Regulations 1985 (SI 1985 No 805).

<sup>5</sup> A number of those who responded to our preliminary consultations expressed the view that although the case for a model agreement appeared strong in theory, it would not be feasible from a practical point of view, because of the wide variety of commercial partnerships.

<sup>6</sup> There are already a number of textbooks available that offer guidance on the drawing up of partnership agreements. See for example, T Sacker, *Practical Partnership Agreements* (1st ed 1995).

# PART XVII

## LITIGATION

### Introduction

17.1 In this Part we discuss the rules on litigation by or against partnerships, or the former partners of dissolved partnerships. We consider, in particular, what changes would be required if partnerships with legal personality were to be introduced in England and Wales. Finally, we deal with a special problem in English law relating to actions for damages between partners.

### Existing law: England and Wales

#### *Actions in the name of the partnership*

17.2 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> This is a procedural rule for administrative convenience only. It does not in any way change the nature of a partnership. As Lord Lindley, commenting on the predecessor to the current rule, noted:<sup>2</sup>

the firm's name, when used in any action, is merely a convenient method of expressing the names of those who constituted the firm when the cause of action accrued. The rule does not incorporate the firm; so that if A is a creditor of a firm, B, C and D, and D retires and E takes his place and the name of the firm continues unchanged, A cannot maintain an action against B, C and E in the name of the firm, unless B, C and E have become or are content to be treated as his debtors. In the case supposed, an action against the firm would mean an action against B, C and D, ie A's real debtors.

17.3 The authority of a partner to commence proceedings in the firm's name depends on the partnership agreement but, in the absence of any provision to the contrary, a partner has implied authority to commence proceedings in the firm's name, subject to providing any non-consenting partners with an indemnity for costs.<sup>3</sup> Any difference between the partners in relation to the proceedings can be resolved, in the absence of provision on the matter in the partnership agreement, by a majority of the partners.<sup>4</sup> If the majority of partners acting mala fide decide not to bring an action on behalf of the firm against a third party, the wronged partners could apply to the court for the partnership to be dissolved.<sup>5</sup>

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<sup>1</sup> CPR, Sched 1, RSC, O 81, r 1. For when a cause of action accrues, see *South Australia v Peat Marwick Mitchell & Co* (1997) 24 ACSR 231.

<sup>2</sup> Quoted in *Lindley & Banks*, para 14-03.

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

<sup>4</sup> 1890 Act, s 24(8). At common law a majority of partners could stay proceedings commenced by one partner: *Harwood v Edwards* (1739) Gow on Partnership, p 65, note.

<sup>5</sup> In the circumstances envisaged a majority of partners are oppressing a minority and this would give each partner a right to apply to the court for the dissolution and winding up of the partnership under s 35 (d) or (f) of the 1890 Act. Cf a company's derivative action: see *Shareholders' Remedies* (1997) Law Com No 246.

17.4 If the partnership has ceased to carry on business or has been dissolved, the firm name may still be used.<sup>6</sup> The composition of the partnership at the date the proceedings are issued is not normally relevant. A plaintiff naming the firm as defendant, or a defendant sued by the firm, may request that the firm identifies the relevant partners.<sup>7</sup> Provided that 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 issued in their individual names, unless the firm is a legal entity under the law of its constitution.<sup>8</sup> Judgment must normally be entered against the firm name if proceedings are commenced against it in the firm name.

### ***Service of claim form***

17.5 Under this head we examine the identity of the person upon whom the claim form should be served.

17.6 When partners are sued in their own names the ordinary rules for service on individuals apply. When they are sued in the name of the firm, formerly Order 81 rule 3 of the Rules of the Supreme Court contained comprehensive provisions for service. The position is now governed by CPR Part 6 and its Practice Direction. If personal service is to be effected there are two alternative methods.<sup>9</sup> The claim form may either be left with a partner or with a person who at the time of service has the control or management of the partnership business at its principal place of business.<sup>10</sup>

17.7 The former Order 81 of the Rules of the Supreme Court provided that, when a plaintiff knew that the firm had been dissolved before commencement of the proceedings, the writ was to be served on every person in the jurisdiction sought to be made liable in the proceedings. This provision has been omitted from Schedule 1 of the CPR which retains much of the former Order. The Schedule is due to be reviewed later this year, however, and it may be that this issue will be clarified at that point.

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<sup>6</sup> *Re Wenham* [1900] 2 QB 698. Also see *Ernst & Young v Butte Mining plc (No. 2)* [1997] 1 WLR 1485, 1491. The firm Arthur Young merged with Ernst & Whinney in September 1989 to form one partnership, Ernst & Young. In an action for alleged negligence by Arthur Young in 1987 - 1988, Butte Mining sued Ernst & Young in its firm name. Lightman J held that they must be struck out as a defendant as no one was carrying on a business in that name when the alleged cause of action accrued. On the other hand Butte Mining plc could use the name Arthur Young, although the firm no longer existed. As Lightman J noted, "the use of the firm name is the shorthand equivalent of specifically naming as defendants each of the persons who were partners at the relevant time": *ibid*, 1491 - 1492.

<sup>7</sup> CPR, Sched 1, RSC, O 81, r 2(1) and (3).

<sup>8</sup> See *Dreyfus v IRC* (1929) 14 TC 560; and *Oxnard Financing SA v Rahn and others* [1998] 1 WLR 1465.

<sup>9</sup> A party may choose whether or not to effect personal service.

<sup>10</sup> CPR, r 6.4(5).

## Existing law: Scotland

### ***Actions in the name of the partnership***

#### PARTNERSHIP STILL IN EXISTENCE

17.8 When the partnership is still in existence, it can sue or be sued in its own name.<sup>11</sup> If the partnership has a social name, that is one which is composed of the names of real people,<sup>12</sup> it can be sued in its name alone.<sup>13</sup> The social name need not include the names of any of the current partners.<sup>14</sup> If the partnership has a descriptive name,<sup>15</sup> there are different rules depending on where the action is raised. If the action is in the Sheriff Court, the firm name can be used alone.<sup>16</sup> In the Court of Session, however, the names of three of the partners, or two if there are only two, must be added to the partnership name.<sup>17</sup> Even in those cases where a partnership can be sued in its own name alone it is customary, but not necessary, to sue partners as such in the same action.

17.9 The decision on whether or not to bring an action in the partnership's name would normally, in the absence of any provision in the partnership agreement regulating the matter, fall to be taken by a majority of the partners.<sup>18</sup>

#### PARTNERSHIP DISSOLVED

17.10 When the firm has been dissolved, and therefore ceases to exist, the partners must sue and be sued in its place. The usual style to be used was said in *J & F Anderson v Balnagown Estates Co Ltd*<sup>19</sup> to be 'A, B, C and D, the whole surviving partners of the now dissolved firm of X, as partners and as individuals'.<sup>20</sup>

17.11 It is necessary to sue all of the former partners of the dissolved firm who are within the court's jurisdiction, or 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>21</sup> This is the general rule in cases where there are people who are jointly and severally liable for an obligation.<sup>22</sup>

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<sup>11</sup> Bell, *Comm. II*, 508.

<sup>12</sup> Eg, 'John Hare and Company'.

<sup>13</sup> *Forsyth v Hare and Company* (1834) 13 S 42.

<sup>14</sup> *Kerr v Clyde Shipping Company* (1839) 1 D 901.

<sup>15</sup> For example, 'the Antermony Coal Company'.

<sup>16</sup> Rule 5.7, Ordinary Cause Rules 1993.

<sup>17</sup> *Antermony Coal Company v Wingate* (1866) 4 M 1017.

<sup>18</sup> 1890 Act s 24(8); *Hutcheon and Partners v Hutcheon and another* 1979 SLT (Sh Ct) 61.

<sup>19</sup> 1939 SC 168.

<sup>20</sup> This is similar to the style recommended by Macphail, *Sheriff Court Practice* (2nd ed 1998) Vol 1, para 4-98.

<sup>21</sup> *Muir v Collett* (1862) 24 D 1119.

<sup>22</sup> *Neilson v Wilson* (1890) 17 R 608.

## **Possible reforms**

### ***Partnerships without legal personality***

17.12 By their nature procedural rules cannot completely remove the difficulties of suing an aggregate group of persons which lacks a separate continuing personality.<sup>23</sup> We discuss elsewhere whether and how partnerships could be given separate continuing personality.<sup>24</sup> For any remaining English partnerships without separate personality it may be that the procedural rules could be made more comprehensible. This is a matter which is currently being handled by the Lord Chancellor's Department. We think it unlikely that Scottish consultees would wish to see partnerships without legal personality introduced in Scotland but, if this were to be favoured, Rules of Court would have to be made to regulate how they should sue or be sued. We make no suggestions here.

17.13 We deal later in this Part with a special problem in the existing English law relating to actions for damages between partners.<sup>25</sup>

### ***Partnerships with legal personality***

17.14 In the case of a partnership with legal personality, whether this was all partnerships or only those which chose to register, litigation would be by or against the partnership in its firm name. Given the unsatisfactory nature of the existing law in Scotland, it would be useful to have a provision to make it clear that a partnership with legal personality could sue or be sued in the firm name alone whether or not the firm had a social name. It would also be useful to have an express provision making it clear that, as in current Scottish practice and under RUPA,<sup>26</sup> partners can be sued in the same proceedings as the partnership. This would be a procedural facility. It would not affect the principle, if such a principle is adopted,<sup>27</sup> that the liability of the partners is subsidiary. The policy justification for allowing partners to be sued in the same proceedings is that this leaves the maximum options open to the creditor. The creditor should not have to raise separate proceedings against an individual partner. Even if, as in Scotland, a decree against the partnership can be enforced against an individual partner there may well be tactical reasons for preferring to have a decree against a named partner. For example, it may be easier to enforce because the enforcing court officers will not have the responsibility of ascertaining whether or not a person is a partner.

17.15 Where the partnership had ceased to exist as a legal person, litigation would be directed against the former partners. It would, in our view, be illogical and unnecessary in such a case to require any action to be directed against the partnership or the "now dissolved partnership" as such. We suggest below that the Scottish rule that a creditor of a

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<sup>23</sup> For which difficulties, see *South Australia v Peat Marwick Mitchell & Co* (1997) 24 ACSR 231.

<sup>24</sup> See Part 4 above.

<sup>25</sup> See paras 17.18 – 17.27 below.

<sup>26</sup> Section 307 (b).

<sup>27</sup> See para 10.15 above.

firm must constitute the claim against the firm before going against the partners<sup>28</sup> should not apply in the case of a dissolved partnership. As the liability of the former partners would be joint and several, if earlier suggestions are implemented, there ought, as a matter of policy, to be no need for a creditor to sue them all. The rule of Scots law to the effect that in this situation it is necessary to call all the former partners who are within the jurisdiction should be swept away.

17.16 The conferring of legal personality by the primary legislation would in itself provide an entity capable of suing and being sued so long as it exists. Primary legislation would also regulate the liability of partners, and former partners, for partnership obligations and the question of whether a judgment against the partnership as an entity could be executed against a partner. We have already dealt with these important questions.<sup>29</sup> It would be useful also, particularly for Scots law, to have a provision imposing an obligation on any partner or former partner sued to provide information about the names and addresses of any other partners or former partners who may be liable and about any changes in the constitution of the firm which might affect liability.<sup>30</sup> This would provide a basis in substantive law for procedural rules on the question.<sup>31</sup> The precise way in which the entity should sue and be sued, in which other procedural steps should be carried out, and in which information should be requested and supplied would, in our view, be best regulated by subordinate legislation.<sup>32</sup>

### ***Invitation for views***

17.17 We invite views on the following provisional proposals:

- (1) It should be made clear that a partnership with a separate legal personality can, so long as it exists, sue or be sued in the firm name alone whether or not that name consists of or includes the names of partners or real people.**
- (2) It should also be made clear that partners can be sued in the same proceedings as the partnership.**
- (3) Where a partnership with a legal personality has been dissolved as regards all the partners, litigation in relation to partnership rights, debts and obligations**

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<sup>28</sup> *Mair v Wood* 1948 SC 83 by Lord President Cooper at 86. See question (3) at para 17.17 below.

<sup>29</sup> See Part 10 above.

<sup>30</sup> This would merely reflect, in a more obvious and clear way, the underlying policy of the law. See *Mitchell v Grangemouth Coal Co* (1894) 2 SLT 104 where the court granted the pursuer a diligence to recover documents instructing who the other partners were. See further Part 21 below.

<sup>31</sup> The current English procedural position is set out in para 21.13 below. See Part 21 generally in relation to the provision of partnership information by the partnership and, in particular, the consultation questions at para 21.31 below.

<sup>32</sup> We envisage that the existing English procedural rules would apply to service of proceedings upon an unregistered partnership with separate legal personality, but that they would be amended to enable proceedings to be served on a registered partnership with separate legal personality in a similar manner to a company. We also envisage that the procedural rules would be amended so that any partner (or the legal representative of the partnership) would be able to acknowledge service of the proceedings in the name of the partnership (whether registered or unregistered).

**should be by or against one or more of the former partners, as former partners of the dissolved firm.**

**(4) Any partner or former partner sued should have an 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.**

**(5) The rule of Scots law to the effect that a partnership debt must first be constituted against the partnership should not apply in the case of a dissolved partnership.**

**(6) The rule of Scots law to the effect that all the former partners of a dissolved firm who are within the jurisdiction must be called as defenders should cease to have effect.**

**(7) Other procedural matters relating to litigation by or against partnerships with a separate legal personality, or against the former partners of such partnerships, should be regulated by subordinate legislation.**

### **Actions between partners**

17.18 The problem with which we now deal is peculiar to English law. It may not require a legislative solution but we would welcome views on this point.

17.19 Before the Judicature Acts<sup>33</sup> an English partnership could not sue or be sued by its own members. A party could not be both a plaintiff and defendant. Under the Civil Procedure Rules the firm name can now be used in an action between partners.<sup>34</sup> However, the firm name is merely a compendious expression for the individuals constituting the firm other than the plaintiff or defendant partner(s).<sup>35</sup> Its use in litigation does not affect the substantive rights between the parties.

17.20 It was stressed in *Meyer v Faber*<sup>36</sup> that a partner cannot be a creditor or debtor of the firm, because English law does not recognise the existence of a firm as distinct from the members of it and a man cannot make a contract with himself.<sup>37</sup> It remains a fundamental

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<sup>33</sup> Supreme Court of Judicature Acts 1873 and 1875.

<sup>34</sup> CPR, Sched 1, RSC, O 14, rr 1 and 6. The firm name may also be used between two firms with a common partner.

<sup>35</sup> *Meyer v Faber (No 2)* [1923] 2 Ch 421, 435, *per* Lord Sterndale MR, and 441, *per* Warrington LJ. Younger LJ (at 450) left this issue open.

<sup>36</sup> *Ibid*, at p 439. See also *Ellis v Kerr* [1910] 1 Ch 529.

<sup>37</sup> However, this strict rule that a person cannot jointly with another make a promise to himself has been amended by s 82(1) of the Law of Property Act 1925. This provides that any agreement entered into by a person with himself and one or more other persons shall be construed and be capable of being enforced as if it had been entered into with the other person or persons alone. Moreover, this did not apply where the contract was joint and several. Each of the promisors could be sued on the separate promise *Rose v Poulton* (1831) 2 B & Ad 822; 109 ER 1348.

partnership principle that a debt owed by a partner to the firm (and vice versa) is normally only recoverable by a partnership account.<sup>38</sup> As *Lindley & Banks* puts it:<sup>39</sup>

It is a well recognised rule that, whenever money allegedly belonging or owing to the firm in respect of a partnership transaction is sought to be recovered from a partner, an action for an account is required,<sup>40</sup> unless an account has already been taken between the partners or, exceptionally, taking an account would serve no useful purpose.<sup>41</sup>

17.21 The case law in this area was comprehensively reviewed by Peter Gibson LJ in the case of *Marshall v Bullock*.<sup>42</sup> A partnership between two joiners had been dissolved. The assets of the partnership were taken by one partner, who discharged its liabilities. No account was taken between the partners. More than six years after the dissolution of the partnership, but within six years of the discharge of liabilities, proceedings were brought by this partner against the other for his share of the discharged liabilities. In holding that this action was time-barred Peter Gibson LJ commented:

Just as one cannot say what is the entitlement of a partner in respect of a partnership asset without the taking of an account, so one cannot say what is the liability of a partner in respect of a partnership liability discharged by another partner without that account being taken. The authorities show that unless the case is an exceptional one the court will not allow one partner to seek to recover from another partner a sum which is referable to a partnership asset save though an action for an account. So too, I would hold, generally a contribution in respect of the discharge of a partnership liability must be sought by an action for an account.<sup>43</sup>

17.22 It is clear that a partner is also entitled to recover damages against another for breach of the partnership agreement.<sup>44</sup> What is not clear is whether there is a requirement that an account must first be taken in order to establish a right to such damages. The current editor of *Lindley & Banks* submits that, on the basis of pre-Judicature Act cases, there is not.<sup>45</sup> We share this view for two reasons.

17.23 Firstly, a partner who has breached the partnership agreement will have no interest in any damages awarded. Any damages awarded will not be a partnership asset or liability. In *Radenhurst v Bates*<sup>46</sup> several people agreed to provide horses for a coach on its journey. Any person defaulting on the agreement was liable to a penalty to be divided among the non-defaulters. It was held, on such default, that:

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<sup>38</sup> The right to an account is embodied in s 28 of the 1890 Act.

<sup>39</sup> Para 23-72.

<sup>40</sup> *Meyer v Faber (No 2)* [1923] 2 Ch 421, 439; *Green v Hertzog* [1954] 1 WLR 1309; *Gopala Chetty v Vijayaraghavachariar* [1922] 1 AC 488.

<sup>41</sup> *Brown v Rivlin* (unreported) February 1 1983 (CAT No 56); [1984] CLY, p 138.

<sup>42</sup> (unreported) 27 March 1998, Court of Appeal. Pill and Ward LJ concurred.

<sup>43</sup> *Ibid*, at pp 12 - 13 of the transcript.

<sup>44</sup> *Lindley & Banks*, paras 23-196 - 23-197.

<sup>45</sup> Paragraph 23-197.

<sup>46</sup> (1826) 3 Bing 463; 130 ER 591.

What is sought to be recovered in this action is not partnership property; the Plaintiff and the Defendant are not tenants in common of it; the Defendant has no interest in it. It is a penalty to be paid by the Defendant to the Plaintiff for the use of the other contracting parties, the Defendant himself being by the agreement expressly excluded from any share of it. There are no accounts to be settled before this claim can be decided, and, therefore, no one reason why this case may not be disposed of in a court of law.

17.24 Secondly, there is pre-Judicature Act authority that a claim for damages for breach of the partnership agreement is distinct from accounting for the various transactions which may arise from it. In *Rawson v Samue*<sup>47</sup> there was an action at law by the plaintiff for damages for breach of contract. The defendant sought from Chancery an injunction staying execution by the plaintiff on any judgment recovered by him at law, because no proper account of the dealings between the parties had been taken. The injunction was refused. The Lord Chancellor held:

It was said that the subjects of the suit in this Court, and of the action of law, arise out of the same contract, but the one is for an account of transactions under the contract, and the other for damages for breach of it. The object and subject-matters are, therefore, totally distinct.

[There is no] equity in preventing a party who has recovered damages at law from receiving them, because he may be found to be indebted, upon the balance of an unsettled account, to the party against whom the damages have been recovered.

17.25 One further point must be made. As is noted in *Lindley & Banks*, if one partner seeks damages from co-partners the mutual trust and confidence which sustains the partnership relationship has broken down, so that a dissolution is “almost inevitable.”<sup>48</sup> The claim for damages can then be pursued when the final accounts are taken. In other words the issue is largely theoretical.

17.26 In the circumstances there appears to be little to be gained from having an express provision that a partner has the right to pursue a claim for damages against co-partners without first taking an account. We are not aware that the absence of an express statement gives rise to any serious problems in practice. It also seems likely that a claim for damages will be accompanied by a claim for an account. Moreover, the panoply of remedies available in the partnership context reflect those available at common law and in equity, so that any reform of the remedy of account ought to be of general application.

17.27 We invite views on the following question:

**Should there 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?**

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<sup>47</sup> (1841) Cr & Ph 161, 178-179; 41 ER 451, 458, *per* Lord Cottenham LC.

<sup>48</sup> *Lindley & Banks*, para 23-197.

# PART XVIII

## ENFORCING JUDGMENTS

### Introduction

18.1 In this Part we consider how a judgment or decree against a partnership or against a partner can be enforced in relation to partnership assets and the assets of a partner, including the partner's share in the partnership. Execution is the English term for this process and diligence the Scottish.

18.2 Partners are liable for obligations incurred during their membership of the firm.<sup>1</sup> The obligation is incurred when the cause of action accrues, which is usually the date of the alleged act (or omission) giving rise to the claim. A partner who satisfies a claim against the firm is entitled to an indemnity from the firm and a pro rata indemnity from the other liable partners.<sup>2</sup> We provisionally propose above that such a partner, in a firm with separate legal personality, should have a right to recover from the firm, failing which from the other liable partners.<sup>3</sup> An indemnity in favour of a former partner may be implied upon their leaving the partnership.<sup>4</sup> We provisionally propose that this should be the default position.<sup>5</sup> We also make provisional proposals for the pre-conditions to enforcement of a judgment in the name of a firm, with separate legal personality, against the liable partners.<sup>6</sup>

### Existing law: England and Wales

#### *Enforcing judgment obtained against partnership*

18.3 If a partnership is sued in its name<sup>7</sup> and judgment is obtained against it, the judgment may be enforced against partnership property within the jurisdiction.<sup>8</sup> The judgment may be enforced against anyone:<sup>9</sup>

- (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;

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<sup>1</sup> Para 10.3 above.

<sup>2</sup> Para 10.4 above.

<sup>3</sup> See provisional proposal (4) at para 10.20 above. The right to an indemnity from the firm would be lost upon it ceasing to exist as a separate legal entity, but the right to a pro rata contribution from the other liable partners would survive in those circumstances.

<sup>4</sup> See n 66 at para 10.48 above.

<sup>5</sup> Paras 7.27 - 7.29 above.

<sup>6</sup> Consultation questions 5 & 6 at para 10.20 above.

<sup>7</sup> Under CPR, Sched 1, RSC O 81, r 1.

<sup>8</sup> CPR, Sched 1, RSC O 81, r 5(1).

<sup>9</sup> Under CPR, Sched 1, RSC O 81, r 5(2).

- (3) who admitted in his statement of case that he is a partner; or
- (4) who was adjudged to be a partner.<sup>10</sup>

A judgment cannot be enforced against a partner who was out of the jurisdiction when the claim form was issued, unless they were served, or acknowledged service, as a partner.

18.4 The judgment need not be enforced against the partnership before it is enforced against the partners. Enforcement against an individual partner is not restricted to the extent of their pro rata liability for the obligations of the partnership.<sup>11</sup> The position is however modified where the firm is insolvent and its partners are bankrupt.

### ***Enforcing judgment obtained against a partner***

18.5 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>12</sup> These rules are contained in section 23 of the 1890 Act which provides as follows:

- (1) 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, ... 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.

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<sup>10</sup> CPR, Sched 1, RSC O81, r 5(4) also permits enforcement against a partner who does not fall within one of these categories, where the leave of the court is obtained.

<sup>11</sup> Such a partner will have a right of pro rata recovery from other partners; see para 10.4 above.

<sup>12</sup> See s 23(3) of the 1890 Act.

<sup>13</sup> See para 10.20 above.

## **Possible reforms: English law**

### ***Partnerships without legal personality***

18.6 The existing law already goes some way towards recognising that the partnership is a separate commercial entity. It probably goes as far in this direction as is possible given the lack of a distinct legal personality for the English partnership. We propose no changes to the existing law in the case of partnerships without legal personality.

### ***Partnerships with legal personality***

18.7 It is clear that a judgment against the partnership could be executed against the assets of the partnership. We have already invited views on whether a judgment against the partnership should be sufficient for execution against the assets of a partner.<sup>13</sup> The scheme of section 23 already seems well adapted to the situation where a judgment has been obtained against a partner. Procedural rules would be necessary to regulate such matters as service on the partnership but we do not believe that any alteration of the primary legislation would be required.

## **Existing law: Scotland**

### ***Enforcing decree obtained against partnership***

18.8 A decree obtained against the 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.

### ***Enforcing decree obtained against a partner***

18.9 Section 23 of the 1890 Act which, in English law, enables a judgment creditor of a partner to obtain a court order charging that partner's share in the firm with payment of the partner's separate debt, does not apply in Scotland. The matter is left to the common law which allows a partner's share in the partnership to be arrested in the hands of the partnership.<sup>14</sup> The common law, however, is not satisfactory in this area.

18.10 It is settled law that, in Scotland, the firm, as an independent legal person, is capable of owning property.<sup>15</sup> The partners do not own the property directly, rather they own a share of the firm. As Bell puts it:

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<sup>14</sup> Bell, *Comm.* II, 536. Arrestment is the procedure by which a creditor can attach, in the hands of a third party, any moveable property belonging to the debtor or any sum of money due by the third party to the debtor. It is an incomplete diligence as, in order to transfer the arrested property to the creditor, it must be followed by an action of furthcoming in which the debt is ordered to be paid direct to the creditor or the arrested subject sold and the proceeds paid to him. The creditor is known as the "arrestor" and the third party is known as the "arrestee".

<sup>15</sup> *Forsyth v Hare* (1834) 13 S 42, 47, per Lord Medwyn.

The share of each partner is a portion of the *universitas*: it forms a debt or demand against the company so as to be arrestable in the hands of the company.<sup>16</sup>

This passage highlights the fact that the partner's interest in the firm is an incorporeal moveable right and, as such, is capable of being arrested by a creditor of the partner.<sup>17</sup>

18.11 The arrester completes the arrestment by an action of furthcoming.<sup>18</sup> Without furthcoming the arrestee is not bound to pay the arrester. It is, however, unclear when an action of furthcoming can be raised by the arrester of a partner's share. Erskine states:

[H]e [the creditor of the partner] may attach it [the partner's share] by arrestment in the hands of the company, to be made forthcoming to him on the dissolution of the partnership, in so far as shall appear to be at that period due to the debtor after payment of all the company-debts.<sup>19</sup>

Professor Gretton uses this as authority for saying that the share can only be made forthcoming once the partnership has been dissolved.<sup>20</sup> It is not clear whether he means that decree of furthcoming can only be obtained following dissolution, or whether it can only be enforced then. Pearson asserts that this passage means that the action of furthcoming cannot be raised until the partnership is dissolved.<sup>21</sup> It is not entirely clear what is meant by "dissolved" in this context.

18.12 In his section on furthcoming, Graham Stewart states that:

Where the subject arrested is the interest of a partner in the co-partnery, the arresting creditor cannot become a partner in the company, but he will have a right to payment of the sum due by the partnership to the common debtor in terms of the contract.<sup>22</sup>

This could be interpreted as meaning that the arrester will be able to obtain furthcoming and then to be paid the partner's share immediately. Graham Stewart cites the case of *Sinclair v Staples*<sup>23</sup> in a footnote after this passage. In that case, which concerned shares in a joint stock company, Lord Cowan stated:

I have never heard it doubted before that any subject in itself capable of being sold and of being arrested may be ordered to be sold in the action of furthcoming.<sup>24</sup>

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<sup>16</sup> Bell, *Comm.* II, 536.

<sup>17</sup> See Gretton, "Who Owns Partnership Property?" (1987) JR 163, 166.

<sup>18</sup> See *Stair Memorial Encyclopaedia*, Vol 8, para 311.

<sup>19</sup> Erskine, *Institutes*, III, 3,24.

<sup>20</sup> *Stair Memorial Encyclopaedia*, Vol 8, para 270.

<sup>21</sup> *Stair Memorial Encyclopaedia*, Vol 16, para 1073.

<sup>22</sup> Graham Stewart, *Law of Diligence* (1st ed 1898) p 240.

<sup>23</sup> (1860) 22 D 600.

<sup>24</sup> *Ibid*, at p 605.

Graham Stewart also states explicitly that it is possible to obtain decree of furthcoming prior to dissolution.<sup>25</sup> He cites Lord Gifford in *Cassels v Stewart*<sup>26</sup> who states that a partner's creditor who attaches the partner's interest in the firm does not become a partner but will be entitled to the profits accruing on the partner's share. In a footnote, Graham Stewart quotes section 31(1) of the 1890 Act, which entitles the assignee of a partner's share to receive the share of any profits to which the partner would be entitled, but not, *inter alia*, to interfere in the management or administration of the partnership business or affairs. He then states that '... this will apply to an arrester who has obtained decree of furthcoming.'<sup>27</sup> This indicates that the decree can be obtained before, even though not enforced until after, dissolution, but does not indicate whether it would be possible to enforce it earlier.

18.13 Professor Gretton notes that a future debt, that is, one which exists but is not payable until a future date, can be arrested and an action of furthcoming raised, but that 'the decree of furthcoming cannot be enforced until the debt has matured, for otherwise there could be prejudice to the arrestee'.<sup>28</sup> This would tend to support the view that the arrester of a partner's share can obtain a decree of furthcoming during the subsistence of the partnership, but only enforce it after dissolution. The arresting creditor cannot force an early dissolution in a fixed term partnership, but it is undecided whether the creditor can make a partner in a partnership at will exercise a right to dissolve the partnership.<sup>29</sup>

18.14 Whether or not a decree of furthcoming can be obtained prior to dissolution of the partnership, it is clear that the arrester cannot enforce it until after this event. Professor Gretton considers this to be unsatisfactory, giving the arrester either too little, because dissolution might not occur for a long time, or too much, because the share paid out after dissolution would include post-arrestment profits, which might be viewed as *acquirenda*.<sup>30</sup> Lord Gifford in *Cassels v Stewart*<sup>31</sup> considered that a creditor who attached a partner's share would be entitled to any share of the profits to which the partner would have been entitled, a right also conferred on an assignee by section 31(1) of the 1890 Act. Graham Stewart states that an arrester who has obtained furthcoming will also be entitled to the partner's share of profits.<sup>32</sup>

18.15 If the creditor has to wait until after dissolution to be paid out the partner's share, it will also be possible for the share to decrease in value. This is recognised by *Lindley & Banks* as also being a problem under English law:

[I]t would seem that the partners (including the debtor) will ... be free to implement an arrangement detrimental to the judgment creditor's interests, for example, by

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<sup>25</sup> Graham Stewart, *Law of Diligence* (1st ed 1898) p 240, n 5.

<sup>26</sup> (1879) 6 R 936, 956.

<sup>27</sup> Graham Stewart, *op cit*, p 240, n 5.

<sup>28</sup> *Stair Memorial Encyclopaedia*, Vol 8, para 268.

<sup>29</sup> Miller, p 410.

<sup>30</sup> *Acquirenda* are things or rights acquired after arrestment, which are not normally affected by the arrestment. *Stair Memorial Encyclopaedia*, Vol 8, paras 265 and 270.

<sup>31</sup> *Op cit*.

<sup>32</sup> *Op cit*, p 240, n 5.

reducing the profits distributable in the normal profit sharing ratios by paying preferential ‘salaries’ to partners, provided that they can demonstrate that the arrangement is bona fide and introduced pursuant to a specific provision in the partnership agreement or otherwise pursuant to their normal management powers.<sup>33</sup>

However, under English law the judgment creditor can go on to obtain an order for the sale of the partner’s share, which it is not possible for an arrester in Scotland to obtain. It appears that the arrester simply has to wait until there is a dissolution.

### **Possible reforms: Scots law**

18.16 It is clear that the common law on arrestment and furthcoming is not easy to apply in the partnership context. It gives rise to great doubt and difficulty and does not provide the range of solutions provided in England by section 23. There is no provision in Scotland for the judgment creditor to obtain an order for the sale of the partner’s share. There is no provision giving the other partners the option of purchasing the arrested share if a sale has been ordered.<sup>34</sup> Our provisional view is that specific provision on the arrestment and furthcoming of a partner’s share at the instance of a judgment creditor would improve the law. We ask below whether a creditor of a partner should be allowed to apply to the court for an order for a sale of the partner’s share.<sup>35</sup> We recognise that this would be contrary to the common law rule that an arrester takes the subjects *tantum et tale*,<sup>36</sup> and so would introduce an exception into the law of arrestment. Nevertheless, it would bring the law in Scotland into line with the position in England and Wales.<sup>37</sup>

18.17 A partner’s share may also be arrested on the dependence of an action.<sup>38</sup> That does not give rise to the same problems because there is no question of furthcoming until a decree has been obtained against the partner and we propose that arrestment on the dependence should be left to the common law. The difficulties arise at the stage where the arrestment has to be put into effect.

18.18 We invite views on the following provisional proposals and questions:

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<sup>33</sup> *Lindley & Banks*, para 19-47.

<sup>34</sup> Section 23(3).

<sup>35</sup> Question (3) in para 18.18 below.

<sup>36</sup> The doctrine of *tantum et tale* means that the arrester receives the property subject to all the conditions and qualities which affect the real right, such as the rights of a trust beneficiary or the right to annul a transaction on the ground of fraud. In the context of partnership, if the partner cannot himself force a sale of his share, the arrester must wait until the partnership is dissolved before the share to which he is entitled can be obtained. As noted at paras 18.13 - 18.14 above, even if a decree of furthcoming can be obtained prior to dissolution of the partnership, the arrester cannot enforce it until after the event.

<sup>37</sup> See paras 18.5 and 18.9 above.

<sup>38</sup> An arrestment on the dependence is a form of diligence by which the pursuer in an action for payment of money may prevent a third party holding moveable property belonging to the debtor, or money due to the debtor, from parting with it pending the disposal of the action so that the pursuer’s debt may eventually be satisfied in whole or in part from the attached property or funds.

- (1) The Scots law on putting into effect an arrestment of a partner's share in the partnership is in need of clarification and reform.**
- (2) It should be made clear that a decree of furthcoming can be obtained after such an arrestment and that the effect of such a decree of furthcoming is 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 fall due.**
- (3) Should a creditor of a partner who has obtained such an arrestment also be able to apply to the court for an order for a sale of the partner's share and for any other appropriate orders (as is possible in England under section 23 of the 1890 Act)?**
- (4) Should the other partners have a right to purchase the partner's share in the event of a sale being ordered?**

# PART XIX

## EXECUTION OF DEEDS BY PARTNERSHIPS

### Introduction

19.1 In this Part we discuss how partnerships execute deeds. Differences between the execution of deeds in English and Scots law arise because, in the latter, the partnership is a separate legal person and deeds can be executed on its behalf by a partner or by any other authorised person.<sup>1</sup>

### Existing law: England and Wales

19.2 The starting point is that the implied authority of a partner does not, in English law, extend to the execution of deeds. There are three difficulties for the execution of deeds by English partnerships:

- (1) a partner has no implied authority to bind the co-partners by deed;<sup>2</sup>
- (2) authority to execute a deed on behalf of another person must be conferred by deed;<sup>3</sup> and
- (3) even if a partner acts with express authority, the form of the deed determines whether the firm is bound.<sup>4</sup>

19.3 Lord Lindley summed up the last issue, which remains today, in the following terms:<sup>5</sup>

If a deed is executed by an agent in his own name, he and he only can sue or be sued thereon, although the deed may disclose the fact that he is acting for another. Therefore, where a partner covenants that anything shall be done, he and he only is liable on the covenant, and the firm is not bound thereby to the covenantee. A person who has to execute a deed as an agent, should take care that the deed and the covenants in it are expressed to be made not by him, but by the person intended to be bound. Thus, if A is the principal and B his agent, the deed and covenants should not be expressed to be made by B for A, but by A; and the execution in like manner should be expressed to be made by A by his agent B.<sup>6</sup>

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<sup>1</sup> Requirements of Writing (Scotland) Act 1995, s 7(7) and Sched 2, para 2.

<sup>2</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>3</sup> *Schack v Anthony* (1813) 1 M & S 573; 105 ER 214; *Harrison v Jackson* (1797) 7 TR 207; 101 ER 935. And see the Powers of Attorney Act 1971, s 1(1) (as amended by the Law of Property (Miscellaneous) Provisions Act 1989, Sched 1, para 6)) and s 1(3). 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* (1996) Law Com No 143, para 8.3.

<sup>4</sup> *Marchant v Morton Down & Co* [1901] 2 KB 829.

<sup>5</sup> *Lindley & Banks*, para 12-171. This rule was expressly preserved by the proviso to s 6 of the 1890 Act.

<sup>6</sup> Footnotes omitted.

19.4 The combination of (1) and (2) in paragraph 19.2 above 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>7</sup> This is a necessary consequence of the firm's lack of personality. For large partnerships this can be an inconvenience. Matters are further complicated for such firms by the rule that any deed conveying a legal estate in land to a firm vests it in no more than four partners.<sup>8</sup>

19.5 The above problems as to execution are avoided if a firm sets up a company to hold land<sup>9</sup> but this is scarcely the most satisfactory solution, particularly for smaller firms.<sup>10</sup>

### **Possible reform**

19.6 Much the easiest and most rational way of reforming the law on the execution of deeds by English partnerships would be the introduction of partnerships with legal personality. The formalities for execution of deeds by such legal persons could then track those which apply generally to bodies corporate.<sup>11</sup>

### ***Partnerships with legal personality***

19.7 Under normal principles, a partner could execute a deed as attorney on behalf of a partnership. Although a partner is an agent of the firm automatically, appointment by deed would still be necessary to enable the partner to execute as attorney on behalf of the firm. Anyone other than a partner executing a deed would also need to be appointed under deed. However, this begs the question: how would a partnership with legal personality itself execute a deed in English law?

19.8 Traditionally a body corporate would do this by affixing a seal.<sup>12</sup> Additionally under section 36(A)(4) of the Companies Act 1985 a document signed by a director and the secretary of a company or by two directors, and expressed to be executed by the company, has the same effect as if executed under the common seal of the company. Other modern corporations, for example friendly societies, have comparable provisions in their enabling statutes.<sup>13</sup>

19.9 We would not propose to require partnerships with legal personality to have seals as current practice and policy are against their use. We propose that the introduction of such partnerships in England and Wales should see a simplification of the formalities for the

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<sup>7</sup> A deed can 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 Burton* (1819) 1 Chitty 707.

<sup>8</sup> See para 11.4 above.

<sup>9</sup> See para 11.4 above.

<sup>10</sup> Although it should be noted that the difficulties increase with the size of the firm; execution by three partners in a three partner firm is a different proposition from execution by 100 partners in a 100 partner firm.

<sup>11</sup> See generally *The Execution of Deeds and Documents by or on behalf of Bodies Corporate* (1998) Law Com No 253.

<sup>12</sup> See *The Execution of Deeds and Documents by or on behalf of Bodies Corporate* (1996) Law Com No 143.

<sup>13</sup> See *Friendly Societies Act 1992*, Sched 6.

execution of deeds and other documents. It would be convenient to introduce a provision along the lines of section 36(A)(4) of the Companies Act 1985, but to provide that a partnership executes a deed (or other document) if it is signed by a partner, and expressed to be executed by the partnership. There would be a presumption of due execution in favour of purchasers in good faith for valuable consideration, as in section 36(A)(6) and a rebuttable presumption of delivery once a deed has been executed. The provision would extend to the execution of electronic documents.

19.10 Although the provision proposed in the previous paragraph would create inconsistency with section 36(A)(4),<sup>14</sup> it would bring English law into line with that in Scotland and provide greater consistency for those dealing with partnerships. This proposal would not affect the position under sections 5 and 6 of the 1890 Act; a partner could only execute the document if he had authority to bind the partnership in the particular transaction.

19.11 We invite views on the following provisional proposals and question:

**(1) If partnerships with legal personality were to be introduced in English law the rules on the execution of deeds by such partnerships should be as follows:**

- (a) a document would be executed by the partnership if signed by a partner and expressed to be executed by the partnership;**
- (b) in a question with a purchaser in good faith a document would be deemed to be duly executed if executed in accordance with (a) above; and**
- (c) there would be a rebuttable presumption that a deed executed in accordance with (a) above was delivered upon execution.**

**(2) Do consultees consider that it should be made clear that these provisions do not affect the legal position under sections 5 and 6?**

### ***Partnerships without legal personality***

19.12 Reform of the English law in this area *without* the introduction of a partnership as a separate entity would be problematic. The rules on execution of deeds by partnerships lacking legal personality are an extension of those which apply to individuals. The scope of this Paper excludes consideration of these rules.

### **Scottish position**

19.13 In Scotland, the execution of partnership deeds is dealt with in the Requirements of Writing (Scotland) Act 1995. Schedule 2, para 2(1) 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

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<sup>14</sup> Which requires the signature of two directors or one director and the secretary.

on its behalf by a partner or by a person authorised to sign the document on its behalf.

The rule that one partner can execute a document on behalf of the partnership is consistent with the rule for signing on behalf of companies which allows one director or secretary to sign on behalf of the company,<sup>15</sup> and we suggest no alteration to it.

19.14 We consider that it is appropriate to reconcile this provision with the limits placed on the authority of a partner to bind the firm under the 1890 Act. Partners can only bind the partnership when they are acting in the ordinary course of the partnership's business (unless that authority is further restricted and the third party knows of the restriction)<sup>16</sup> or if they have authority to act outwith the ordinary course of the partnership's business.<sup>17</sup> The partnership itself, on the other hand, can enter into any transaction whether or not in the ordinary course of its business. As there is no doctrine of *ultra vires* in relation to partnerships, a partnership can sign any document. So, a partner signing a document for the partnership signs as the partnership and can sign any document, even though he has no authority to act in the particular matter. An alternative view has been expressed that a partner must have authority under sections 5 and 6 of the 1890 Act for the document to be validly executed.<sup>18</sup>

19.15 We think that a partner should not be able to bind the partnership, when he has no authority to do so, by signing a document as the partnership. If he were able to do so, sections 5 and 6 of the 1890 Act could be circumvented.

19.16 We invite views on the following question:

**Do consultees agree 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?**

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<sup>15</sup> Requirements of Writing (Scotland) Act 1995, Sched 2, para 3(1).

<sup>16</sup> Section 5, 1890 Act.

<sup>17</sup> Section 6, 1890 Act.

<sup>18</sup> See Rennie and Cusine, *The Requirements of Writing* (1st ed 1995) p 72. Another view is that the document would be formally valid but reducible if the partner acted beyond his authority. See KGC Reid, *The Requirements of Writing (Scotland) Act 1995* (1st ed 1995) p 36.

# **PART XX**

## **REGISTERED PARTNERSHIPS**

### **Introduction**

20.1 There are at least two ways of conferring continuing legal personality on partnerships. One is by conferring it automatically by a provision in the Partnership Act like that which confers legal personality at present on Scottish partnerships. The other is by giving partnerships the option of registering in a register of partnerships and providing that registered partnerships, but only registered partnerships, will have continuing personality. Whichever option is chosen it would be necessary to adapt some provisions of the 1890 Act to cover partnerships with continuing legal personality. Many of these adaptations would be useful in any event to cater more adequately for Scottish partnerships. We have already considered the necessary adaptations in relation to such matters as the agency of partners, partnership property, liability for partnership debts, litigation involving partnerships and the execution of deeds by partnerships. In this Part we are not concerned with those rules which would be necessary for any partnership with continuing legal personality. We are concerned only with those rules which would be peculiar to registered partnerships.

20.2 Whether or not there is to be continuity of personality without registration, registered partnerships would have the benefit of providing greater certainty both to partners and to outside parties. A partner would be assisted in any dealings with outside parties: being on the register would be evidence of status. Outgoing partners would be able to publicise their withdrawal by removing their names from the register. The register would provide certainty for a partner as to the duration of his liability. If the register were kept up to date creditors of the partnership would be able without difficulty to ascertain the identity of the partners who had subsidiary liability for their claims. The advantage of certainty would assist the partnership to obtain recognition in foreign jurisdictions. Registration would assist a partnership to hold and transfer property whose ownership is registered, such as land.

20.3 At the same time, registered partnerships would preserve the flexibility and informality associated with the traditional partnership. The internal financial and management relations between the partners would be substantially the same.<sup>1</sup> Their duties to each other would remain the same. The partnership agreement, which regulates such matters, should remain a private document. In contrast to LLPs, the partners would have unlimited liability for the partnership's debts and there would be no obligation to publish accounts disclosing the partnership's profits and the earnings of the highest earner.

20.4 Registration would have important legal consequences, which are discussed in this Part. A set of rules would be required governing both the mechanics and effect of registration. We set out in this Part a possible scheme of such rules. We invite views on the details of the rules. We also invite views below on whether partners should be able to register the firm even if reforms make continuity the default position or enable it to be obtained without registration.<sup>2</sup>

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<sup>1</sup> Subject to the interposition of the separate personality of the firm in England and Wales.

<sup>2</sup> See Part 4 above and 20.85 below.

## Setting up the register

### *Location*

20.5 It is probable that a new register of partnerships would be set up as an adjunct of the register of companies. There would be a registrar of registered partnerships for England and Wales and a registrar for registered partnerships for Scotland.<sup>3</sup>

### *Cost*

20.6 The initial cost of setting up the register would have to be borne by public funds. Thereafter it might be expected that the register would be self-financing. We have not been able to arrive at any estimate of costs and fees. Much would depend on the level of applications. This in turn would depend on how attractive registration was perceived to be by partnerships. If registration was perceived as an unnecessary bureaucratic involvement conferring few advantages which could not be achieved by a well-drafted partnership agreement, and involving potential trouble, costs and sanctions, then it is likely that the level would be low. The possible advantages of a system of registered partnerships for third parties, such as creditors, would be unlikely to induce partnerships to register.

20.7 We invite views on the following provisional proposal:

**In principle, and after an initial period when costs would have to be borne out of public funds, a register of partnerships should be financed out of fees charged for registration and for updating the register.**

### **The nature of registration**

20.8 Registration could be seen as a way in which partnerships can acquire continuing legal personality or as a way in which a new type of legal person, having no necessary relationship with the standard definition of a partnership, can be created.

20.9 If registration is simply a way in which a partnership, satisfying the definition of a partnership in the 1890 Act,<sup>4</sup> can acquire continuing legal personality then only partnerships could register. It would not be possible, for example, for the following to register – a sole trader; a group consisting of a single employer and one or more employees; a charitable, religious or political association; a company; or a cohabiting couple, whether of the same sex or different sexes. Under the existing law it would be necessary for the partnership to be already carrying on business with a view to profit before it could apply for registration because only then would it be a partnership. This would not be a problem, however, if the statutory definition were amended so that the only requirement in this respect was that the association had been formed with the object of carrying on business with a view to profit.<sup>5</sup> There would need to be some system of checks or statutory declarations to enable the

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<sup>3</sup> See Companies Act 1985, s 10.

<sup>4</sup> Either as it is or as it might be amended.

<sup>5</sup> See paras 5.20 – 5.23 and question (3) in para 5.26 above, where we provisionally propose that the statutory definition be amended in this way.

registrar to be satisfied that the association applying for registration was within the statutory definition of a partnership.

20.10 If however a system of registration is seen as a way of creating a new type of legal person, with no necessary connection to the general law of partnership, then it might be thought anomalous if a sole trader was not able to take advantage of that system to segregate his business and private affairs.<sup>6</sup> This might also facilitate the transfer of his business, both during his lifetime and on his death. A similar point could be made in relation to non-profit making organisations. Partnership is an association of people who come together for commercial reasons.<sup>7</sup> We are not proposing that this should change. However, a system of registration conferring legal personality, without being subject to the provisions, and burdens, of the Companies Act 1985, might be considered advantageous for clubs, voluntary associations and non-commercial organisations such as charities and tenants' companies holding the freehold of blocks of flats. Although a review of the law in relation to sole traders and non-profit making organisations is beyond our terms of reference,<sup>8</sup> it may be that a system of registration conferring legal personality could be extended, beyond partnerships, to offer an alternative legal structure for sole traders and such organisations.<sup>9</sup>

20.11 Our provisional view is that there would be no advantage in having a new definition of partnership for the purposes of the register and that only partnerships satisfying the normal statutory definition, improved as suggested earlier, should be allowed to register.

20.12 We invite views on the following provisional proposal and question:

**(1) Registration in a new register of partnerships, were one to be established, should be limited to partnerships within the normal statutory definition of a partnership.**

**(2) If consultees disagree, should there be any restrictions on who could register and, if so, what?**

### **The process of first registration**

20.13 It may be supposed that application for registration would be made to the appropriate registrar of registered partnerships on a prescribed form accompanied by a prescribed fee.

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<sup>6</sup> As a person cannot be in partnership with himself, a partnership automatically ceases if the number of partners falls below two: see paras 5.4 and 6.8 above.

<sup>7</sup> See para 2.2 above.

<sup>8</sup> See para 1.1 above. The position of charities, other non-profit making organisations and tenants' companies is being addressed as part of the DTI Company Law Review: see chapter 9 of the March 2000 consultation document "Developing the Framework".

<sup>9</sup> This has been recommended in *Alternative Company Structures for Small Business*, Chartered Association of Certified Accountants, Research Report 42, by Andrew Hicks, Robert Drury and Jeff Smallcombe, 1995; and by Andrew Hicks, "Corporate Form: Questioning the Unsung Hero" [1997] JBL 306.

20.14 Our provisional view is that the minimum information required for registration should be:

- (1) the name of the partnership;
- (2) the names and addresses<sup>10</sup> of the partners; and
- (3) the address of the partnership premises (its registered office).

20.15 If the registered partnership intends to hold real or heritable property then before title can be registered with the Land Registry the partnership register should, in addition to the information in paragraph 20.14 above, set out:

- (1) either the names of the partners entitled to carry out land transactions; or
- (2) a minimum number of partners that have to sign dealings with land.

20.16 The original filings relating to the partnership would have to be kept by the registrar for sufficient time to allow the identification of relevant partners in future legal proceedings. It might be sensible, therefore, to specify a long retention period of (say) 20 years.<sup>11</sup>

### **Name**

20.17 For companies, limited partnerships and LLPs the Registrar of Companies will only register a name if it is not the same (or substantially the same) as one already registered.<sup>12</sup> We propose that this should also apply to registered partnerships. To have numerous registered partnerships with the same name may confuse the public, even if the registered numbers are unique. It would, moreover, be inconsistent with the practice for every other registered entity, and would inevitably cause the Registrar practical difficulties.

20.18 A registered partnership would, like a company, be able to trade in a name other than its registered name, so that a partnership registered as Smith & Jones (Leeds) could trade simply as Smith & Jones provided it disclosed its registered name.<sup>13</sup> There would probably need to be a shorthand reference (equivalent to “Ltd” or “plc” for companies) to the fact that the partnership is a registered entity. An obvious shorthand reference would be “Regd Pship” or “RP” but we would be grateful for other suggestions.

20.19 We invite views on the following provisional proposal and question:

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<sup>10</sup> See Sched 1, para 1(a) to the Companies Act 1985 for a provision that the first directors of a company on filing Form 10 must disclose their ‘usual residential address’; and Companies Act 1985, ss 288 - 289.

<sup>11</sup> Cf the 10 year period in Companies Act 1985, s 707A(2).

<sup>12</sup> Companies Act 1985, s 26(1)(c); and Companies Act 1985, s 714. See also the LLP Act 2000, paras 3, 4 and 8 of the Schedule.

<sup>13</sup> The disclosure requirements of s 4 of the Business Names Act 1985 would then apply. The registered partnership would also have to disclose its registered number on correspondence etc: see Companies Act 1985, ss 348 - 351.

**(1) A partnership should only be able to register a name if it is not the same (or substantially the same) as one already registered.**

**(2) What would be a suitable way (for example, Regd Pship or RP) of indicating on letterheads and elsewhere that a partnership was a registered partnership?**

### ***Premises***

20.20 The registered office should be an address in England and Wales or Scotland. We do not propose a requirement that a partnership business should only be carried on in the country of registration. There is no territorial limitation imposed on a company. For similar reasons there should be no nationality or residence qualifications for the partners. Thus a registered partnership could conduct business offshore with no domestic nationals as partners. However, to avoid the existence of partnerships with no physical presence in the country of registration,<sup>14</sup> it might be appropriate to adopt the 'real seat' principle. This would mean that the registered partnership had to maintain a head office in England and Wales or Scotland, as the case may be, for registration, although it would be free to carry on business elsewhere. If it did not have a head office in the relevant country at the time of registration the application for registration could be refused. If it later ceased to have a head office in England and Wales or Scotland it could be struck off the register.

20.21 We invite views on the following provisional proposal:

**A registered partnership should be required to have, as its registered office, an address in England and Wales or Scotland.**

### ***Normal business***

20.22 It may be desirable that the partnership's normal business is also stated and made public. This would help a third party establish the limits of a partner's implied authority.<sup>15</sup> However, the normal business of a partnership ought to be reasonably self-evident. We would also like to keep the mandatory registered particulars to a minimum.<sup>16</sup>

20.23 We invite views on the following provisional proposal:

**It should not be necessary to register any statement or information about the partnership's normal business.**

### **Certificate of registration**

20.24 It may be supposed that if the application were in order, and the fee had been paid, a certificate of registration would be issued.

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<sup>14</sup> This has caused problems for the Inland Revenue in relation to limited partnerships registered under the Limited Partnerships Act 1907.

<sup>15</sup> See paras 9.2 – 9.4 above.

<sup>16</sup> See also the LLP Act 2000, s 2(2): there is no requirement to state the normal business of the LLP on the incorporation document.

20.25 On registration of a company's memorandum, the Registrar of Companies issues a certificate that the company is incorporated.<sup>17</sup> The certificate is conclusive evidence that the requirements of the Act in respect of registration have been complied with and that the association is a company authorised to be registered, and is duly registered, under the Act. To enable the Registrar to issue the certificate there must be a statutory declaration from either a solicitor or an incorporator that all the formalities have been complied with.<sup>18</sup> The conclusiveness of the certificate means that queries over the due formation of the company cannot arise.<sup>19</sup>

20.26 We provisionally propose that on the formation of a registered partnership there should be a certificate which is similarly conclusive. The registered partnership would exist as a legal person from the date of registration stated in the certificate. However, it is not clear that the certificate of registration could be regarded as conclusive evidence that there continued to be a registered partnership. All the partners may, for example, have died. We return to this question of duration later.<sup>20</sup> In the meantime, we provisionally propose that:

**Once a partnership is registered, the certificate of registration should be conclusive that the requirements for registration have been satisfied at the time of registration.**

## **Maintaining the accuracy of the register**

### ***The danger***

20.27 It is important that a register is not allowed to become inaccurate. Whilst it is not desirable to impose sanctions which would make the registration scheme unattractive, in the absence of sanctions it is likely that over the years the register would become increasingly inaccurate. This was the experience of the former register of business names kept under the Registration of Business Names Act 1916; the main reason for its repeal in 1981<sup>21</sup> was lack of compliance, with businesses which should have registered failing to do so and those that did failing to keep their records up to date.<sup>22</sup> It would be in the interests of those leaving a partnership to ensure that their names were removed from the register, to avoid liability for debts incurred subsequently. Similarly, it would be in the interests of existing partners that the name of a new partner be added to the register. However, in practice, this is unlikely to be sufficient to ensure the accuracy of the register; partners will not necessarily be legally aware, will have many other concerns and may not have an interest in maintaining the accuracy of other important information such as the name of the partnership and the address of its registered office.

### ***An annual registration fee and annual return***

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<sup>17</sup> Companies Act 1985, s 13(1).

<sup>18</sup> Companies Act 1985, s12 (3).

<sup>19</sup> The conclusivity of the certificate was, however, overruled in *R v Registrar of Companies, ex p A-G* [1991] BCLC 476 in which it was held that the company had not been formed for a lawful purpose.

<sup>20</sup> Paras 20.49 – 20.55 below.

<sup>21</sup> By the Companies Act 1981, Sched 4.

<sup>22</sup> See Hansard (HC) 1 June 1981, vol 5 cols 646, 650 - 652.

20.28 When the Jenkins Committee considered, in its 1962 Report,<sup>23</sup> the problem of “dead businesses”, which were no longer trading but were still on the Register of Business Names, it recommended that a small annual registration fee should be imposed to encourage compliance with the obligation to notify the Registrar of the cessation of business. It was thought that the failure to pay would alert the Registrar to names which were no longer in use, and that the fee income could be used to publicise the statutory requirements.<sup>24</sup>

20.29 There is certainly merit in this view. An annual registration fee could be combined with an annual return for the registered partnership. This form need not be unduly complicated; for example, the Registrar could send a statement of the registered particulars asking the partnership to confirm their accuracy or notify any changes. The annual fee would avoid the need to charge fees for every other amendment of the registered particulars. The failure to file an annual return would put the Registrar on notice that the partnership may have ceased trading, in which case it could be struck off.<sup>25</sup>

20.30 An annual return, even if duly submitted, would not in itself guarantee accuracy. An entry could be inaccurate for months if the membership of the partnership changed shortly after the filing of an annual return. It would be for consideration therefore whether the partnership should also be under an obligation to file particulars of changes in membership, business address and so on as they occurred.

### ***Sanctions and time limits***

20.31 It seems clear that there would have to be some sanctions to ensure that registered partnerships filed annual returns and other up-dating information. Without sanctions, the filing obligations would be meaningless and would be widely disregarded.

20.32 As a minimum, there could be a provision that the partnership could not rely against other persons on a change in the name, address, or membership of the firm, unless this had been registered. The mere fact that the change had been specifically notified to the third party would not be sufficient. There is a similar provision for companies in section 42 of the Companies Act 1985, although this links reliance to the official notification of the change,<sup>26</sup> rather than to registration. Official notification is in the Gazette which may be several days after registration itself. The company can rely on the change in the interim, however, if the other person had actual knowledge of it. There are also complicated provisions which provide a “grace period” of 15 days after official notification during which the company can rely on the notification unless the other person was unavoidably prevented from knowing of the change at the relevant time.

20.33 For registered partnerships, the most important changes that would be notified to the registrar would relate to the membership of the partnership. These would affect the liability and authority of incoming and outgoing partners. We discuss this in more detail below

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<sup>23</sup> Report of the Company Law Committee (1962) Cmnd 1749.

<sup>24</sup> *Ibid*, at para 441.

<sup>25</sup> Cf Companies Act 1985, s 652.

<sup>26</sup> The First Company Law Directive required the Registrar to publish a number of other matters in the London Gazette.

from the point of view of the individual partners.<sup>27</sup> Here we are concerned with the liability of the partnership. Other changes which might be of significance to third parties would relate to the registered office or name of the partnership. Our provisional view is that the ability of the partnership to rely on changes in any of these particulars should be linked to their registration. We provisionally propose that:

**A registered partnership should not be able to rely against other persons on a change in the name, address, or membership of the firm unless this has been registered.**

20.34 Some further sanction for non-compliance may also be necessary. There are two main options:

- (1) time-limits and fines for default; and
- (2) preventing a registered partnership from bringing or defending civil actions while in breach of registration requirements.

20.35 Imposing a time-limit would not in itself ensure compliance. Penalties for missing the time limit would be necessary, but would be likely to be resented by the partners, particularly if no harm was suffered by a third party. If a fine were imposed only if time limits were consistently missed, this might be more acceptable, although it would be more difficult to administer.

20.36 As an alternative, or in addition to time limits, a civil disability could have much merit. The registered partnership could be precluded from bringing or defending any civil action while in default of its registration requirements, unless and until it remedies the default. This would be a more stringent civil disability than that imposed by section 5 of the Business Names Act 1985 which provides that a firm cannot bring an action based on any contract made when in breach of its disclosure obligations, if the defendant (or defender in Scotland) shows that the breach prevented him from pursuing a claim against the partnership or caused him financial loss. This is a weak sanction, particularly as the court has a discretion to allow the proceedings to continue if it considers that this would be just and equitable. The 1985 Act, however, also contains criminal sanctions in section 7. Here we are envisaging only a civil disability. Moreover, the main purpose of the civil disability would be to induce registration. It seems preferable, therefore, that it should relate to breach of the requirements at the time of the proceedings and not at the time of any contract entered into. The amendment to the register would not have retrospective effect. It would be for consideration whether there should also be a disability, designed to protect third parties, on the lines of that in section 5 of the 1985 Act.

20.37 We invite views on the following provisional proposals and question:

- (1) There should be time limits for compliance with registration requirements designed to maintain the accuracy of the register.**

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<sup>27</sup> See paras 20.58 – 20.63 below.

**(2) A registered partnership in breach of registration requirements should be precluded from bringing or defending civil actions unless and until it remedies the default.**

**(3) Should there also be fines for missing, or for persistently missing, any time-limit for registering information about changes or annual returns?**

***Authority to register changes***

20.38 In all cases when a change was to be registered there would be a prescribed form.<sup>28</sup> If a partnership submitted this and complied with the statutory formalities, the Registrar would register the change. There would be no need to check that any internal partnership rules (for example, requiring a quorum or specified majority) had been observed.

20.39 There are three main options for the general authority to amend the registered particulars:

- (1) any partner could sign the form;
- (2) a minimum of two partners could be required to sign the form; or
- (3) there could be an official like a secretary in a company who had both the authority and responsibility to register changes.<sup>29</sup>

20.40 As the nature of a partnership is such that each partner should have mutual trust and confidence in the other partners it might be thought that any partner should have authority to sign on behalf of the partnership.<sup>30</sup> This would make matters simple, particularly for smaller partnerships. However, as the accuracy of the register will be relied on, it might be sensible to guard against possible abuse by a requirement that two partners must sign a form changing the registered particulars. Alternatively one partner could be appointed as a designated partner with sole authority to amend the registered particulars.

20.41 We invite views on the following question:

**In order to change the registered particulars:**

- (a) should any partner be able to sign the form;**
- (b) should a minimum of two partners be required to sign the form; or**
- (c) should there be an official like a secretary in a company with both the authority and the responsibility to register changes?**

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<sup>28</sup> Or electronic equivalent.

<sup>29</sup> See the LLP Act 2000, s 9(1) and (3).

<sup>30</sup> This discussion is not intended to affect the existing rules which apply to limited partnerships, for which see *Lindley & Banks* paras 30-04 - 30-05.

20.42 It is for consideration whether any different rules should be prescribed in relation to the entry or deletion of a person's name from the register.

20.43 As the consequences of being on the register are potentially serious,<sup>31</sup> it is important that both the prospective partner and the partnership agree that someone should become a partner. In addition to the partnership consenting to admit someone as a partner, any person who is to be registered as a partner would also have to give consent. This could be most easily evidenced by the person's signature. If both consents were produced, the Registrar would be able to update the register.<sup>32</sup> It would be inconvenient and costly if any further check were necessary, and we do not propose one. Only a person who had truly consented to be a partner would be liable, and a forged signature would not make the purported signatory a partner for any purposes.

20.44 It might be possible for the prescribed form to set out the date of the partner's admission to the firm. This date on the registration form could be either before or after the form is delivered to the Registrar, and the person would become a partner from the date specified in that form. If no such date were specified, the person would become a partner on the date the form was delivered.<sup>33</sup> If a partner were registered some weeks after admission, the registration statement could be a simple way to deal with unintentional oversights.<sup>34</sup> To specify a future date might also be administratively convenient for the partnership. However, to register a future appointment may cause problems if the partner, for whatever reason, does not join. The Registrar would then have to be notified of this. This is needlessly complicated, compared to a simple requirement to notify the Registrar within a set time.

20.45 In the case of an outgoing partner there are four approaches to amending the particulars. It could be provided that the partner's name could be removed on the application of:

- (1) the partnership alone;
- (2) the partner alone;
- (3) the partnership or the partner; or
- (4) the partnership and the partner.

20.46 It is clearly important that an outgoing partner should be able to preclude liability for future debts and obligations. This is currently recognised by section 36 of the 1890 Act which allows a partner to give notice of retirement to creditors and compel the partnership to co-operate where necessary, for example by issuing a notice in the London Gazette or Edinburgh Gazette. From the partnership's perspective, the firm may wish to prevent a partner who (say) has been expelled from remaining on the register and thus having authority to bind the partnership. A partner who has been expelled might be reluctant to co-operate. Moreover, the general duty of ensuring that the register is up to date would fall on

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<sup>31</sup> How serious would depend on the solutions adopted in relation to the conclusiveness of the entry in the register in relation to third parties and the partners. See paras 20.58 – 20.63 and 20.68 - 20.69 below.

<sup>32</sup> This is also the approach taken in the LLP Act 2000, s 9(3).

<sup>33</sup> For a similar provision, see Limited Liability Partnerships (Jersey) Act 1997, art 17(4).

<sup>34</sup> It will also be a simple way of rectifying the register: see paras 20.70 – 20.74 below.

the partnership. If the register is inaccurate, then civil disabilities and fines might be incurred by the partnership.

20.47 It seems to us that the most sensible option is to allow either the partnership or the partner to remove the partner's name from the register. Both are interested, and so both should have a means of protecting their legitimate concerns. Only one current partner would be required to sign the form on behalf of the partnership. A partner wrongfully removed from the register could apply for rectification of the register.<sup>35</sup>

20.48 We invite views on the following provisional proposals:

**(1) In order to register a new partner a prescribed form signed both by a current partner on behalf of the partnership and by the proposed new partner would have to be filed.**

**(2) In order to remove a partner from the register, a prescribed form signed either by a current partner on behalf of the partnership or by the partner concerned would have to be filed.**

### **Duration of registered partnerships**

20.49 A partnership may come to an end as regards all the partners in various situations. The following are common examples:

- (a) The number of partners falls below two.
- (b) The partners dissolve the partnership by unanimous agreement.
- (c) A partner dies (and the partnership agreement does not opt out of dissolution as regards all the partners).
- (d) The partnership ceases permanently to carry on business.
- (e) It becomes illegal to carry on the business.
- (f) A court dissolves the partnership on one of the statutory grounds.
- (g) An event provided for in the partnership agreement as a dissolving event occurs. This might be, for example, the expiry of a fixed term, the conclusion of a particular enterprise or the giving of notice by one or more partners.

What should be the effect on a registered partnership of the occurrence of an event which would normally dissolve the partnership? There are two possibilities.

20.50 The first is that the partnership will come to an end in the usual way, just as if it were unregistered. The register would then be inaccurate. However, the former partners could be under an obligation, reinforced by appropriate sanctions, to notify the Registrar that the

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<sup>35</sup> See paras 20.70 – 20.74 below.

partnership had come to an end and the Registrar could have a power and a duty to strike it off the register.

20.51 The second is that the partnership would not come to an end. It would continue until its entry was removed from the register. There would need to be adequate powers for the Registrar to remove the partnership from the register.<sup>36</sup> There would also have to be fundamental changes, for registered partnerships only, to the rules on the duration of partnerships. It might be necessary to provide, for example, that a registered partnership did not come to an end merely because it permanently ceased to trade or merely because the number of partners dropped below two or merely because it became illegal for its business to be carried on. It might be necessary to provide that any purported dissolution of the partnership by the unanimous agreement of the partners was void (unless the moment of dissolution coincided with the moment of removal from the register) and that any term of the partnership agreement providing for the partnership to come to an end at a certain time or on the occurrence of a particular event was treated as providing for the partnership to come to an end on being removed from the register as a result of the expiry of the stated time or the occurrence of the stated event. The power to dissolve by unanimous agreement would presumably have to be replaced by a power to de-register the partnership by unanimous agreement. If there were no such power partners could be locked into a partnership against their will, which would appear to be contrary to the consensual nature of partnership. The power of the court to dissolve the partnership on certain grounds would have to be replaced, for registered partnerships, by a power to order the partnership to be removed from the register.

20.52 We invite views on the following questions:

**(1) Should the normal rules on the duration of partnerships apply to registered partnerships?**

**(2) If so:**

**(a) should the former partners of a registered partnership which was dissolved as regards all the partners be under an obligation, backed up by sanctions, to notify the Registrar of the dissolution of the partnership so that the entry relating to the partnership could be removed from the register;**

**(b) should the Registrar have a power, and a duty, to strike a dissolved partnership off the register?**

**(3) Should the normal rules on duration be altered for registered partnerships so that the partnership would continue until taken off the register and accordingly:**

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<sup>36</sup> The majority of companies that are dissolved each year are never formally wound up. Instead they cease to exist when the Registrar strikes them off the register. This may be done where the Registrar of Companies “has reasonable cause to believe that a company is not carrying on business or in operation” (s 652(1)).

- (a) **the partnership could continue as a legal entity even if it had permanently ceased to trade or it had become illegal for it to carry on trading;**
  - (b) **the partnership could continue as a legal entity even if it had only one partner or no partners;**
  - (c) **any purported dissolution of the partnership by the unanimous agreement of the partners would be void unless the moment of dissolution coincided with the moment of removal from the register;**
  - (d) **any term of the partnership agreement providing for the partnership to come to an end at the end of a stated time or on the occurrence of a particular event (other than removal from the register) would be treated as providing for the partnership to come to an end on removal from the register as a result of the expiry of the stated time or the occurrence of the stated event;**
  - (e) **the power of the court to dissolve the partnership on the statutory grounds would be replaced by a power to order the partnership to be removed from the register?**
- (4) If the normal rules on duration do not apply, should the Registrar have a power and a duty to strike the partnership off the register, and so bring it to an end:**
- (a) **on becoming aware that the partnership had permanently ceased to trade or that it had become illegal for it to carry on trading;**
  - (b) **on becoming aware that the number of partners had been reduced below two;**
  - (c) **if all the partners so requested;**
  - (d) **if informed that the partnership had been entered into for a fixed period, or until the occurrence of a specified event, and that that period had expired or that event had occurred;**
  - (e) **if the court had directed that the partnership be de-registered?**
- (5) Are there any other circumstances in which the Registrar should have a power or a duty to strike a registered partnership off the register?**

20.53 We have invited views already as to whether any special provision should be made to allow a sole remaining partner a period of grace to find a new partner and avoid a winding up of the partnership.<sup>37</sup> This question would be relevant also to registered partnerships were they to be introduced.

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<sup>37</sup> See paras 6.62 – 6.64 above.

20.54 A company that has been dissolved or been struck off without being wound up can be restored to the register.<sup>38</sup> Comparable provisions could apply to a registered partnership if the striking-off turned out to be unjustified.

20.55 We invite views on the following question:

**Should there be a power to restore a struck-off partnership to the register if the striking-off turned out to be unjustified?**

## **Effects of registration**

### ***Continuing legal personality***

20.56 One effect of registration, and the main reason for having a system of registered partnerships, would be that the partnership would acquire a legal personality which would continue notwithstanding changes in its membership. We have already considered the consequential effects of this on such matters as partnership property, liabilities and litigation. The effects of a legal personality acquired in this way would in general be the same as the effects of a continuing legal personality conferred directly on partnerships by the partnership legislation without any need for registration. However, there may be a need for a special rule on the capacity of registered partnerships and it is for consideration whether it would be possible to use the fact of registration to have firmer rules on the authority and liability of partners.

### ***Capacity***

20.57 There should be no question of the *ultra vires* doctrine applying to the registered partnership.<sup>39</sup> If the new statute said nothing about the objects of a partnership, then the doctrine could hardly apply.<sup>40</sup> However, it might be decided that the registered particulars should include the nature of the partnership's business. If this were so then it might be argued that a certain activity was not within the registered business of the partnership, and so was beyond the powers of the partnership. We have already provisionally proposed that there should be an express statutory statement of a partnership's unlimited capacity to act.<sup>41</sup> This would apply to registered and unregistered partnership alike.

### ***Authority and liability of partners in questions with third parties***

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<sup>38</sup> Under Companies Act 1985, s 651 and s 653 respectively.

<sup>39</sup> The House of Lords decided in *Ashbury Railway Carriage and Iron Co Ltd v Riche* (1875) LR 7 HL 653 that the *ultra vires* doctrine applied to a company, which was incorporated by or under a statute. If such a company acted beyond the objects stated in the statute or in its memorandum of association the actions were *ultra vires* the company and thus void. Chartered companies were unaffected by this doctrine: see *Sutton's Hospital Case* (1612) 10 Co Rep 1a, 23a; 77 ER 937, 960. Recent legislative changes have meant that in relation to companies the *ultra vires* doctrine no longer has any practical effect as against third parties, although it has not been wholly abolished: Companies Act 1985, s 35 and ss 35A and 35B.

<sup>40</sup> Cf the limitations on the objects for which an EEIG may be used, which means that the *ultra vires* doctrine may apply to it: see Art 3 of Council Regulation 1985/2137 and Dr Janet Dine, "The European Economic Interest Grouping (EEIG): Some Private International Law Issues" (1992) 13 Co Law 13.

<sup>41</sup> See paras 5.11 and 5.26 above.

20.58 It is tempting to suggest that in the case of a registered partnership the authority and liability of partners would be determined, in any question with a third party,<sup>42</sup> conclusively by the register. A person named on the register as a partner at the relevant time would have authority to bind the partnership and would be liable for any debt contracted at that time.<sup>43</sup> A person not so named would not have authority and would not be liable. This would provide certainty for third parties dealing with partnerships. There are really two questions here - first, the conclusiveness of the register in a question with a third party who knows its contents at the relevant time and, secondly, the conclusiveness of the register in a question with a third party who does not know its contents at the relevant time. The second question would be by far the more important in practice. It seems unlikely that third parties dealing with partnerships in a routine way would make regular checks against the register. To fix them with constructive notice of the contents of the register would be oppressive and would turn something intended, at least partly, to be for their advantage into something which would frequently operate to their disadvantage.

20.59 It seems clear that the register of partners could not be completely conclusive as to the status of a partner in questions with third parties, particularly third parties who had no actual knowledge of the contents of the register.

20.60 First, it would be unfair to third parties to deny them relief against a person who had been admitted as a partner and was in fact acting as a partner, merely because that person had not registered. Similarly, it would be unfair to third parties to prevent them from relying on the apparent authority of a person who had been admitted as a partner and was in fact acting as a partner, even if not on the register. Failure to register should not be allowed to prejudice third parties.<sup>44</sup> Either the register would have to be regarded as indicative of a person's status as a partner but not conclusive or there would have to be special provisions on *de facto* partners to cover those persons who had been admitted as partners and were in fact acting as partners but who were not registered.

20.61 Secondly, there would be no good reason to hold a retired or expelled partner, who was still on the register, liable for new partnership debts if the creditor in question had been specifically informed of the retirement or expulsion, or could be proved to have known of the retirement or expulsion. There would also be no good reason to cloak such a person with authority to bind the partnership if the third party knew that there was in fact no such authority. Either the register would have to be regarded as merely indicative of a person's status as a partner or there would have to be special provisions for retired and other former partners in cases where the creditor had actual knowledge that the person had left the partnership at the relevant time.

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<sup>42</sup> Namely, someone who was not a partner in the firm.

<sup>43</sup> We have invited views earlier on whether this liability of the partner should be subsidiary to the liability of the partnership, the primary debtor. See paras 10.15 and 10.20 above.

<sup>44</sup> The possibility was suggested to us that even in the absence of special provisions a third party might be able to prove that the registered partnership (as a separate legal person) and the unregistered partner were members of a separate unregistered partnership. However, it seems unlikely that this would be the case in fact. The unregistered partner would have entered into partnership with the other partners, not with the registered partnership as such. In any event this would be a devious and unsatisfactory solution to an obvious problem and we do not think it could or should be relied on.

20.62 Thirdly, it would probably be necessary to have a special provision to the effect that no liability would attach to the personal representatives or executors of a deceased partner or to the trustee of a bankrupt partner for matters arising after the death or bankruptcy respectively. This protection would be automatic, and not contingent on de-registering the partner. The partnership would still have an incentive to ensure the partner's name was removed from the register, for otherwise the civil disabilities and penalties discussed above would apply.<sup>45</sup> The personal representatives, executors or trustee would also have duties to wind up the estate which would help to ensure that the name of the former partner was removed from the register.

20.63 We invite views on the following questions:

**(1) Should the appearance or non-appearance of a person's name in the register as a partner of the registered partnership at a certain time be conclusive, as a general rule, in any question with a non-partner, as to that person's status as a partner in the partnership at that time, or merely indicative?**

**(2) If the entry in the register is regarded as conclusive, as a general rule, should there nonetheless be special provisions:**

- (a) treating as partners persons who had been admitted as partners and who had in fact acted as partners at the relevant time, even if not registered;**
- (b) treating retired, expelled or other former partners still on the register as if they were not partners in any question with a third party who in fact knew that they had left the partnership at the relevant time; and**
- (c) ensuring that no liability would attach to the personal representatives or executors of a deceased partner or to the trustee of a bankrupt partner for matters arising after the death or bankruptcy respectively?**

***Need for rule on holding out in section 14?***

20.64 Section 14(1) of the 1890 Act contains a rule on holding out, which we have considered earlier.<sup>46</sup> It provides 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 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.

It could be argued that there would be no need for this rule to apply to registered partnerships. The entry in the register would provide all the information necessary.

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<sup>45</sup> See paras 20.31 – 20.37 above.

<sup>46</sup> See paras 10.31 – 10.37 above.

Against this argument it could be observed that the existence of a register would not prevent people from holding themselves out as partners and that it might be considered hard on third parties to require them to check the register at frequent intervals. We are not satisfied that the introduction of registered partnerships would justify the disapplication of the rule on holding out in section 14. However, we would be grateful for views. This question is similar to the question on persons admitted as, and in fact acting as, partners. However, that earlier question is aimed at the situation where as between the partners a person is a partner. The question on section 14 is aimed at the situation where, as between the partners, a person is not a partner but where that person is nonetheless held out as a partner.

20.65 We invite views on the following provisional proposal:

**The rule on holding out in section 14 of the 1890 Act should apply to registered partnerships.**

***Modification of section 36?***

20.66 It seems clear that the removal of a partner's name from the register should be regarded as the equivalent of a notice in the London Gazette or the Edinburgh Gazette for the purpose of precluding liability for future debts under section 36 of the 1890 Act in relation to persons who had had no previous dealings with the partnership.<sup>47</sup> It might be suggested that notice in the register should be not only sufficient but also necessary for this purpose and that a notice in the Gazette should be of no effect in relation to a partner in a registered partnership. The argument would be that if there is a register it is to the register that third parties should look.

20.67 We invite views on the following question:

**Should section 36(2) of the 1890 Act be disappplied to registered partnerships so that for the purpose of precluding the liability of an outgoing partner for future debts in relation to persons who had had no previous dealings with the partnership the removal of the partner's name from the register of partnerships should be both sufficient and, failing actual notice, necessary?**

***Conclusiveness of the register as between the partners***

20.68 It would be possible to provide that the appearance or non-appearance of a person's name on the register as a partner would be conclusive not only in relation to third parties (subject to the qualifications noted above) but also in relation to the other partners. However, this could easily give rise to complications and injustice. It would be unfortunate, for example, if someone who had been admitted as a partner and who had worked as a partner for a full year were to be denied a share of the partnership profits on the ground that there was no entry in the register of partnerships. There would seem to be no good reason for making the register conclusive in questions between the partners, who can be expected to be aware of the relevant facts. To make the register conclusive in such cases could lead, unless the position were corrected by complicated rules, to artificial results. It could turn registration from a facility into a trap.

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<sup>47</sup> We consider s 36 at paras 10.49 – 10.53 above.

20.69 We invite views on the following provisional proposal:

**The appearance or non-appearance of a person's name in the register as a partner of the registered partnership at a certain time should not be conclusive, in any question with a partner, as to that person's status as a partner in the partnership at that time.**

### **Rectification of the register**

20.70 There is no guarantee that, however rigorous the safeguards are, the register will be accurate. There will need to be some mechanism for the rectification of the register. Obviously the consent of all relevant parties would be sufficient for this. So, if there had been a simple typographical mistake, this could be easily amended.<sup>48</sup>

20.71 Rectification might need the involvement of the court in the event of disputes about the composition of the register. In the Companies Act the register of members can be rectified if (1) the name of any person is without sufficient cause entered in or omitted from the register of members of any company,<sup>49</sup> or (2) default is made or unnecessary delay takes place in entering in the register the fact of any person having ceased to be a member of the company, in which case the person aggrieved, or any member of the company, or the company itself, may apply for the order of the court that the register may be rectified. The court may order payment by the company of any damages sustained by any party aggrieved.<sup>50</sup>

20.72 The court has power to rectify the register after as well as before a winding up order has been made,<sup>51</sup> and the order may be made retrospective.<sup>52</sup> Thus by an application to the court a liquidator can enforce the liability of persons who are not, but ought to have been, entered in the register of members.

20.73 It could easily be provided that if the name of a person was without sufficient cause omitted or removed from the register, the register of partners could be rectified to show the true position. Similarly, it could be provided that the register could be rectified if a person's name had been wrongly entered in the register but, we would suggest, no such rectification should be allowed to prejudice third parties who had relied on the entry.

20.74 We invite views on the following provisional proposals:

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<sup>48</sup> It could not be rectified to backdate the retirement of a partner.

<sup>49</sup> It is sufficient for an applicant to show that the register of members is incorrect because an entry has been omitted or made in error. The applicant need not show any wrong by the company: *Re Fagins Bookshop plc* [1992] BCLC 118, 123.

<sup>50</sup> Companies Act 1985, s 359(2). See *Re Ottos Kopje Diamond Mines* [1893] 1 Ch 618, CA; *Balkis Consolidated Co Ltd v Tomkinson* [1893] AC 396, HL.

<sup>51</sup> Companies Act 1985, s 550.

<sup>52</sup> See *Re Sussex Brick Co* [1904] 1 Ch 598, where a transfer was ordered to be registered as on a date before the liquidation so as to allow the transferee the right of a dissentient; see also *Barbor v Middleton* 1988 SLT 288.

- (1) **The partnership, any partner or any person aggrieved should be able to apply to a court for the register to be rectified if the name of any person had, without sufficient cause, been entered in, or omitted or removed from, the register of partners.**
- (2) **The court should be able to order payment by the partnership of any damages sustained by any party aggrieved.**
- (3) **The court should have power to make a rectification retrospective, provided that the retrospective removal of a name from the register should not be allowed to prejudice any third party who had relied on the entry in the register.**

## Agency

20.75 Section 5 of the 1890 Act provides that a firm is bound by acts of a partner for carrying on in the usual way business of the kind carried on by the firm:

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*.<sup>53</sup>

The first part of this proviso presents little difficulty in the case of a registered partnership. If the partner has no authority and the third party knows this, then the partnership is not bound. The italicised latter part of this proviso could, however, be problematic in the case of a registered partnership. The situation here is different from the situation where a third party relies on the register against the partnership even if it is inaccurate. Here there is no question that the register is inaccurate; rather the partner has no authority to act in the particular matter and the third party ‘does not know or believe him to be a partner’. If the existence of a register was constructive knowledge of an individual’s status as a partner for these purposes, everyone would be deemed to know who was a partner. This would, in our view, lead to unreasonable results. There is no good reason to hold a partnership liable for the acts of a partner who had no actual authority and who was dealing with a party who did not in fact know that the partner was a partner in the firm. Knowledge for these purposes could not sensibly mean constructive knowledge of the contents of the register merely because this is a public record.<sup>54</sup> We believe that, consistent with the current law of partnership, the proviso should apply, but that for these purposes knowledge should not include constructive knowledge of any matter merely because it is disclosed on a public register.<sup>55</sup>

20.76 Therefore, we provisionally propose that:

**The proviso to section 5 of the 1890 Act should apply in the case of a registered partnership, but for these purposes knowledge should not include constructive knowledge of any matter merely because it is disclosed on a public register.**

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<sup>53</sup> (emphasis added).

<sup>54</sup> For a similar provision see Companies Act 1985, s 711A. Section 711A does not affect whether a person is taken to know of any matter by reason of a failure to make such enquiries as ought reasonably to be made.

<sup>55</sup> The above proposals reflect closely the approach taken in the LLP Act 2000: see s 6.

20.77 It would also be possible for partners to use the registration system to file a restriction on a partner's authority.<sup>56</sup> The utility of this facility would be related to whether third parties have constructive notice of it. They are unlikely to check whether a partner with whom they have previously dealt has become subject to a restriction on his authority. Constructive notice of this would mean that a consultation would be essential. This might place an unjustifiable burden on businesses, especially the smaller ones.

20.78 We invite views on the following questions:

- (1) Should partners in a registered partnership be able to file a restriction on a partner's authority?**
- (2) Should a third party be regarded, for these purposes, as having constructive notice of the filing?**

### **Transitional provisions**

20.79 If current partnerships become registered partnerships, what happens to the assets and liabilities of the predecessor unregistered firm? There are three options:

- (1) the 'old' partnership must be wound up, and all the partners register the new firm: assets will have to be assigned to the new legal person, which will have to undertake responsibility for the liabilities of the 'old' firm;
- (2) the 'old' firm is automatically dissolved, and its assets and liabilities vested by operation of law in the 'new' firm; or
- (3) partners remain liable for (and take the benefit of) pre-registration contracts; it is not necessary formally to wind up the firm.

20.80 Option two has the advantage of simplicity. It is, however, unnecessary and potentially fraught with difficulty. The statutory novation of the 'old' partnership's contracts is less easy when dealing with a business association without legal personality. It is entirely possible that partnership A, B, C & Co may have formed contracts with different memberships and hence in the eyes of the law (at least in England and Wales)<sup>57</sup> different firms for several years preceding the registration. The burden of some of these contracts may never have been assumed by A, B, C & Co. And, of course, this may be precisely what the third party intended.<sup>58</sup>

20.81 Options one and three are substantially the same, except that in option three there is no requirement to wind up the firm. It would be much neater if firms did expressly transfer assets and business from the unregistered firm to the newly registered one, but whether this

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<sup>56</sup> 1890 Act, s 8. Also see the ability of an overseas company to limit the authority of an officer under article 2(1)(e) of the Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of the State.

<sup>57</sup> For the doubts on the Scots law see paras 2.34 – 2.35 above.

<sup>58</sup> 1890 Act, s 17(3).

should be compulsory is a moot point. Nor would any assumption of liability by the registered partnership be binding on a third party without the third party's express consent.<sup>59</sup>

20.82 We invite views on the following provisional proposal:

**If an existing partnership wishes to become a registered partnership, it should be necessary for the “old” partnership to be wound up, and for all the partners to register the new firm: assets would have to be assigned to the new legal person, which would have to undertake responsibility for the liabilities of the “old” firm.**

### **Summary of a possible scheme for registered partnerships**

20.83 To summarise, the scheme for registered partnerships, if introduced, and subject always to the results of consultation, might have the following main features:

- (1) In principle, and after an initial period when costs would have to be borne out of public funds, a register of partnerships would be financed out of fees charged for registration and for maintaining and updating the register.
- (2) Registration would (probably) be limited to partnerships within the normal statutory definition of a partnership.
- (3) A registered partnership would have a legal personality capable of continuing notwithstanding changes in its membership.
- (4) A registered partnership would exist with unlimited capacity from the date of registration stated in the certificate of registration, which would be conclusive that all statutory requirements had been complied with at the time of registration.
- (5) The name of the partnership, the names and addresses of the partners, and the address of the partnership's registered office in England and Wales or in Scotland, but not the partnership's normal business, would have to be stated on the register.
- (6) It would be possible to use a name for the registered partnership only if it was not the same (or substantially the same) as one already registered.
- (7) The partnership could not rely against third parties on a change in its name, office, or membership unless this had been registered.
- (8) There would be time limits for compliance with registration requirements relating to annual returns and notification of changes. A possible sanction for a registered partnership could be that it was unable to bring or defend any civil action while in default of its registration requirements. Another possibility might be that the registered partnership would be liable to fines for repeated default.

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<sup>59</sup> Note, however, s 26 of Companies Act 1989 may apply when a partnership (other than a Scottish firm) has been appointed as a company auditor. Section 26(3) extends the appointment when a partnership ceases to any partnership which succeeds to the practice of that partnership.

- (9) To change the registered particulars there would be a prescribed form which would have to be signed by one or two partners, and it could also be open to partnerships to designate a single “secretary” partner to effect relevant changes.
- (10) However, in order to register a new partner a prescribed form would have to be signed both by a current partner on behalf of the partnership and by the proposed new partner; and in order to remove a partner from the register, a prescribed form would have to be signed either by a current partner on behalf of the partnership or by the partner concerned.
- (11) A person who had agreed to become a partner and was registered as such would be treated as a partner in a question with third parties, subject to exceptions for (a) outgoing partners where the third party knew the true position and (b) the representatives of a deceased partner or the trustee of a bankrupt partner. A person who had been admitted as a partner and had acted as a partner would be treated as a partner in a question with a third party, even if they were not registered as such.
- (12) If the name of a person was without sufficient cause entered in or omitted or removed from the register, the register of partners could be rectified to show the true position.
- (13) There would be no need for a partner in a registered partnership to follow the notice provisions in section 36 of the 1890 Act on leaving the partnership.
- (14) The register would not be conclusive internally as between the partners.
- (15) It would be for consideration whether a registered partnership would last as a legal entity until removed from the register even if, for example, the partnership had been dissolved by the unanimous agreement of the partners or had been reduced to one member or no members.
- (16) A registered partnership could be struck off the register either when it had been dissolved as regards all the partners on the normal grounds or (if it were to be decided that a registered partnership must continue in existence until removed from the register) on specified grounds, and restored if the striking-off turned out to be unjustified.

20.84 We invite views on the following question:

**Do consultees have any suggestions as to how the scheme may be improved?**

20.85 A scheme for registered partnerships would have advantages to partnerships even if continuing personality is available without registration.<sup>60</sup> We invite views on the following question:

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<sup>60</sup> See para 20.2 above for the advantages in relation to doing business overseas and in holding and transacting in land. If registered partnerships were to be allowed to grant floating charges that would be another advantage; see part 22.

**Should a scheme for registered partnerships be introduced if continuing personality is available without registration?**

# **PART XXI**

## **PARTNERSHIP INFORMATION**

### **Introduction**

21.1 In this Part, we consider the provision of information about the partnership and its partners to third parties. We examine what information a third party might need to obtain, what information a third party currently has access to and how this is acquired, and how some reforms might facilitate the provision of partnership information.

### **The need for partnership information**

21.2 People deal with partnerships in a variety of ways – the sale and purchase of goods, the provision of services, the lease of property, and so on – without necessarily knowing who the partners are. They may deal with only one of the partners, or even with an employee. Yet if something goes wrong with the transaction, a third party may need to know more than simply the partnership’s name and address.

21.3 In England and Wales, where a partnership currently has no legal personality, the partners are liable for partnership obligations. In Scotland, although the partnership has primary liability for all debts and obligations which it incurs, the partners have a subsidiary liability.<sup>1</sup> If the partnership fails to meet any of its obligations, a third party can enforce these against the partners directly. This is also the case if the partnership has been dissolved. The third party will need to know the names of those who were partners immediately before the dissolution, and an address for each of them for the effective service of documents. The third party might also need to know the names and addresses of other former partners and the dates when they were partners, as they will be liable if they were partners at the time when the liability was incurred.

21.4 Someone dealing with a partnership might also want to know whether the partnership currently carrying on the business is the same one as the one which incurred the obligation. Even if our provisional proposal to allow partnerships to have continuing personality is introduced,<sup>2</sup> there will continue to be partnerships which do not continue on every change of membership, which might have an undisclosed break in continuity. The third party will want to know whether the partnership currently carrying on the business is the one to pursue.

21.5 In summary, the information which third parties may need to know includes:

- (a) the name and business address of the partnership;
- (b) the names and addresses of the partners;<sup>3</sup>

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<sup>1</sup> See Part 10 ‘Liability for Partnership Obligations’ above.

<sup>2</sup> See Part 4 ‘Legal Personality: Options for Reform’ above.

<sup>3</sup> This information is available under the Business Names Act in respect of partnerships to which that Act applies: see para 21.9 below.

- (c) the names and addresses of former partners;<sup>4</sup>
- (d) the dates of admissions, retirements and deaths of the partners; and
- (e) the continuity status of the partnership.

21.6 Some of this information is available in certain circumstances to third parties under existing law. It is desirable that any reform concerning the provision of information to third parties should be introduced uniformly in England and Wales and in Scotland. There is no reason why third parties should have access to more information about partnerships under one law than under the other, particularly if any reforms concerning legal personality are the same in both jurisdictions.

## **The present law**

### ***The Business Names Act 1985***

21.7 The Business Names Act 1985 regulates the provision of information about businesses to the public.<sup>5</sup> Because it does not just cover partnerships, its provisions are not specifically tailored to the needs of those dealing with partnerships.

21.8 The Act applies to partnerships which have a place of business in Great Britain and carry on business under a name which does not consist solely of the surnames of all of the partners who are individuals, and the corporate names of corporate partners.<sup>6</sup> The purpose of the Act is to protect people dealing with businesses by giving them access to information about the true owners.<sup>7</sup>

21.9 Partnerships to which the Act applies must state on their business documents<sup>8</sup> the name of each partner and an address in Great Britain for each of them for the effective service of documents relating to the business.<sup>9</sup> This information must be displayed on a notice in a prominent position where it can be easily read by customers or suppliers in any premises where the business is carried on and to which they have access.<sup>10</sup> This information must also be supplied by written notice to any person with whom anything is done or discussed in the course of business and who asks for it.<sup>11</sup> Partnerships of over 20 partners

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<sup>4</sup> This information is available in England and Wales under the Civil Procedure Rules: see para 21.13 below.

<sup>5</sup> 'Business' means individual traders and companies as well as partnerships.

<sup>6</sup> Section 1(1)(a), 1985 Act.

<sup>7</sup> During the Parliamentary debates on the introduction of these provisions in the Companies Act 1981, much was made of the consumer protection aspect, that is, allowing people to find out who ran businesses and how credit-worthy they were.

<sup>8</sup> Namely, 'all business letters, written orders for goods or services to be supplied to the business, invoices and receipts issued in the course of the business and written demands for payment of debts arising in the course of the business.'

<sup>9</sup> Section 4(1)(a), 1985 Act.

<sup>10</sup> Section 4(1)(b).

<sup>11</sup> Section 4(2).

are exempt from listing all of the partners on their business documents if they maintain at their principal place of business a list of the names of all of the partners, if none of the partners' names appear on the document except in the body of the text or as a signatory, and the documents state the address of the firm's principal place of business and that the list is open to inspection there.<sup>12</sup> The list must be available for inspection by any person during office hours.<sup>13</sup>

21.10 There are criminal and civil sanctions for failure to comply with these requirements. Breach of the provisions is punishable on summary conviction by a fine.<sup>14</sup> If the firm has breached its duties then any legal proceedings brought by it to enforce a right arising out of a business contract made when it was in breach must be dismissed if the other party had been unable to pursue a claim against the partnership because of the breach, or had suffered some financial loss in connection with the contract because of the breach.<sup>15</sup> However, if the other party to the contract brings the proceedings, the partnership's right to enforce any rights it has against that person is not prejudiced.<sup>16</sup>

21.11 The predecessor to the provisions in the 1985 Act was the Registration of Business Names Act 1916. This required registration, by written statement, of the business name, the general nature of the business, the principal place of business; the Christian names and surnames (and any former names), the nationality, the usual residence and the other business occupation (if any) of each individual partner, and the corporate name and registered or principal office of every corporate partner, and the date of commencement of the business.<sup>17</sup> The partners<sup>18</sup> were also required to notify the Registrar, within three months of cessation, that the partnership had ceased to carry on business, whereupon it could be removed from the register.<sup>19</sup> There was also a requirement to exhibit a certificate of registration, or a certified copy, in the principal place of business of the partnership<sup>20</sup> and to state the names of the current partners on business documents.<sup>21</sup> For a prescribed fee, a person could inspect the filed documents or require a certificate of registration, or a copy of or extract from any registered statement to be certified by the Registrar. These would be received in evidence in all legal proceedings.<sup>22</sup>

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<sup>12</sup> Section 4(3).

<sup>13</sup> Section 4(4).

<sup>14</sup> Sections 4(6) and (7) make it an offence to breach any of these provisions, without reasonable excuse. This is punishable by a fine of up to one-fifth of the statutory maximum. If a person is convicted a second or subsequent time of failure to state the relevant information on business documents or to provide it to a person who is entitled to request it, there is a liability to a fine of up to one-fiftieth of the statutory maximum for each day the contravention is continued – section 7(3).

<sup>15</sup> Section 5(1).

<sup>16</sup> Section 5(2).

<sup>17</sup> Section 3(1).

<sup>18</sup> Or personal representative of a deceased partner: s 13(1).

<sup>19</sup> Section 13. If the Registrar had reasonable cause to believe that a firm was not carrying on business, the firm could be notified that it would be removed unless an answer was received within one month. If the partnership did not reply, or replied that it was not carrying on business, the Registrar could then remove it from the register.

<sup>20</sup> Section 11.

<sup>21</sup> '...in all trade catalogues, trade circulars, showcards and business letters' - s 18(1).

<sup>22</sup> Section 16.

21.12 The 1916 Act, like the 1985 Act, contained criminal and civil sanctions for breach of its provisions.<sup>23</sup> A business could not enforce its rights under or arising out of a contract made or entered into whilst it was in default.<sup>24</sup> However, it could apply to the court on certain grounds for relief against the disability.

### ***The Civil Procedure Rules: England and Wales***

21.13 Where the claim has been brought either by or against a partnership in the name of the firm, the third party bringing or defending that claim may serve a notice on the firm requiring it to furnish 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 court has various powers in the event of failure to comply with the notice.<sup>26</sup>

### ***Court orders: Scotland***

#### COMMISSION AND DILIGENCE

21.14 Currently, a partnership with a descriptive name must generally sue and be sued in its own name plus the names of three of its partners (if there are three) in the Court of Session.<sup>27</sup> In *Mitchell v Grangemouth Coal Company*<sup>28</sup> the court allowed the pursuer a diligence to recover documents instructing who the partners were. It held that the rule is not absolute when the partnership is the defender, as someone could have a good claim against the partnership without necessarily knowing who the partners were.

#### THE ADMINISTRATION OF JUSTICE (SCOTLAND) ACT 1972

21.15 Section 1(1A)(b) of the Administration of Justice (Scotland) Act 1972<sup>29</sup> gives the court the power to order any person to disclose information as to the identity of any persons who appear to the court to be persons who might be defenders in any civil proceedings which appear to the court to be likely to be brought. The court may exercise the power on the application at any time of any person who appears to the court to be likely to be a party to or minuter in proceedings which are likely to be brought.<sup>30</sup> Therefore, someone wishing to sue the partners directly will be able to apply to the court for such an order.

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<sup>23</sup> Sections 7, 8, 11, 13 and 18.

<sup>24</sup> Section 8.

<sup>25</sup> CPR, Sched 1, RSC, O 81, rr 2(1) and 2(3) where the partnership is the claimant and defendant respectively. See also para 17.16 and consultation question (4) at para 17.17 above.

<sup>26</sup> The court may order the claimants or their solicitor to furnish the other party with such a statement and to verify it on oath or otherwise as may be specified in the order, or where the partnership is the claimant, it may order that further proceedings in the claim be stayed on such terms as the court may direct: CPR, Sched 1, RSC, O 81, rr 2(1) and 2(3).

<sup>27</sup> *Antermony Coal Company v Wingate* (1866) 4 M 1017. See Part 17 'Litigation' above.

<sup>28</sup> (1894) 2 SLT 104.

<sup>29</sup> Inserted by s 19 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985.

<sup>30</sup> Section 1(2), 1972 Act.

## **Criticisms of the present law**

### ***The Business Names Act 1985***

21.16 The 1985 Act does not apply to all partnerships. It covers only the provision of information about current partners.<sup>31</sup> Therefore it will not assist a third party seeking information about former partners, and their dates of admissions and retirements. Old business documents might contain this information, but a third party with a valid claim need not necessarily have any old letters or other documents, and partnerships of over twenty partners may never have included this information on such documents.

21.17 It is also unclear how the 1985 Act's provisions are enforced. Although there are criminal and civil sanctions, there is no regime in the statute for ensuring that businesses conform with it. The fact that something is a statutory requirement does not ensure compliance, as experiences under the 1916 Act show. There was a low incidence of compliance until banks began to insist on seeing evidence of registration before providing businesses with services. Given that the civil sanctions are not a complete bar to civil proceedings, it is also questionable how much of an incentive they are for compliance. A default might never come to light, as there is no way to check the validity of the information provided. As this information does not affect liability, there is no real incentive to keep it up to date.

### ***The Civil Procedure Rules***

21.18 A third party involved in litigation against a partnership does have a right to ascertain the names and addresses of any present and former partners who were partners at the time the cause of action accrued.<sup>32</sup> However, the third party is only able to serve the notice requiring the provision of this information once litigation has commenced.

### ***Procedure for obtaining court orders***

21.19 The procedures for obtaining information under court orders apply only in the context of litigation, and are therefore of limited value to third parties wishing to avoid going to court. Neither do they give the third party an automatic right to partnership information, as it is up to the court to grant the order.

## **Possible reforms**

21.20 We have already identified the information to which a third party should have access in dealing with a partnership.<sup>33</sup> We have also seen that the present law is inadequate in providing this information. In Part 17,<sup>34</sup> we have suggested some reforms which would

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<sup>31</sup> The 1916 Act also only provided that the current partners needed to be registered, but it is possible that old information was kept on the register. It was stated during the Parliamentary debates on the abolition of the register that it did contain a lot of historical information, but it is unclear what this was.

<sup>32</sup> Para 21.13 above.

<sup>33</sup> Para 21.5 above.

<sup>34</sup> 'Litigation.'

lessen the need for third parties to find out this information. These include allowing a partnership which has a legal personality to sue and be sued in its name alone, without the addition of any of its partners' names, and placing an obligation on any partner or former partner, if called upon, to provide information about the names and addresses of other partners or former partners who may also be liable and about any changes in the partnership's membership which might affect liability. These reforms, if implemented, would improve the third party's position. However, third parties may have an interest in obtaining partnership information otherwise than in the context of litigation. For example, a third party might want to find out the credit-worthiness of the partners before entering into a transaction with the partnership. If the registered partnership were to be introduced, third parties would be able to find out relevant information from the register. We consider below whether it is desirable to introduce further reforms to facilitate this.

21.21 In Part 4,<sup>35</sup> we consult on whether there should be rules to enable third parties dealing with a firm to treat the firm as continuing until they have notice of a change. If there were such rules, this would also reduce the need for partnership information, as the third party would not always need to know whether the partnership was a continuing one, although there might still be situations in which this information was useful.

21.22 We have already discussed the option of introducing registered partnerships and have invited consultees' views.<sup>36</sup> If consultees favoured the introduction of a registered partnership, this would provide information about those partnerships which did register. Third parties dealing with partnerships which did not register would not benefit from this. Even if the registered partnership is introduced, it will still be necessary to provide information about those partnerships which do not register.

21.23 We now consider three options for reform which would give third parties better access to partnership information without having to commence proceedings. These are:

- (a) a form of registration, similar to that in the repealed 1916 Act;
- (b) an extension of the requirements under the 1985 Act; and
- (c) giving a right to third parties to obtain information from the partnership.

21.24 We have considered the option of re-introducing a register like the Register of Business Names under the 1916 Act. We do not favour this option.<sup>37</sup> Establishing a new register would be costly, and undesirable if the registered partnership was also established. Requiring registration would place an unnecessary burden on small, informal partnerships. There would also be problems of enforcement. The 1916 Act, despite its civil and criminal sanctions, did not achieve full compliance.

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<sup>35</sup> See paras 4.44 - 4.45 above.

<sup>36</sup> Part 20 above.

<sup>37</sup> We also considered, for Scotland, the option of using the existing Books of Council and Session. Similar objections apply.

21.25 A simpler option would be to extend the categories of information required to be disclosed under the Business Names Act 1985.<sup>38</sup> The required information could include the names and addresses of any persons who had been partners in, say, the last ten years and the name of any other partnership whose business the partnership had taken over in, say, the last ten years.

21.26 There is, at first sight, some attraction in the option of giving third parties a right to obtain certain information from partnerships if, for example, they wanted to check the partners' credit-worthiness. This option would complement the requirements of the Business Names Act 1985. There might be four elements:

- (a) a right for the third party to demand information from a partnership;
- (b) a right for the third party to obtain a court order for the recovery of documents giving the information if the information had not been furnished voluntarily,<sup>39</sup> with the partnership to meet the third party's costs;
- (c) a court order if the information was still not forthcoming, ordering the partnership to provide the information; and
- (d) a finding of contempt of court if the court order was still not complied with.

21.27 The information which a partnership would be obliged to provide would be that identified in para 21.5, namely, the name and address of the partnership; the names of the current partners and an address for each of them for the service of documents; the names of former partners, together with details of the dates when they were partners; and whether the partnership is the same as the one which incurred the obligation.

21.28 Such a provision would place the onus on partnerships to maintain their own records of admissions to the partnership, retirements and deaths, as they could be in contempt of court if they did not furnish this information to a third party entitled to request it.

21.29 There would, however, be dangers and drawbacks in any such solution. Partnerships could be exposed to troublesome enquiries from third parties, perhaps business rivals out to cause difficulties. If a third party genuinely wanted to find out information for valid reasons, he could request it from the partnership.<sup>40</sup> If the partnership refused to meet the request, it would be open to the third party not to deal with the partnership. A third party already in a business relationship with the partnership would be able to request the information currently available under the 1985 Act.<sup>41</sup>

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<sup>38</sup> Under section 8 of the Electronic Communications Act 2000 it would be possible for secondary legislation to be drawn up authorising the use of electronic communications as an alternative method of fulfilling the requirements of the Business Names Act 1985.

<sup>39</sup> The form would be a matter for rules of court. In Scotland a commission and diligence would probably be the appropriate form.

<sup>40</sup> Either under the Business Names Act 1985 or otherwise.

<sup>41</sup> See paras 21.8 - 21.9 above.

21.30 It would clearly be necessary to limit the categories of third parties entitled to demand information. The obvious category would be those with claims against the partnership. However, people could hardly be allowed to impose obligations on the partnership merely by asserting the existence of a claim. If any control by a third party were introduced there would be a question whether it would not be sufficient to rely on the mechanisms whereby a court can order information to be divulged.<sup>42</sup>

21.31 We have not formed any provisional view on this issue but invite views on the following questions:

- (1) Should the categories of information required to be disclosed under the Business Names Act 1985 be extended to include the names and addresses of persons who had been partners in, say, the last ten years and the name and address of any partnership whose business the partnership had taken over in, say, the last ten years?**
- (2) Should third parties be given a right to obtain information, on demand, from a partnership about former partners and predecessor partnerships?**
- (3) If so, should the right be:**
  - (a) limited to third parties with a claim against the partnership;**
  - (b) limited in any other way;**
  - (c) enforceable by a court under the sanction of punishment for contempt of court?**

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<sup>42</sup> See also paras 17.16, 17.17(4), 21.13 and 21.15 above.

# PART XXII

## FLOATING AND OTHER CHARGES

### Introduction

22.1 In this Part we consider charges and rights in security granted over partnership assets.

### Existing law

#### *England and Wales*

22.2 As an English partnership lacks separate legal personality, security granted over partnership assets must be granted by the partners. Although it is often said that a partnership is incapable of granting a floating charge<sup>1</sup> there seems nothing inherently impossible about a sole trader or a member of a partnership granting one.<sup>2</sup>

#### INDIVIDUAL PARTNERS

22.3 Insofar as individual partners are concerned the historical position was that the provisions of the Bankruptcy Act 1914 meant that the availability of floating charges was not considered in practice.<sup>3</sup>

22.4 The granting of security by individuals over chattels (and in some cases over book debts) is governed by the Bills of Sale Acts 1878 and 1882.<sup>4</sup>

22.5 Section 5 of the 1882 Act requires the grantor of a bill of sale to be the true owner of the chattels. This does not prevent a partner charging partnership chattels because beneficial ownership of a share in the assets is sufficient for this purpose.<sup>5</sup>

22.6 The bills of sale legislation prevents an individual from granting a floating charge. This is because under the 1878 Act future property is outside the definition of property that

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<sup>1</sup> See for example Chadwick J in *Re West Park Golf & Country Club* [1997] 1 BCLC 20, 21. Although a partnership cannot create a floating charge, where all the partners are corporate they may be able to create a floating charge over the partnership assets; see paras 22.8 - 22.12 below.

<sup>2</sup> See W J Gough, *Company Charges* (2nd ed 1996) pp 52-55 and *Tailby v Official Receiver* (1880) 13 App Cas 523 at 541 where Lord Macnaughten suggested that the nature of a floating security as such is to “reach over all the trade assets of the mortgagor for the time being and intended to fasten upon and bind the assets in existence at the time when the mortgagee intervenes”.

<sup>3</sup> Under s 38 a bankrupt’s property for division among creditors included other people’s property in his possession with their permission if it was reputed to be his property. It also included “debts due or growing due to the bankrupt in the course of his trade or business”. These provisions, which have since been repealed, effectively prevented an individual from creating a floating charge, although Gough, *op cit*, states that the doctrine of reputed ownership did not necessarily apply in the partnership context.

<sup>4</sup> Agricultural charges are deemed not to be bills of sale: s 8(1), Agricultural Credits Act 1928. Under the 1928 Act, a separate regime exists for granting charges over farming stock and agricultural assets.

<sup>5</sup> *Re Tamplin, ex p Barnett* (1890) 62 LT 264.

can be charged under a bill of sale.<sup>6</sup> The bill must have scheduled to it an inventory of the chattels charged<sup>7</sup> and is void if statutory formalities are not followed.<sup>8</sup> If it purports to assign by way of mortgage present and future property it will be void.<sup>9</sup>

22.7 The Bills of Sale Acts apply only to chattels and not to choses in action. However, a general assignment (including an assignment by way of security or a charge)<sup>10</sup> by a trader of existing or future book debts is void against a trustee in bankruptcy, unless it is registered as if it were an absolute bill of sale.<sup>11</sup> The bills of sale regime causes some degree of inconvenience and expense, although it provides creditor protection through publicity of charges.<sup>12</sup>

#### CORPORATE PARTNERS

22.8 If all the partners are corporate then there would seem to be no reason why they should not together grant a floating charge over the partnership assets.<sup>13</sup> Every partner has a beneficial interest in each and every partnership asset and therefore the partnership assets are the property of the companies and therefore capable of forming the subject matter of a floating charge granted by all the corporate partners. This would be registrable by each company as a “floating charge on the whole or part of the company’s property”<sup>14</sup> and as a “floating charge on the company’s undertaking or property”.<sup>15</sup> Each corporate partner

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<sup>6</sup> This is because it is not “capable of complete transfer by delivery” ie delivery at the time of execution of the bill: see *Thomas v Kelly* (1888) 13 App Cas 506.

<sup>7</sup> Bills of Sale Act 1882, s 4.

<sup>8</sup> Sections 3 and 8, 1882 Act.

<sup>9</sup> Under s 9 of the 1882 Act: see *Thomas v Kelly*, above. A reference to future property in a registered bill of sale would not undermine its validity in relation to present property. It may be that security given only in respect of future property would escape registration under the Bills of Sale legislation but see para 22.7 in relation to choses in action and future book debts. Also see *United Builders Pty Ltd v Mutual Acceptance Ltd* (1980) 33 ALR 1 in which one corporate partner gave the other partner a charge over “all its right title and interest” in the partnership. This was held to be a fixed charge secured on the mortgagor partner’s chose in action in relation to its share on dissolution. In the dissenting judgment it was held to be a floating charge since it extended to rights to be exercised in the course of management of the partnership.

<sup>10</sup> Insolvency Act 1986, s 344 (3)(a).

<sup>11</sup> Insolvency Act 1986, s 344(2). This does not apply to an assignment of book debts due at the date of assignment from specified debtors, or debts growing due under specified contracts, or an assignment of book debts included in a transfer of a business made in good faith and for value or in an assignment of assets for the benefit of creditors generally: s 344(b). See *In re Briggs & Co ex p Wright* [1906] 2 KB 209 for an example of assignment by a partnership of book debts by way of a deed and schedule of debts.

<sup>12</sup> There have been a number of calls for reform: see the Crowther Report on Consumer Credit (1971) Cmnd 4596 (para 4); The Report of a Working Party on Security over Moveable Property (published by the Scottish Law Commission in March 1986); The Review of Security Interests in Property, 1989, HMSO (The Diamond Report, paras 1.13, 12.4.2, 18.1.8 and 23.9.14); and The DTI Consultation Paper on Security over Moveable Property in Scotland (November 1994).

<sup>13</sup> See for example *Bailey v Manos Breeder Farms Pty Ltd* [1990] 3 ACSR 143 and *Bailey and Ors v Manos Breeder Farms Pty Ltd* [1991] SASC 2799.

<sup>14</sup> Section 396(1)(e) in its present form. Section 396 of the Companies Act 1985 deals with the charges which require registration in the company charges register. The Companies Act 1989 ss 92 - 104 inserted new ss 395 - 420 in place of ss 395 - 408 and 410 - 423 of the Companies Act 1985 but these have not been brought into force and it is now unlikely that they will be brought into force in their present form.

<sup>15</sup> Section 396(1)(f) as inserted by the Companies Act 1989.

would also have to comply with its duties to keep copies of the instruments creating or evidencing the charge and maintaining a register of all charges at its registered office.<sup>16</sup>

22.9 The bills of sale legislation would not apply to a charge by corporate partners.<sup>17</sup>

22.10 The provisions of the Insolvent Partnership Order<sup>18</sup> may, however, make it unattractive for lenders to lend to a corporate partnership on the security of a floating charge. The terms of a contract of floating charge usually allow the chargee to appoint an administrative receiver<sup>19</sup> and the holder of a floating charge normally has the power to prevent the court making an administration order.<sup>20</sup> However the Insolvent Partnerships Order would not allow the creditor to block the appointment of an administrator by somebody else. Provision is made only for such blocking to take place where an agricultural partnership has granted a charge.<sup>21</sup>

22.11 Practitioners have informed us that there are other uncertainties in insolvency law as it applies to partnerships that are wholly or partly corporate which may make it unattractive or difficult for floating charges to be used. Particular problems arise in relation to foreign corporations which is unfortunate given that we are informed that they are heavily involved in financing large infrastructure projects in the United Kingdom.<sup>22</sup>

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<sup>16</sup> Sections 406 and 407 as inserted by CA 1989 whereby companies must keep at their registered offices a copy of every instrument creating a charge requiring registration and a register of charges. The Companies Act 1989, ss 92 - 104 inserted new sections in place of ss 395 - 420 and 410 - 423 of the Companies Act 1985. Consequently, see ss 411 and 412 of the proposed amendment however, as pointed out in n 14 above, it is unlikely that the proposed amendments will be brought into force in their present form.

<sup>17</sup> According to W J Gough, *Company Charges* (2nd ed 1996) pp 55, 863-867, the provisions of the bills of sale legislation in general apply only to individuals and not to companies. In *NV Slavenburg's Bank v Intercontinental Natural Resources Ltd* [1980] 1 WLR 1076, 1098, Lloyd J reviewed the authorities extensively and concluded that 'the Bills of Sale Acts apply to individuals only and not to corporations at all'. Subsequent legislation leaves this position unchanged.

<sup>18</sup> SI 1994 No 2421.

<sup>19</sup> Section 29(2), Insolvency Act 1986.

<sup>20</sup> Section 9(2) and (3), Insolvency Act 1986.

<sup>21</sup> Insolvent Partnership Order, art 6, Sched 2, para 3 which apply the provisions of s 9 of the Insolvency Act with modifications.

<sup>22</sup> One such uncertainty is as to the applicability of the Insolvent Partnership Order 1994 to a partnership consisting of foreign corporate partners. It is unclear whether the word "company" in Article 2, which defines "corporate member" as "an insolvent member which is a company", applies to foreign registered corporations. Secondly, there is doubt as to the availability of administration orders and corporate voluntary arrangements to partnerships consisting of foreign companies. Articles 6 and 10 apply the relevant provisions of the Insolvency Act to partnerships but there is doubt as to whether these types of procedures can apply to foreign companies. See the following articles by Gabriel Moss QC:- "Insolvency Administration for Foreign Companies in England" (1993) 15 Comparative Law Year Book of International Business 3; "Administration Orders for Foreign Companies" (1993) 6 Insolvency Intelligence 19; "Administration Orders for Foreign Companies Revisited" (1994) 7 Insolvency Intelligence 33. Although a partnership consisting solely of individuals would not grant a floating charge for the reasons set out above, a mixed partnership of individual and corporate partners might grant one. That would result in an anomalous situation. The assignment of book debts would be void as against a trustee in bankruptcy of an individual partner, see s 344 of the Insolvency Act 1986, but would not be invalid as against the partnership liquidator. Another anomaly arises in relation to s 245 of the Insolvency Act 1986 which avoids certain floating charges created by companies but which would not apply to partnerships. In considering the validity of a floating charge granted by a mixed partnership it is necessary to examine three provisions

22.12 Although partnership insolvency is outside our terms of reference, we are interested in the views of consultees as to the need, if any, for reform in relation to uncertainties in the Insolvent Partnership Order.

### ***Scotland***

22.13 Partnerships in Scotland have a separate legal personality, and so can own property, although historically they could not be infeft in feudal land.<sup>23</sup> In so far as a Scottish partnership can own property, it can grant security over that property. Thus, a Scottish partnership can grant a pledge over moveable property, can assign incorporeal property, such as book debts, in security, and can grant a standard security over a recorded lease.<sup>24</sup> There are no registration requirements, except for standard securities.<sup>25</sup> Security over corporeal moveables is possible only by giving up possession and intimation is necessary before an assignation of incorporeal property will take effect. The floating charge in Scotland is entirely a creation of statute and can be granted only by “incorporated companies”.<sup>26</sup> Accordingly, a Scottish partnership, despite its separate personality, cannot grant a floating charge.

### **Possible reforms**

#### ***Partnerships without legal personality***

22.14 Since such partnerships will remain unable to own property, they will not themselves be able to grant security. It is outside our terms of reference to consider charges granted over assets of partnerships without separate personality, since the question is indistinguishable from that of security granted by individuals. Accordingly, we propose no change in relation to firms without legal personality.

**No change is proposed to the law on the granting of charges by partnerships without legal personality.**

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namely ss 245 and 344 of the Insolvency Act and s 9 of the Bills of Sale Act 1882. This appears unduly complex but may well not arise in practice. There is a last problem which applies whether the partners are corporate or individual and this relates to s 238 of the Insolvency Act which sets aside transactions at an undervalue. The Insolvent Partnerships Order provides for partnerships to be wound up as unregistered companies and purports to apply the provision but its wording is inapt because it refers only to companies. A purposive construction would overcome this problem and it is to be hoped that such a construction would be adopted.

<sup>23</sup> This anomaly will be removed when s 70 of the Abolition of Feudal Tenure etc (Scotland) Act 2000 is brought into force.

<sup>24</sup> Conveyancing and Feudal Reform (Scotland) Act 1970, s 9(2) and (8)(b).

<sup>25</sup> There are registration provisions for statutory securities: ship mortgages, Merchant Shipping Act 1995, s 16(1) and Schedule 1 paras 7 - 13; aircraft mortgages, Civil Aviation Act 1982 s 86 and The Mortgaging of Aircraft Order 1972, SI 1972/1268.

<sup>26</sup> Companies Act 1985, s 462.

## ***Registered partnerships***

### INTRODUCTION

22.15 If registered partnerships were to be introduced it would be possible to devise a new regime for the granting of charges and rights in security by such partnerships. The obvious model would be the regime applying to companies.

### A REGIME MODELLED ON COMPANY CHARGES

22.16 Under section 396(1) of the Companies Act 1985 which applies in England and Wales the following company charges must be registered within 21 days from the date of creation of the charge:

- (1) a charge for the purpose of securing any issue of debentures;
- (2) a charge on uncalled share capital of the company;
- (3) a charge created or evidenced by an instrument which, if executed by an individual would require registration as a bill of sale;
- (4) a charge on land (wherever situated) or any interest in it, but not including a charge for any rent or other periodical sum issuing out of the land;
- (5) a charge on book debts of the company;
- (6) a floating charge on the company's undertaking or property;
- (7) a charge on calls made but not paid;
- (8) a charge on a ship or aircraft or any share in a ship; and
- (9) a charge on goodwill or on any intellectual property.

22.17 Companies registered in Scotland have a separate regime for the registration of charges in section 410 of the Companies Act 1985. The company charges covered by that section<sup>27</sup> must be registered within 21 days from the date of creation of the charge.

22.18 The company system is aimed at transactions and not merely at documents. Unlike the bills of sale regime, it covers oral securities. Charges created by a company must be registered with the Registrar of Companies<sup>28</sup> and in its own register of charges.<sup>29</sup> The

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<sup>27</sup> Section 410 applies to (a) charges on land or any interest in land, (b) a security over uncalled share capital of the company, (c) a security over the following categories of incorporeal moveable property: book debts, calls made but unpaid, goodwill, a patent or a licence under a patent, a trademark and a copyright or a licence under a copyright, (d) a security over a ship or aircraft or any share in a ship, and (e) a floating charge.

<sup>28</sup> Section 395 of the Companies Act 1985 provides that "prescribed particulars" (including the name of the company, description of the charge instrument, the amount secured and short particulars of the property charged: see ss 397 and 410, Companies Act 1985, SI 854/1985) of the charges created by companies

purpose of the public register is to allow those dealing with the company to find out whether the company has encumbered its property.<sup>30</sup> This is not necessarily linked to the limited liability of the members of a company. Unlimited companies are subject to the same registration system.<sup>31</sup>

22.19 The effect of registration differs from that under the bills of sale legislation. Under the Companies Acts registration is a perfection requirement.<sup>32</sup> Failure to register renders the charge void against the liquidator and any creditor of the company.<sup>33</sup> In English Law priority is determined from the date of creation rather than the date of registration. In Scots Law, priority is determined by the date of registration.<sup>34</sup> Additionally an unregistered charge by a company remains valid between the parties, while under the bills of sale legislation registration is obligatory to preserve the security against the grantor.<sup>35</sup>

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registered in England must be delivered to the Registrar within 21 days of their creation, together with the instrument, if any, creating them. The equivalent provision for Scotland (s 410) specifies different charges and requires certified copies of the instruments creating the charges. If the charge is not registered, its holder is reduced to the level of an unsecured creditor: Companies Act 1985, ss 395 (England) and 410 (Scotland).

<sup>29</sup> In England, every limited company (and in Scotland all companies: s 422) must keep a register of all floating charges on the undertaking or any property of the company: Companies Act 1985, s 407. The register must give a short description of the property charged, the amount of the charge, and, except in the case of bearer securities, the names of the persons entitled to it. Every company, both in England (Companies Act 1985, s 406) and Scotland (Companies Act 1985, s 421), must also keep a copy of every instrument creating a charge required to be registered. This should be available for public inspection. The statutory system of registration was intended to be changed by Part IV of the Companies Act 1989. However, those changes have not yet been brought into force. A DTI consultative document of November 1994 entitled 'Company Law Review: Proposals for Reform of Part XII of the Companies Act 1985' proposed changes to the system of registration. The issues raised in the consultative document of November 1994 are being examined in the Company Law Review.

<sup>30</sup> *Re Jackson and Bassford Ltd* [1906] 2 Ch 467. See the President of the Board of Trade in the House of Commons on the Second Reading of the Companies Bill 1900: "Another evil which at present exists is that when it comes to the winding up of some companies it is found that the whole of the available assets of the company are mortgaged, and there is nothing at all to divide amongst the unhappy creditors. The only remedy that can apply to this particular evil is to take care that publicity is given to any mortgages which exist...". *Hansard* (HC) 26 June 1900, vol 84, col 1143. And see the Diamond Report, *A Review of Security Interests in Property* (HMSO February 1989) p 98.

<sup>31</sup> Companies Act 1985, ss 395 and 410(5).

<sup>32</sup> Perfection has been described by Professor Goode as the taking of additional steps prescribed by law for giving public notice of the security interest so as to bind third parties. See Goode, *Commercial Law* (2nd ed 1995) 673 - 674.

<sup>33</sup> Companies Act 1985, s 395(1). For these purposes, creditor means a person with rights over the property charged (eg a subsequent encumbrancer) and does not include an unsecured creditor, unless the company has gone into liquidation. For Scotland see s 410(2).

<sup>34</sup> In Scotland s 464(4) provides that it is the creation of a real right which determines the priority of the charge. Therefore, floating charges will rank with one another and with other securities according to the time of registration. See also s 410(5) of the Companies Act 1985 which provides that in Scotland a charge, other than a floating charge, is created when a real right in security is constituted.

<sup>35</sup> See para 22.6 above.

22.20 Although the system of registration of company charges is not perfect<sup>36</sup> we think it would be preferable to apply this system, so far as applicable, to registered partnerships rather than devise an entirely new system or, in England and Wales, extend the bill of sale regime<sup>37</sup> to such partnerships. This is also the approach adopted in the draft regulations for LLPs.<sup>38</sup>

22.21 If the company charges registration system were to apply to the registered partnership it would be necessary to disapply certain categories of charges that need to be registered for companies. The partnership will not have transferable shares and therefore could not charge its uncalled share capital or calls made but not paid. Neither of these provisions<sup>39</sup> should apply to the registered partnership.<sup>40</sup> A more controversial matter is whether registered partnerships should be permitted to grant floating charges.

#### FLOATING CHARGES

22.22 The primary advantage of the floating charge to the person granting it is its flexibility.<sup>41</sup> Security can be taken over property for which it is impracticable to have a fixed charge, notably stock in trade. Management autonomy over the assets subject to the floating charge is preserved. Finance can be obtained while all assets are retained within the business. There may be circumstances in which a business may wish to offer *all* its assets as security to a lender. Concentrating security in one lender, with both fixed and floating charges, may produce the cheapest source of finance.

22.23 Floating charges also have disadvantages for those granting them.<sup>42</sup> Although the object of floating charges is to increase the ability of a business to raise money and gain credit, they can have the opposite future effect.<sup>43</sup> If a floating charge is issued over all the

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<sup>36</sup> See generally the Diamond Report, *op cit*.

<sup>37</sup> The bill of sale focus on the instrument rather than the transaction is unhelpful. The Crowther Report on Consumer Credit (1971) Cmnd 4596 felt that the regulation of transactions according to their form instead of according to their substance and function was a grave weakness in the law. The legislation on bills of sale is also complex, and there are few who would like to see it extended.

<sup>38</sup> DTI Consultation Document "Limited Liability Partnerships Draft Bill" (July 1999), draft Reg 4, Sched 2.

<sup>39</sup> *Ie*, CA 1985, s 396(1)(b) and (g), s 410(4)(b) and (c)(ii).

<sup>40</sup> This would then mirror the position adopted by the DTI for LLPs: draft Reg 4, Sched 2.

<sup>41</sup> The existence of such a charge over the whole or substantially the whole of the company's undertaking effectively entitles the chargee to veto any proposal for an administration order: Insolvency Act 1986, ss 9 and 10.

<sup>42</sup> For a further discussion of these disadvantages, see *Alternative Company Structures for Small Business*, Chartered Association of Certified Accountants, Research Report 42, by Andrew Hicks, Robert Drury and Jeff Smallcombe, 1995, para 13.2.2. There may also be disadvantages from the chargee's point of view. The management autonomy of the business over the subject matter of the charge allows for the creation of a fixed charge over specific assets. Unless the floating charge provides otherwise and the fixed chargee has notice of that provision, the fixed charge will take priority. *Wheatley v Silkstone, etc, Coal Co* (1885) 29 ChD 715. In Scotland a floating charge may contain a prohibition against the grant of further securities: CA 1985, s 464(1). Details of the prohibition may be registered: CA 1985, s 417(3)(e). The subsequent charge holder is thereby put on notice.

<sup>43</sup> There are some organisations representing small business who have called for the abolition of floating charges: Union of Independent Companies, *Common Sense: Floating Towards Disaster* (1994); Small Business Bureau Policy Unit, *Finance for Independent Manufacturers* (1993).

assets of the business, its creditworthiness may be exhausted. Another floating charge cannot be granted over the same assets to rank in priority to or *pari passu* with the original charge, unless the original charge allows this.<sup>44</sup> Suppliers who are aware there is a floating charge are less likely to give credit. They know they are unlikely to receive anything in the event of the business' insolvency.

22.24 Floating charges may also have undesirable social consequences. The Cork Report<sup>45</sup> commented that "the floating charge has serious disadvantages, and is capable of working great injustice",<sup>46</sup> and that, along with preferential debts, "[i]t has, as much as any other single factor, brought the law of insolvency into disrepute".<sup>47</sup> Floating charges lead to a low level of distributions to unsecured creditors;<sup>48</sup> while the chargee (for example, a bank) is substantially paid, ordinary creditors (for example, unpaid sellers)<sup>49</sup> receive nothing. Further, the chargee's power to enforce the security may undermine other provisions aimed at rescuing the business.<sup>50</sup> There is some evidence that banks take 'lightweight' floating charges solely in order to veto an administration order.<sup>51</sup> In our view such a restraint on a formal rescue procedure is undesirable.<sup>52</sup>

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<sup>44</sup> *Re Automatic Bottle Makers Ltd* [1926] Ch 412 (CA).

<sup>45</sup> Insolvency Law and Practice, Report of the Review Committee (1982), chaired by Sir Kenneth Cork, CBE, Cmnd 8558.

<sup>46</sup> *Ibid*, para 105.

<sup>47</sup> *Ibid*, para 1480.

<sup>48</sup> *Ibid*, para 437. However, it should be noted that floating charges may be avoided if created two years before a company's insolvency if the chargee is connected with the company, and one year for any other person: Insolvency Act 1986, s245.

<sup>49</sup> *Re London Pressed Hinge Co Ltd* [1905] 1 Ch 576.

<sup>50</sup> See the proposal in the consultative document 'Facilitating Administrations' (15th February 1996) under which a court would have been able to appoint an administrator where floating security was not at risk. Also see the proposal in the Insolvency Service consultative document 'Revised Proposals for a New Company Voluntary Arrangement Procedure' (April 1995) under which banks would have had to give five days notice before appointing an administrative receiver to allow for the possibility of a corporate voluntary arrangement. This latter proposal effectively appeared in a twelve-point Code produced by the British Bankers Association (1 July 1997). This includes a requirement to support rescue procedures they believe will succeed (Principle 9); and a qualified commitment that a bank will not normally seek the immediate appointment of a receiver or start other recovery proceedings (Principle 10).

<sup>51</sup> Insolvency Act 1986, ss 9(2) and (3). A 'lightweight' floating charge is a floating charge taken by a lender in addition to a fixed charge (notwithstanding that specific security may fully secure the lender's exposure) in order that the lender might avail himself of various provisions in the Insolvency Act 1986 dependent upon holding a floating charge. Consequently such charges may not contain all the covenants and restrictions usually contained in floating charges. Where there are two or more lenders with floating charges it is argued that the lender whose combination of fixed and floating charges has overall priority to the whole or substantially the whole of the assets, is entitled to appoint an administrative receiver, which in the absence of the floating charge would not be the case: F Oditah, "Lightweight floating charges" [1991] JBL 49.

<sup>52</sup> The Insolvency Bill 2000, currently before Parliament, proposes to introduce a moratorium to assist a company in putting in place a voluntary arrangement. Whilst in force, the moratorium would prevent crystallisation of a floating charge or action by creditors.

22.25 There is no doubt that floating charges can have an adverse impact. However, whilst recommending reform,<sup>53</sup> the Cork Report accepted that the floating charge had become so fundamental a part of the financial structure that its abolition could not be contemplated.<sup>54</sup> It is important to recognise that, whatever its flaws, there is at present no discernible momentum behind the abolition of the floating charge.

22.26 On a practical level it is not clear whether partnerships have any real need for floating charges. Financing is clearly crucial for all business. However, a report produced for ACCA<sup>55</sup> suggested that the floating charge may not be important for the smaller business. Only 15 out of a sample of 90 companies surveyed had issued floating charges. None of the companies or advisers questioned (120 in total) saw the ability to issue floating charges as an advantage of the limited company or a reason for incorporation. It was suggested that this may be because many small firms do not have sufficient circulating or fixed assets free of security to cover the costs of receivership and offer a reasonable return to the bank. As partnerships are often amongst the smallest of businesses, it could be argued that they do not need floating charges. Indeed it has been suggested that if a business is of such a size that a floating charge becomes a viable means of raising finance, it would probably be appropriate for it to become a limited company.

22.27 A floating charge is a normal and accepted facility available to registered businesses. The fact that smaller partnerships may not use it is not a good reason to exclude its availability. It would be unattractive if growth were to be impeded by the lack of this means of security and if its unavailability to partnerships led to inappropriate incorporation with limited liability. Accordingly, we provisionally propose that a registered partnership should be able to issue a floating charge.<sup>56</sup> This would, in Scotland, require express permissive legislation. Statutory provision would be required both to authorise the creation of the floating charge and to introduce the receivership of the assets of the registered partnership.

22.28 We invite views on the following provisional proposal:

**If registered partnerships are introduced, they should be permitted to grant floating charges.**

### ***Unregistered partnerships with legal personality***

22.29 If partnerships were to have legal personality without registration, either in Scotland as at present or in England and Wales as well, it would be possible for them to own and

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<sup>53</sup> Suggested reforms included permitting the general body of creditors to participate in up to ten per cent of the proceeds of assets comprised in the floating charge, registration of a monetary limit on the amount secured by the charge and allowing the creation of floating charges by individuals. These reforms have not been implemented.

<sup>54</sup> The Cork Report, *op cit*, para 1531 *et seq*. The Crowther Report similarly considered it to be “an essential function of English credit law to provide the commercial world with an effective, flexible and economic method of taking security interests in personal property of all kinds” (para 5.5.8). See also DTI, *A New Form of Incorporation for Small Firms*, *op cit*, para 4.17.

<sup>55</sup> *Alternative Company Structures for Small Business*, Chartered Association of Certified Accountants, Research Report 42, by Andrew Hicks, Robert Drury and Jeff Smallcombe, 1995.

<sup>56</sup> The registered partnerships should be expressly excluded from the operation of the Bills of Sale Acts.

grant charges or rights in security over property. However, the absence of any entry in a register of partnerships would mean either that the law applicable to individuals would have to apply to such charges and rights in security or that a special register would have to be set up. The latter, we think, would not be justified for partnerships alone.<sup>57</sup> Accordingly we suggest that unregistered partnerships with legal personality should be able to grant charges and rights in security in the same way as individuals. This would mean that they would not, unless the law was reformed as part of a general reform of the law on security rights or interests,<sup>58</sup> be able to grant floating charges. They would be able to grant securities over land in the usual way. So far as chattels in England and Wales are concerned, the bill of sale rules would apply. So far as corporeal moveable property in Scotland is concerned the existing inadequate law on pledges would apply. There is a need for reform in this area but it is a general need, not confined to partnerships.

22.30 We invite views on the following provisional proposal:

**Unregistered partnerships with legal personality should be able to grant charges or rights in security in the same way as individuals.**

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<sup>57</sup> There may be a case for a new system of registered securities generally. That is beyond our terms of reference.

<sup>58</sup> Such reform has been under consideration for some time. See the Crowther Report on Consumer Credit (1971) Cmnd 4596 (paras 4.2, 12 and 5.7.77); The Report of a Working Party on Security over Moveable Property (published by the Scottish Law Commission in March 1986); the Review of Security Interests in Property, 1989, HMSO (The Diamond Report); The Cork Report para 1538 *et seq*; The DTI Consultation Paper on Security over Moveable Property in Scotland (November 1994).

# **PART XXIII**

## **MISCELLANEOUS QUESTIONS**

### **Introduction**

23.1 In this Part we consider some miscellaneous points which do not belong clearly in any of the preceding parts of this Paper.

### **Continuing guaranty or cautionary obligation: section 18**

#### ***Existing law***

23.2 Section 18 of the Partnership Act 1890 provides that:

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.

This provision reflects the pre-1890 law in both England and Wales and Scotland.<sup>1</sup> It covers two situations – the granting of a guaranty that a debtor of the partnership will perform and the granting of a guaranty that the partnership will perform.

#### ***Possible reform***

23.3 The question for consideration is whether this section is now necessary or useful, particularly if there were to be an increase in the number of partnerships with continuing personality. Should the normal rule be that an obligation of the type mentioned continues, notwithstanding changes in the membership of the firm, unless it provides to the contrary, or that it comes to an end on every change in membership, unless it provides to the contrary?

23.4 The policy considerations differ in the two situations covered by the section. Where the guaranty is that a debtor of the partnership will perform it is not easy to see why the default rule should be that changes in the membership of the partnership (the creditor in the primary obligation) should bring the guaranty or cautionary obligation to an end, assuming that the partnership continues as the same legal person. If the partnership does not continue as the same legal person then a guaranty granted to the old partnership (and not to the “house” or to the old partnership and its successors as creditor in the primary obligation) would automatically come to an end when it ceased to exist. In this situation the section seems to be either unnecessary or inappropriate.

23.5 Where the guaranty is that the partnership will perform its obligation it is easier to justify a default rule that a change in the composition of the partnership will bring the guaranty or cautionary obligation to an end, even if the partnership has a continuing legal

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<sup>1</sup> See *Lindley & Banks*, paras 3.43 – 3.46; Miller, 284 – 289.

personality. It can be argued that the risk depends on the trustworthiness of the partners for the time being. Against this it can be argued that those granting continuing guarantees or cautionary obligations nowadays are well able to look after themselves and to insert whatever terms they consider useful for their protection and that the section is not necessary. This argument does not seem, however, to be strong enough to justify a change in the default rule where the partnership is the debtor in the primary obligation.

### ***Invitation for views***

23.6 Our provisional view is that there is no reason to change section 18 for the case where the partnership is the debtor in the primary obligation but that the section makes little sense in the case where the partnership is the creditor in the primary obligation. We have reached no conclusion on this point but invite views on the following question:

**Should section 18 of the 1890 Act (“Revocation of continuing guaranty by change in firm”) be amended so that it would not apply:**

- (a) where the partnership (whether or not it has a continuing legal personality) is the creditor in the primary obligation; or**
- (b) where the partnership has a continuing legal personality and is the creditor in the primary obligation?**

### **Continuing expired partnership: section 27**

#### ***Existing law***

23.7 Section 27 of the 1890 Act provides that:

(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.

23.8 The section is dealing with the situation where a new partnership is formed by tacit agreement. If there was, before the expiry of the fixed term, a tacit agreement to alter the terms of the partnership agreement so that it was no longer for a fixed term, or was for a new fixed term, then the section would be unnecessary. The terms, as modified by agreement, would simply apply in the normal way. What the section does, therefore, is modify the statutory default rules which would normally apply to a new partnership formed by tacit agreement by replacing them with the rules of the old partnership agreement, so far as consistent with the incidents of a partnership at will. A power to expel, in the case of a large professional partnership, has been held to be consistent with the incidents of a partnership at will.<sup>2</sup>

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<sup>2</sup> *Walters v Bingham* [1988] 1 FTLR 260.

### ***Possible reform***

23.9 The drafting of section 27 could be improved. The word “continued” is misleading because technically the old partnership has not been continued. It has ended on the expiry of the fixed term and has then been tacitly replaced or renewed. This point is not important enough for a proposition or question but could be taken into account in any redrafting of the provision. The only more substantive reform which might, in our view, be suggested is that the reference to a partnership at will (a term not defined or explained in the Act) might be replaced by a reference to a partnership of undefined duration from which any partner could withdraw on giving notice. If suggestions made earlier were to be accepted, the effect of a notice of withdrawal, in any case where two or more partners would remain, would be that the notice would not dissolve the partnership as regards all the partners.<sup>3</sup>

### ***Invitation for views***

23.10 We have formed no provisional view on this question, which is to some extent conditional on what is done to section 26, but invite views on the following question:

**Should the reference to a partnership at will in section 27 (“Where partnership for term is continued over, a continuance on old terms presumed”) be replaced by a reference to a partnership of undefined duration where any partner has the right to withdraw on giving notice?**

### **Rights of assignee of share in partnership: section 31**

#### ***Existing law***

23.11 Section 31 of the 1890 Act provides that:

(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.

23.12 The effect of this provision is that an assignment (or, in Scotland, an assignation) of a partner’s share does not make the assignee a partner, or cause the assignor to cease to be a

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<sup>3</sup> See paras 6.16 – 6.19 above.

partner, but only gives the assignee certain financial rights. The value of these financial rights is at the mercy of the partners who could, for example, pay more in salaries or expenses in order to diminish the profits.

### ***Possible reform***

23.13 The policy underlying section 31 seems satisfactory. The section is hard on the assignee but that is necessary if the element of personal choice in partnership is to be adequately respected.

23.14 One possible reform would be to make it clear in the section that the assignment or assignation did not cause the assignor to cease to be a partner or the assignee to become a partner. It is not like the transfer of a share in a company. Indeed, it is not so much an assignment or assignation of a share in the partnership as an assignment or assignation of the partner's financial rights in the partnership. We are not convinced, however, that any redrafting on these lines is necessary. It is clear enough from the terms of the section that the assignee does not become a partner or the assignor cease to be a partner.

23.15 Another possible reform would be to extend the principle of section 31 to anyone acquiring a partner's share otherwise than by assignment or assignation, for example by the operation of the law on bankruptcy, while the partner remains a partner. No such extension would be necessary in the case of a deceased partner because the deceased partner would not remain a partner and the right to a share in the partnership would, if suggestions made earlier were adopted,<sup>4</sup> be converted into a right to be paid the value of the share. For the same reason, no such extension would be necessary where a partner ceased to be a partner on becoming bankrupt. It is, however, possible, although perhaps unlikely, that a partner whose share had passed to a third party by operation of law might continue to be a partner in terms of the partnership agreement.

### ***Invitation for views***

23.16 The problem does not seem to be acute but, for completeness, we invite views on whether some provision analogous to section 31 would be useful for those cases where a person other than a partner acquires a partner's share by operation of law while the partner remains a partner.

**Should the principle of section 31 of the 1890 Act (that an assignee of a partner's share in a partnership acquires financial rights but no rights to act as a partner) be extended to those acquiring a partner's share by operation of law while the partner remains a partner?**

### **Preserving the rules of equity and common law**

23.17 Section 46 of the 1890 Act provides that:

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 the Act.

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<sup>4</sup> See paras 7.13 – 7.17 above.

We think a similar provision should be contained in the new Partnership Act although we recognise that much of the common law will no longer be applicable if, as we suggest, all partnerships will have continuing legal personality under the new Act. This will not be a problem however if the Act is clear as to the consequences of separate personality.

23.18 We invite views on the following provisional proposal:

**The rules of equity and common law should be expressly preserved in the new Partnership Act.**

### **Criminal proceedings against partnerships**

23.19 An anomaly in the law of Scotland concerning criminal proceedings against partnerships has been brought to our attention. It is possible for summary criminal proceedings to be brought against partnerships in their own name but not for solemn proceedings to be so brought.<sup>5</sup> There may be cases, such as those where a partnership has caused the deaths of many people by selling poisonous food, where the Crown would wish to use solemn procedure.

23.20 We invite views on the following provisional proposal:

**It should be possible to prosecute partnerships in Scotland not only by summary procedure but also by solemn procedure.**

### **Employment of partner by firm**

23.21 There is doubt in the law of Scotland as to whether a partnership can enter into a contract of employment with one of its partners.<sup>6</sup> As the firm is a separate legal person, we see no reason why it should not be able to employ one of its partners and we provisionally propose that the law should be changed to make this possible.

**It should be made clear that where a partnership has a separate legal personality there is nothing to prevent it from entering into a contract of employment with one of its partners.**

### **Other provisions in the Partnership Act 1890**

23.22 For the sake of completeness we refer to three other sections. We propose no change to section 19, which allows the partners by unanimous agreement to vary the terms of the partnership. This is a necessary provision if the Act is to be a default code. We also propose no change to the substance of section 37, which allows a partner to notify the dissolution of a partnership. Nor do we propose any substantive alteration of section 40, which provides for

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<sup>5</sup> 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, on solemn proceedings, refers only to bodies corporate. Solemn procedure is applied in cases which the Crown considers serious enough to merit trial on indictment before a jury. The court can impose heavier sentences under solemn procedure than would be competent under summary procedure.

<sup>6</sup> See *Allison v Allison's Trustees* (1904) 6 F 496; *Fife County Council v Minister of National Insurance* 1947 SC 629.

the repayment of all or part of a premium paid on entering a partnership for a fixed term, when that partnership is prematurely dissolved.

## **PART XXIV**

# **SUMMARY OF PROPOSITIONS, PROPOSALS AND QUESTIONS**

24.1 In this paper we have formed provisional views on many aspects of partnership law. In respect of the three major problems which we identified with the existing law we propose:

- (1) The introduction of independent continuing personality for partnerships, to bridge the gulf between the commercial perception, of the firm as an entity which continues regardless of changes in membership, and the legal reality.**
- (2) Encouraging continuity and stability in business relationships by restricting the circumstances in which there will be an automatic discontinuance of the partnership business.**
- (3) The introduction of a more efficient and cheaper mechanism for the dissolution of a solvent partnership.**

24.2 We set out below a summary of the issues on which we seek consultees' views. In particular we draw the attention of consultees to our principal proposals for reform referred to in the previous paragraph (for ease of reference these and other major issues are highlighted in bold below).

24.3 We invite comments on any matters raised in this paper and any other suggestions which consultees may have. Consultees should not feel obliged to answer all the questions: we appreciate that their views or experience may be relevant to some matters only. For the purposes of analysing the responses it would be very helpful if, as far as possible, consultees could refer to the numbering of the original paragraphs in which the questions appear.

### **Legal personality: options for reform**

24.4 We invite views on the following provisional proposals:

- (1) The law of England and Wales should make it possible for a partnership to have a legal personality capable of surviving changes in its composition.**
- (2) The existing doubts as to the law of Scotland on this point should be resolved by making it clear that it is possible for a partnership to have a legal personality capable of surviving changes in its composition.**

(Paragraph 4.17)

24.5 We invite views on the following provisional proposal:

**On balance, option 2 is to be preferred; namely that all partnerships would have separate legal personality and that continuing legal personality would be optional. Do consultees agree?**

(Paragraph 4.32)

24.6 We invite views on the following question:

If continuing personality without registration were introduced (or, in Scotland, confirmed) should there be rules, on the lines of those in section 36 of the 1890 Act, enabling third parties dealing with a firm to treat the firm as continuing until they had notice of a change?

(Paragraph 4.44)

24.7 We invite views on the following:

(1) Our provisional view would be to favour a transition period for the application of the new rules to partnerships (option 2) as it creates more certainty in the longer term.

(2) The advantages and disadvantages of the first option (to introduce continuing personality to all partnerships from the commencement of legislation implementing the reform) and the third option (to apply the new rules only to partnerships created after the new law came into force).

(3) The proposed measure to protect the interests of landlords and tenants of agricultural holdings.

(4) If continuing personality without registration were introduced, do consultees agree that the transitional rules should provide for the delayed application of the new rules to all partnerships (as in RUPA)?

(5) If consultees favour a delayed application of the new rules, how long should the transitional period be?

(6) If consultees favour the option of delayed application of the new rules, should a partner in an existing partnership have the option to elect that the partnership should not have continuity of personality?

(Paragraph 4.56)

### **Definition, formation and size of a partnership**

24.8 We invite views on the following provisional proposals and question:

(1) The statutory definition of a partnership should be a definition of a type of voluntary association rather than a definition of a type of “relation”.

- (2) The definition should make it clear that the association must be constituted by an agreement.
- (3) It should not be necessary for a business to be actually carried on before there can be a partnership only that that should be the object of the partnership.
- (4) In cases where the partnership has a legal personality distinct from that of the members, the definition should refer to the business being carried on by the partnership rather than by the partners.
- (5) Companies incorporated under the Companies Acts or other legislation should continue to be excluded but the terms of the exclusions should be updated.
- (6) For the avoidance of doubt, it should be made clear that the division of profits is not an essential feature of partnership.
- (7) For the avoidance of doubt, it should be made clear that a partnership has unlimited capacity to act.
- (8) Are any other changes in the statutory definition desirable?

(Paragraph 5.26)

24.9 We invite views on the following question:

Would it be useful to provide that a change in the composition of the partnership does not necessarily mean that there is a new partnership agreement?

(Paragraph 5.29)

24.10 We invite views on the following provisional proposal and question:

- (1) On the basis that it has served its historical purpose and is no longer needed, section 2 of the 1890 Act, which contains rules for determining the existence of a partnership, should be repealed.
- (2) If consultees disagree with the provisional proposal in the preceding paragraph, should section 2 be amended by:
  - (a) changing the opening words of section 2(3) so that they simply provide that the receipt by a person of a share of the profits of a business does not of itself make him a partner in the business; and / or
  - (b) repealing the proviso to section 2(3)(d); and / or
  - (c) repealing the references in section 2(3) to a person being “liable as such”?

(Paragraph 5.43)

24.11 We invite views on the following provisional proposals:

We see no justification for section 3 of the 1890 Act which postpones the rights of certain creditors of a partnership. It should be repealed.

(Paragraph 5.50)

**The size restriction affecting partnerships should be abolished.**

(Paragraph 5.61)

### **Duration of partnership**

24.12 We invite views on the following provisional proposals:

- (1) **For the avoidance of any doubt, it should be made clear that a partnership consisting of three or more partners is not necessarily dissolved as a legal relationship or voluntary association between the surviving or remaining partners when one partner ceases to be a partner.**
- (2) **Accordingly, in any case where two or more partners would remain after the act or event giving rise to the dissolution, a clear distinction should be drawn between (i) the dissolution of the relationship between a particular outgoing partner and the other partner or partners and (ii) the dissolution of the partnership as regards all the partners.**

(Paragraph 6.4)

24.13 We invite views on the following provisional proposals:

**For the avoidance of any doubt, it should be made clear that a partnership is not dissolved as a legal relationship or voluntary association merely because a new partner is admitted.**

(Paragraph 6.7)

**The general policy should be to give the maximum duration to partnerships which is consistent with the wishes or presumed wishes of the partners.**

(Paragraph 6.15)

24.14 We invite views on the following provisional proposals:

- (1) The following terms used in the Act could usefully be revised along the lines in paragraph 6.18:

- (a) “fixed term”
- (b) “partnership at will”

(c) “notice of intention to determine the partnership”.

**(2) A partner should not have the right to withdraw from a partnership which is for a defined duration, subject to agreement to the contrary.**

**(3) Section 26 of the 1890 Act (“Retirement from partnership at will”) should be amended:**

**(d) so that the heading refers to withdrawal from a partnership of undefined duration, and**

**(e) to provide that where the partnership is of undefined duration any partner may withdraw from, rather than determine, the partnership by giving notice.**

(Paragraph 6.19)

24.15 We would welcome views on the following proposition in (1) and any suggestions as to appropriate solutions in the case of propositions (2) and (3):

**(1) In the case of a partnership where two or more partners would remain after the event in question, the effect of the death or bankruptcy of a partner should be only to dissolve the relationship between that partner and the others and not, unless the partnership agreement so provides, to dissolve the partnership as regards all the partners.**

(2) An equivalent of “death” should be referred to in the case of a partner which is a legal person.

(3) The meaning of “bankruptcy” in relation to English, Scottish or foreign partners, whether natural persons or legal persons, should be clarified.

(Paragraph 6.25)

24.16 We invite views on the following provisional proposals:

In the case of a partnership where two or more partners would remain after the illegality, the effect of illegality affecting only the ability of one partner to carry on the business of the partnership should be only to dissolve the relationship between that partner and the others and not, unless the partnership agreement so provides, to dissolve the partnership as regards all the partners.

(Paragraph 6.27)

In cases of partnership, acceptance of a repudiatory breach should not terminate the contract and dissolve the partnership. “Innocent” partners must apply to the court for dissolution under section 35.

(Paragraph 6.32)

24.17 We invite views on the following questions:

- (1) Where a partner is locked out from the management and the working of the partnership, should there be an exception to our provisional view that acceptance of a repudiatory breach would not terminate the contract and dissolve the partnership? In this situation, accepted repudiatory breach could amount to a dissolution of the partnership.
- (2) Are there any other situations where such an exception may be warranted?

(Paragraph 6.33)

24.18 We invite views on the following provisional proposal:

In cases of partnership, rescission on the grounds of fraud or misrepresentation should not terminate the contract or dissolve the partnership but “innocent” partners must apply to the court for an order of rescission.

(Paragraph 6.35)

24.19 We invite views on the following questions:

**Should the court have an 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, in any or all of the following cases:**

- (a) when a partner has become permanently incapable of performing the partnership duties;**
- (b) when a partner 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;**
- (c) when a partner wilfully or persistently commits a breach of the partnership agreement, or otherwise so behaves in matters relating to the partnership business that it is not reasonably practicable for the other partners to carry on the business in partnership with that partner;**
- (d) whenever in any case circumstances have arisen which, in the opinion of the court, render it just and equitable that the relationship between one partner and the others should be dissolved?**

(Paragraph 6.42)

Should there be any other reform of the rules on grounds for dissolution by a court?

(Paragraph 6.43)

24.20 We invite views on the following questions:

(1) Should the frustration of the partnership contract be treated in the same way as illegality, involving the possibility of a dissolution restricted to terminating the relationship between the party affected by the frustration and the other partners? Or

(2) Is it sufficient that cases of frustration not otherwise dealt with by the 1890 Act fall within the just and equitable ground of judicial dissolution of the partnership under section 35(f)?

(Paragraph 6.48)

24.21 We invite views on the following questions and proposition:

(1) Should the rule in section 33(2) of the 1890 Act (giving an option to dissolve the partnership if a partner's share is "charged under this Act") extend to other similar situations, such as an arrestment in execution of the share under the Scots common law or a voluntary assignment or assignation of the share, and if so which?

(2) If the rule were to be extended would any safeguards, such as a threshold amount or a period of grace for rectifying the situation, be necessary for the protection of the partner concerned?

(3) The partners, if two or more in number, other than the one concerned should have an option under section 33(2) to expel the partner concerned in addition to the existing option to dissolve the partnership.

(4) Should it be made clear that the option to dissolve the partnership given in section 33(2) requires the unanimity of the other partners?

(Paragraph 6.53)

24.22 We invite views on the following provisional proposal:

**There should be a general provision that a partnership comes to an end as regards all the partners at any such time, or on the occurrence of any act or event, as may be provided for, expressly or impliedly, in the partnership agreement as having this effect.**

(Paragraph 6.55)

24.23 We invite views on the following questions:

(1) Should special provision be made to enable a partnership to be deemed 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?

(2) Alternatively, should the last remaining partner be given an option to buy out the share of the last outgoing partner, whether or not the last remaining partner intends to assume a new partner?

(3) If either of the above approaches were adopted, would any special rules be necessary to prevent abuse?

(Paragraph 6.64)

### **Position of outgoing partner**

24.24 We invite views on the following provisional proposals:

**(1) Where a partner leaves a partnership, which continues as between the remaining partners, the outgoing partner should not have the right to require the business to be wound up unless this right has been conferred by the partnership agreement.**

**(2) The outgoing partner should, however, have a right to apply to the court to have the business wound up on the ground that there was a substantial likelihood either that the remaining partners would not be able to pay out the share of the outgoing partner or that the outgoing partner would not be indemnified against the liabilities of the firm.**

(Paragraph 7.12)

24.25 We invite views on the following provisional proposals:

**(1) The outgoing partner's share in a continuing partnership should be transferred to the remaining partners by operation of law at the moment of departure.**

**(2) The counterpart of this automatic transfer should be that the outgoing partner becomes entitled to the value of the share. This value is a debt from the date of departure.**

**(3) Where particular partnership assets are held in the name of the outgoing partner, the outgoing partner should be bound, on request, to transfer title to the remaining partners or to the partnership (if it has a continuing legal personality) or to trustees for the partnership, as may be appropriate.**

(Paragraph 7.17)

24.26 We invite views on the following provisional proposal and question:

**(1) The outgoing partner should no longer have a right under section 42 to a share of the profits attributable to the outgoing partner's share in the partnership assets. Instead there should be a right to interest, at a rate reflecting current rates, on the amount of the share due to the outgoing partner.**

**(2) Should the rate of interest be a specified percentage above the Bank of England base rate and, if so, what should it be?**

(Paragraph 7.26)

24.27 We invite views on the following questions:

(1) Do consultees agree that there should be a default rule that if the outgoing partner's share is to be paid out the outgoing partner should receive the benefit of an indemnity from the remaining partners?

(2) If so, should the indemnity be qualified:

(a) to exclude any liability attributable to the outgoing partner's wrongful acts or omissions; or

(b) so that it is without prejudice to any claims which the partners or firm may have against the outgoing partner for breach of duty to the firm; or

(c) in any other way?

(Paragraph 7.29)

24.28 We invite views on the following provisional proposal and question:

(1) There should be a statutory default measure of the value of the partnership which should be applied to determine the amount payable to a partner leaving a continuing partnership.

(2) Should the statutory measure be based upon:

(a) a notional sale of the business; or

(b) the accounting practice adopted in the last annual accounts (or normal accounting standards if a partnership does not have an established accounting practice)?

(Paragraph 7.44)

24.29 We invite views on the following options for reform of dispute resolution procedures:

(1) No reform;

- (2) A statutory default procedure; and
- (3) A self-help procedure.

24.30 If option (2) is favoured, should the statute provide for:

- (1) Arbitration; or
- (2) Expert determination; or
- (3) An arbitration scheme similar to that suggested by the Company Law Review for shareholder disputes in small companies?

24.31 If option (3) is followed:

- (1) Should the prescribed time to pay an estimated amount of the sum due following the written demand be 120 days, or six months, or another period; and
- (2) Should the outgoing partner be able to specify an amount in the written demand for payment which becomes a debt if the firm makes no offer?

(Paragraphs 7.68 - 7.70)

24.32 We invite views on the following alternatives concerning provision for payment by instalments which would apply in the absence of agreement to the contrary:

- (1) A uniform provision for instalments (our provisional view is against this);
- (2) A provision for instalments linked to the reason for departure of the outgoing partner which could apply in all such cases or unless the tribunal makes a contrary ruling;
- (3) A provision requiring tribunals to consider instalments and order them in appropriate cases; and
- (4) An outgoing partner should become immediately entitled to the full value of the share.

(Paragraph 7.81)

### **Winding up dissolved partnerships**

24.33 We invite views on the following propositions:

- (1) Section 38 (winding up affairs of dissolved partnership by former partners) does not require fundamental change so far as partnerships without legal personality are concerned.

(2) However, section 38 should be amended to make it clear that the 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, and that the former partners may confer such authority on any or all of their number.

(Paragraph 8.17)

24.34 We invite views on the following propositions:

(1) Section 38 of the 1890 Act is inadequate in relation to partnerships having a separate personality.

(2) In relation to such partnerships the dissolved partnership should be deemed to continue for the purposes of winding up its affairs and completing unfinished transactions.

(Paragraph 8.28)

24.35 We invite views on the following provisional proposals and questions for a new system for winding up dissolved partnerships under court supervision in England and Wales and Scotland:

**(1) There should be a new system for winding up the affairs of solvent dissolved partnerships under court supervision, the key feature of the new system being the appointment of an officer with powers and duties modelled on those of the liquidator in a members' voluntary winding up of a company.**

**(2) A former partner or creditor should have the right to apply to the court to determine any question arising in the winding up.**

**(3) A former partner should have the right to apply to the court for an account.**

**(4) Suggestions are invited for an appropriate name for the officer. Possibilities include: receiver (England and Wales) or judicial factor (Scotland); partnership liquidator; partnership administrator; dissolution manager; and partnership manager. (We use "partnership liquidator" provisionally in the remainder of these proposals.)**

**(5) The partnership liquidator should be under a duty to report to the court if of the opinion that the debts of the former partnership could not be paid within 12 months of appointment, with a view to initiating the appropriate insolvency procedure.**

**(6) The partnership liquidator should have full powers to deal with the assets of the partnership, the rights of the partners to deal with the partnership property ceasing on his appointment.**

**(7) The partnership liquidator should be regarded as the statutory agent of the former partners for the purposes of the winding up but should be given express power, without the sanction of the court or the approval of the former partners, to:**

- (a) **bring or defend legal proceedings judged by the partnership liquidator to be necessary or expedient for the winding up;**
  - (b) **sell or transfer any of the dissolved partnership's property;**
  - (c) **borrow against the security of the dissolved partnership's assets; and**
  - (d) **do all other things necessary for winding up the partnership's affairs and distributing its assets.**
- (8) In each of the following situations the partnership liquidator should be required to obtain the prior unanimous approval of the former partners:**
- (a) **making any compromise or arrangements with creditors;**
  - (b) **compromising any liability a former partner may have to contribute in accordance with section 44 of the 1890 Act; and**
  - (c) **carrying on the business for its beneficial winding up.**
- (9) Should the partnership liquidator be able to disclaim onerous property? If so, in the case of contracts, including leases, should the power to disclaim apply only to those entered into after the relevant legislation came into force?**
- (10) Are any other special provisions required?**
- (11) In general, would it be appropriate to base any other special provisions which might be required on the rules for the solvent winding up of a company?**

(Paragraph 8.60)

24.36 We invite views on the following questions:

- (1) In addition to provision for winding up by the former partners under section 38 and provision for winding up by a partnership liquidator appointed by a court, should there be provision for the winding up of a dissolved partnership by a partnership liquidator appointed by the former partners without recourse to the court?
- (2) Should a majority of the former partners be able to impose such a partnership liquidator on the others?
- (3) If so, should any special majority be required?
- (4) Should a partner-appointed liquidator, if such a system were introduced, have the same powers and duties as those of a court-appointed liquidator?

(5) Should the assets of the dissolved partnership vest in a partner-appointed liquidator for the purposes of the winding up?

(Paragraph 8.66)

24.37 We invite views on the operation of section 44 in general and on the rule in *Garner v Murray* in particular:

(1) Does section 44 of the 1890 Act (Rules for distribution of assets on final settlement of accounts) operate in a satisfactory way?

(2) In particular, does it operate in a satisfactory way in a case where one former partner is insolvent and where the so-called rule in *Garner v Murray* applies?

(Paragraph 8.79)

### **Partnership and agency**

24.38 We invite views on the following provisional proposals:

On the assumption that some partnerships will, and some will not, have a separate legal personality, section 5 of the 1890 Act should be amended on the following lines:

(a) Where a partnership does not have a separate legal personality the basic rule should be that the partners are agents of the other partners;

(b) Where the partnership does have a separate legal personality the basic rule should be that the partners are agents of the partnership.

(Paragraph 9.7)

The reference to “all the partners” at the end of section 6 of the 1890 Act should be deleted as unnecessary and, in some cases, inappropriate.

(Paragraph 9.11)

24.39 We invite views on the following provisional proposals:

(1) Section 7 of the 1890 Act should be amended to reflect the fact that, in a firm with legal personality, the authorisation should come from the firm.

(2) There should be no need for the partner to have been “specially” authorised. The question should simply be whether the partner was in fact authorised.

(Paragraph 9.15)

### **Liability for partnership obligations**

24.40 We invite views on the following provisional proposals:

The liability of a partner, under section 9 of the 1890 Act, for debts and obligations of the firm should be joint and several and not, as is presently the case in England and Wales, joint.

(Paragraph 10.10)

Section 9 of the 1890 Act should be amended to remove the anomalous postponement to separate creditors mentioned, in the context of the liability of a deceased partner's estate, at the end of the section.

(Paragraph 10.12)

24.41 We invite views on the following provisional proposals and question:

**(1) The Partnership Act should specify the nature of the partners' liability for partnership obligations in those cases where the partnership has a separate legal personality.**

**(2) In such cases, the partnership should have the primary liability and the partners' liability should be subsidiary.**

**(3) Creditors of the 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.**

**(4) A partner satisfying the whole or part of a claim against the partnership shall have the right to be indemnified by the partnership, failing which, to the extent that that partner has paid more than their due proportion, they shall have the right to a pro rata contribution from the other partners.**

**(5) A creditor should be permitted to enforce a judgment obtained against a partnership directly against the assets of a partner without it also being necessary to obtain a judgment against that partner.**

**(6) On the assumption that the creditor has obtained an appropriate judgment, do consultees agree that the creditor need not be required to exhaust enforcement remedies against the assets of the partnership before enforcing the judgment against the assets of a partner?**

(Paragraph 10.20)

24.42 We invite views on the following provisional proposals:

It should no longer be the law that a partnership is not liable for loss or injury wrongfully caused by one partner, acting with authority or in the ordinary course of the firm's business, to another partner.

(Paragraph 10.26)

To cater for partnerships with separate legal personality, section 13 of the 1890 Act should provide not only that the other partners are not liable but also that the partnership is not liable.

(Paragraph 10.30)

Section 14(2) (the effect of the continued use of a firm name or of a deceased partner's name as part of a firm name) should apply not only to a deceased partner but also to any other outgoing partner.

(Paragraph 10.37)

Section 17(2) and (3) of the 1890 Act (on the liability of a retiring partner) should apply also to all outgoing partners.

(Paragraph 10.44)

Statutory effect should be given to the proposal that in English law an agreement whereby a partner retires from the partnership and is released from further liability is not a contract which needs to be supported by valuable consideration.

(Paragraph 10.47)

24.43 We invite views on the following provisional proposals:

(1) It should remain the case that former partners continue to be liable for the obligations of a dissolved partnership.

(2) Where the dissolved partnership had a separate legal personality, and the liability of the partners was subsidiary to that of the partnership, it should be made clear that the liability of the former partners ceased to be subsidiary and became primary when the partnership was dissolved.

(Paragraph 10.61)

### **Partnership property**

24.44 We invite views on the following provisional proposals:

(1) For partnerships without a continuing legal personality, the policy of sections 20 and 21 in England and Wales and sections 20 to 22 in Scotland of the 1890 Act should continue to apply.

(2) For partnerships with a continuing legal personality

(a) sections 20 to 22 should not apply

- (b) it should be made clear that such partnerships can own property of any kind in their own name, and that property can be held in trust for them
- (c) 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
- (d) 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
- (e) 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.

(Paragraph 11.20)

24.45 We invite views on the following provisional proposals:

- (1) For registered partnerships with legal personality it would be open to the partners to state on the partnership register either the names of the partners entitled to carry out land transactions or, alternatively, the minimum number of partners that have to sign dealings with land.
- (2) For unregistered partnerships with legal personality there should be a voluntary register of authority to transact in land.

(Paragraph 11.23)

### **Partners' financial and management rights**

24.46 We invite views on the following provisional proposals:

- (1) Partnerships should not have a mandatory obligation to comply with specified accounting standards when compiling their internal accounts.
- (2) A partnership's internal accounts should be required to comply with accepted accounting standards, unless partners agree otherwise.

(Paragraph 12.12)

24.47 We invite views on the following questions:

- (1) Do consultees consider that in the light of the Court of Appeal's decision in *Popat v Shonchhatra* there is a need to amend section 24(1) of the 1890 Act?

(2) If so, would they 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?

(Paragraph 12.18)

24.48 We invite views on the following question:

Should section 24 provide that, subject to agreement to the contrary, losses are borne in the same proportion as the ultimate residue of assets would be shared under section 44 of the 1890 Act?

(Paragraph 12.25)

24.49 We invite views on the following provisional proposal:

The rate of interest, specified in section 24(3) of the 1890 Act, on a payment or advance by a partner beyond the partner's agreed capital contribution should be a "commercial" rate, related to the Bank of England's base rate, and not a fixed rate of five per cent.

(Paragraph 12.28)

24.50 We invite views on the following questions:

(1) Should section 24(8) of the 1890 Act be amended so that, subject to agreement to the contrary, the consent of all the partners is 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?

(2) Should unanimity be required for any other decisions?

(Paragraph 12.39)

24.51 We invite views on the following provisional proposal:

There should be no new statutory rules as to special majorities for votes on "extraordinary" decisions.

(Paragraph 12.42)

### **Expulsion, suspension and compulsory retirement**

24.52 We invite views on the following provisional proposal and question:

(1) If, as suggested earlier, courts were to have a power to expel a partner under section 35, there should be no other power of expulsion unless the partnership agreement expressly provides for it.

(2) If, contrary to our earlier suggestion, courts were to have no power to expel under section 35, should a majority of partners have a statutory power to expel and, if so, what grounds should be specified and what safeguards, if any, should be included?

(Paragraph 13.9)

24.53 We invite views on the following provisional proposals:

There should be no power of suspension unless the partners expressly agree to one.

(Paragraph 13.13)

A compulsory retirement power should not be included as a “default” rule.

(Paragraph 13.15)

### **Partners’ duties**

24.54 We invite views on the following questions:

**(1) Should the court be empowered to relieve partners from liability for breach of duty where they have acted honestly and reasonably?**

**(2) If so, should the power be available in all circumstances or only on dissolution of a partnership?**

(Paragraph 14.6)

24.55 We invite views on the following questions:

**(1) Do consultees agree that there should continue to be a duty of good faith in partnership relations?**

**(2) If so, do consultees also agree that it should be set out in the Act, without prejudice to the particular provisions in sections 28 to 30?**

**(3) As an alternative to a general statement, should it be expressly provided that an obligation to act in good faith applies:**

**(a) when a partner is expelled; and**

**(b) when a firm is dissolved?**

**(4) Are there any other specific circumstances in which partners should be expressly required to act in good faith?**

(Paragraph 14.17)

24.56 We invite views on the following provisional proposal and question:

(1) Do consultees agree 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?

(2) If consultees disagree with the provisional proposal in (1) above, should it be provided that, in the absence of agreement to the contrary:

- (a) partners are expected to act in partnership matters with the care and skill that they would show in their own affairs; or
- (b) partners are expected to act with such care and skill which would be exercised in the same circumstances 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?

(Paragraph 14.32)

24.57 We invite views on the following provisional proposal:

There should not be a statutory duty to devote full time and attention, or any other specified amount of time and attention, to the partnership.

(Paragraph 14.38)

**The effect of a partnership's separate legal personality on partners' duties**

24.58 We invite views on the following questions:

**(1) Do consultees agree that for a partnership with separate personality there should be provision defining the duties which a partner owes to the partnership and to the other partners respectively?**

**(2) Do consultees agree that a rule that a partner owes duties only to the partnership (option 1) is inappropriate?**

**(3) If a partner owes duties to the partnership and also to the other partners:**

- (a) **Do consultees agree that certain duties - the duty to account for profits, the duty not to compete with the partnership, the duty of skill and care and the duty to act in good faith for the benefit of the partnership - should be specified as being owed to the partnership alone while other duties - the duty of good faith in partnership relations and the duty to give accounts and full information to other partners - should be specified as owed by a partner to the other partners (option 3)?**
- (b) **In the alternative do consultees prefer the option that the duty of skill and care, the duty to account for profit and the duty not to compete with the partnership should be specified as owed to and enforceable by both the partnership and the other partners (option 2)?**

**(4) If option 3 in paragraph (3)(a) above is preferred, do consultees agree 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?**

(Paragraphs 15.21)

### **A model agreement?**

24.59 We invite views on the following question:

Do consultees agree that the problems in formulating a model partnership agreement that addressed fully the needs of all types of partnership would militate against such an idea?

(Paragraph 16.8)

### **Litigation**

24.60 We invite views on the following provisional proposals:

- (1) It should be made clear that a partnership with a separate legal personality can, so long as it exists, sue or be sued in the firm name alone whether or not that name consists of or includes the names of partners or real people.**
- (2) It should also be made clear that partners can be sued in the same proceedings as the partnership.**
- (3) Where a partnership with a legal personality has been dissolved as regards all the partners, 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 firm.**
- (4) Any partner or former partner sued should have an 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.**

**(5) The rule of Scots law to the effect that a partnership debt must first be constituted against the partnership should not apply in the case of a dissolved partnership.**

**(6) The rule of Scots law to the effect that all the former partners of a dissolved firm who are within the jurisdiction must be called as defenders should cease to have effect.**

**(7) Other procedural matters relating to litigation by or against partnerships with a separate legal personality, or against the former partners of such partnerships, should be regulated by subordinate legislation.**

(Paragraph 17.17)

24.61 We invite views on the following question:

Should there 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?

(Paragraph 17.27)

### **Enforcing judgments**

24.62 We invite views on the following provisional proposals and questions:

(1) The Scots law on putting into effect an arrestment of a partner's share in the partnership is in need of clarification and reform.

(2) It should be made clear that a decree of furthcoming can be obtained after such an arrestment and that the effect of such a decree of furthcoming is 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 fall due.

(3) Should a creditor of a partner who has obtained such an arrestment also be able to apply to the court for an order for a sale of the partner's share and for any other appropriate orders (as is possible in England under section 23 of the 1890 Act)?

(4) Should the other partners have a right to purchase the partner's share in the event of a sale being ordered?

(Paragraph 18.18)

### **Execution of deeds by partnerships**

24.63 We invite views on the following provisional proposals and question:

(1) If partnerships with legal personality were to be introduced in English law the rules on the execution of deeds by such partnerships should be as follows:

- (a) a document would be executed by the partnership if signed by a partner and expressed to be executed by the partnership;
- (b) in a question with a purchaser in good faith a document would be deemed to be duly executed if executed in accordance with (a) above; and
- (c) there would be a rebuttable presumption that a deed executed in accordance with (a) above was delivered upon execution.

(2) Do consultees consider that it should be made clear that these provisions do not affect the legal position under sections 5 and 6?

(Paragraph 19.11)

24.64 We invite views on the following question:

Do consultees agree 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?

(Paragraph 19.16)

### **Registered partnerships**

24.65 We invite views on the following provisional proposal:

In principle, and after an initial period when costs would have to be borne out of public funds, a register of partnerships should be financed out of fees charged for registration and for updating the register.

(Paragraph 20.7)

24.66 We invite views on the following provisional proposition and question:

(1) Registration in a new register of partnerships, were one to be established, should be limited to partnerships within the normal statutory definition of a partnership.

(2) If consultees disagree, should there be any restrictions on who could register and, if so, what?

(Paragraph 20.12)

24.67 We invite views on the following provisional proposal and question:

(1) A partnership should only be able to register a name if it is not the same (or substantially the same) as one already registered.

(2) What would be a suitable way (for example, Regd Pship or RP) of indicating on letterheads and elsewhere that a partnership was a registered partnership?

(Paragraph 20.19)

24.68 We invite views on the following provisional proposals:

A registered partnership should be required to have, as its registered office, an address in England and Wales or Scotland.

(Paragraph 20.21)

It should not be necessary to register any statement or information about the partnership's normal business.

(Paragraph 20.23)

Once a partnership is registered, the certificate of registration should be conclusive that the requirements for registration have been satisfied at the time of registration.

(Paragraph 20.26)

A registered partnership should not be able to rely against other persons on a change in the name, office, or membership of the firm unless this has been registered.

(Paragraph 20.33)

24.69 We invite views on the following proposals and question:

(1) There should be time limits for compliance with registration requirements designed to maintain the accuracy of the register.

(2) A registered partnership in breach of registration requirements should be precluded from bringing or defending civil actions unless and until it remedies the default.

(3) Should there also be fines for missing, or for persistently missing, any time-limit for registering information about changes or annual returns?

(Paragraph 20.37)

24.70 We invite views on the following question:

In order to change the registered particulars:

(a) should any partner be able to sign the form;

- (b) should a minimum of two partners be required to sign the form; or
- (c) should there be an official like a secretary in a company with both the authority and the responsibility to register changes?

(Paragraph 20.41)

24.71 We invite views on the following provisional proposals:

- (1) In order to register a new partner a prescribed form signed both by a current partner on behalf of the partnership and by the proposed new partner would have to be filed.
- (2) In order to remove a partner from the register, a prescribed form signed either by a current partner on behalf of the partnership or by the partner concerned would have to be filed.

(Paragraph 20.48)

24.72 We invite views on the following questions:

- (1) Should the normal rules on the duration of partnerships apply to registered partnerships?
- (2) If so:
  - (a) should the former partners of a registered partnership which was dissolved as regards all the partners be under an obligation, backed up by sanctions, to notify the Registrar of the dissolution of the partnership so that the entry relating to the partnership could be removed from the register;
  - (b) should the Registrar have a power, and a duty, to strike a dissolved partnership off the register?
- (3) Should the normal rules on duration be altered for registered partnerships so that the partnership would continue until taken off the register and accordingly:
  - (a) the partnership could continue as a legal entity even if it had permanently ceased to trade or it had become illegal for it to carry on trading;
  - (b) the partnership could continue as a legal entity even if it had only one partner or no partners;
  - (c) any purported dissolution of the partnership by the unanimous agreement of the partners would be void unless the moment of dissolution coincided with the moment of removal from the register;

- (d) any term of the partnership agreement providing for the partnership to come to an end at the end of a stated time or on the occurrence of a particular event (other than removal from the register) would be treated as providing for the partnership to come to an end on removal from the register as a result of the expiry of the stated time or the occurrence of the stated event;
  - (e) the power of the court to dissolve the partnership on the statutory grounds would be replaced by a power to order the partnership to be removed from the register?
- (4) If the normal rules on duration do not apply, should the Registrar have a power and a duty to strike the partnership off the register, and so bring it to an end:
- (a) on becoming aware that the partnership had permanently ceased to trade or that it had become illegal for it to carry on trading;
  - (b) on becoming aware that the number of partners had been reduced below two;
  - (c) if all the partners so requested;
  - (d) if informed that the partnership had been entered into for a fixed period, or until the occurrence of a specified event, and that that period had expired or that event had occurred;
  - (e) if the court had directed that the partnership be de-registered?
- (5) Are there any other circumstances in which the Registrar should have a power or a duty to strike a registered partnership off the register?

(Paragraph 20.52)

24.73 We invite views on the following question:

Should there be a power to restore a struck-off partnership to the register if the striking-off turned out to be unjustified?

(Paragraph 20.55)

24.74 We invite views on the following questions:

- (1) Should the appearance or non-appearance of a person's name in the register as a partner of the registered partnership at a certain time be conclusive, as a general rule, in any question with a non-partner, as to that person's status as a partner in the partnership at that time, or merely indicative?

(2) If the entry in the register is regarded as conclusive, as a general rule, should there nonetheless be special provisions:

- (a) treating as partners persons who had been admitted as partners and who had in fact acted as partners at the relevant time, even if not registered;
- (b) treating retired, expelled or other former partners still on the register as if they were not partners in any question with a third party who in fact knew that they had left the partnership at the relevant time; and
- (c) ensuring that no liability would attach to the personal representatives or executors of a deceased partner or to the trustee of a bankrupt partner for matters arising after the death or bankruptcy respectively?

(Paragraph 20.63)

24.75 We invite views on the following provisional proposal:

The rule on holding out in section 14 of the 1890 Act should apply to registered partnerships.

(Paragraph 20.65)

24.76 We invite views on the following question:

Should section 36(2) of the 1890 Act be disapplied to registered partnerships so that for the purpose of precluding the liability of an outgoing partner for future debts in relation to persons who had had no previous dealings with the partnership the removal of the partner's name from the register of partnerships should be both sufficient and, failing actual notice, necessary?

(Paragraph 20.67)

24.77 We invite views on the following provisional proposal:

The appearance or non-appearance of a person's name in the register as a partner of the registered partnership at a certain time should not be conclusive, in any question with a partner, as to that person's status as a partner in the partnership at that time.

(Paragraph 20.69)

24.78 We invite views on the following provisional proposals:

(1) The partnership, any partner or any person aggrieved should be able to apply to a court for the register to be rectified if the name of any person had, without sufficient cause, been entered in, or omitted or removed from, the register of partners.

(2) The court should be able to order payment by the partnership of any damages sustained by any party aggrieved.

(3) The court should have power to make a rectification retrospective, provided that the retrospective removal of a name from the register should not be allowed to prejudice any third party who had relied on the entry in the register.

(Paragraph 20.74)

24.79 We invite views on the following provisional proposal:

The proviso to section 5 of the 1890 Act should apply in the case of a registered partnership, but for these purposes knowledge should not include constructive knowledge of any matter merely because it is disclosed on a public register.

(Paragraph 20.76)

24.80 We invite views on the following questions:

(1) Should partners in a registered partnership be able to file a restriction on a partner's authority?

(2) Should a third party be regarded, for these purposes, as having constructive notice of the filing?

(Paragraph 20.78)

24.81 We invite views on the following provisional proposal:

If an existing partnership wishes to become a registered partnership, it should be necessary for the "old" partnership to be wound up, and for all the partners to register the new firm: assets would have to be assigned to the new legal person, which would have to undertake responsibility for the liabilities of the "old" firm.

(Paragraph 20.82)

24.82 We invite views on the following questions:

Do consultees have any suggestions as to how the scheme may be improved?

(Paragraph 20.84)

Should a scheme for registered partnerships be introduced if continuing personality is available without registration?

(Paragraph 20.85)

## **Partnership information**

24.83 We invite views on the following questions:

- (1) Should the categories of information required to be disclosed under the Business Names Act 1985 be extended to include the names and addresses of persons who had been partners in, say, the last ten years and the name and address of any partnership whose business the partnership had taken over in, say, the last ten years?**
- (2) Should third parties be given a right to obtain information, on demand, from a partnership about former partners and predecessor partnerships?**
- (3) If so, should the right be:**
  - (a) limited to third parties with a claim against the partnership;**
  - (b) limited in any other way;**
  - (c) enforceable by a court under the sanction of punishment for contempt of court?**

(Paragraph 21.31)

## **Floating and other charges**

24.84 We invite views on the following provisional proposals:

No change is proposed to the law on the granting of charges by partnerships without legal personality.

(Paragraph 22.14)

**If registered partnerships are introduced, they should be permitted to grant floating charges.**

(Paragraph 22.28)

Unregistered partnerships with legal personality should be able to grant charges or rights in security in the same way as individuals.

(Paragraph 22.30)

## **Miscellaneous questions**

24.85 We invite views on the following questions:

Should section 18 of the 1890 Act (“Revocation of continuing guaranty by change in firm”) be amended so that it would not apply:

- (a) where the partnership (whether or not it has a continuing legal personality) is the creditor in the primary obligation; or
- (b) where the partnership has a continuing legal personality and is the creditor in the primary obligation?

(Paragraph 23.6)

Should the reference to a partnership at will in section 27 (“Where partnership for term is continued over, a continuance on old terms presumed”) be replaced by a reference to a partnership of undefined duration where any partner has the right to withdraw on giving notice?

(Paragraph 23.10)

Should the principle of section 31 of the 1890 Act (that an assignee of a partner’s share in a partnership acquires financial rights but no rights to act as a partner) be extended to those acquiring a partner’s share by operation of law while the partner remains a partner?

(Paragraph 23.16)

24.86 We invite views on the following provisional proposals:

The rules of equity and common law should be expressly preserved in the new Partnership Act.

(Paragraph 23.18)

It should be possible to prosecute partnerships in Scotland not only by summary procedure but also by solemn procedure.

(Paragraph 23.20)

It should be made clear that where a partnership has a separate legal personality there is nothing to prevent it from entering into a contract of employment with one of its partners.

(Paragraph 23.21)

# APPENDIX A

## THE 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
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24. Rules as to interests and duties of partners subject to special agreement
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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*

32. Dissolution by expiration or notice
33. Dissolution by bankruptcy, death, or charge
34. Dissolution by illegality of partnership
35. Dissolution by the Court
36. Rights of persons dealing with firm against apparent members of firm
37. Right of partners to notify dissolution
38. Continuing authority of partners for purposes of winding up
39. Rights of partners as to application of partnership property
40. Apportionment of premium where partnership prematurely dissolved
41. Rights where partnership dissolved for fraud or misrepresentation
42. Right of outgoing partner in certain cases to share profits made after dissolution
43. Retiring or deceased partner's share to be a debt
44. Rule for distribution of assets on final settlement of accounts

*Supplemental*

45. Definitions of "court" and "business"
46. Saving for rules of equity and common law
47. Provision as to bankruptcy in Scotland
50. Short title

**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.

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<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 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.

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<sup>2</sup> Substituted by the Decimal Currency Act 1969, s 10(1).

### **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.

[(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.

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<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 Sched.

<sup>5</sup> Repealed by the Courts Act 1971, s 56(4) and Sched 11, Part II.

<sup>6</sup> Repealed by the Statute Law (Repeals) Act 1998, s 1(1) and Sched 1, Part X.

- (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.

#### **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:
- (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

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<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.

<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).

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 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.

*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. [...]⁹

### **Short title**

50. This Act may be cited as the Partnership Act 1890.

### SCHEDULE

[...]¹⁰

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<sup>9</sup> Sections 48 and 49 were repealed by the Statute Law Revision Act 1908, s 1 and Sched.

<sup>10</sup> Repealed by the Statute Law Revision Act 1908, s 1 and Sched.

## APPENDIX B: HOW THE SECTIONS OF THE 1890 ACT ARE DEALT WITH IN THIS PAPER

Section	Title	Dealt with in Paper at paragraphs	Suggested reform
1	Definition of partnership	5.2 - 5.26	We suggest that the statutory definition of partnership should be amended and modernised. (5.26)
2	Rules for determining existence of partnership	5.30 – 5.43	We suggest that the rules for determining the existence of a partnership in section 2 no longer serve a useful function and that the section should be repealed. (5.43)
3	Postponement of rights of person lending or selling in consideration of share of profits in case of insolvency	5.44 – 5.50	We suggest repealing this section as the policy behind the provision is no longer relevant. (5.50)
4	Meaning of firm	5.14, 18.8	We suggest no amendment to section 4. (5.14, 18.8)
5	Power of partner to bind the firm	9.2 – 9.8	We suggest that section 5 should be amended to state that partners are agents of the partnership where the partnership has a separate legal personality or that partners are agents for each other where the partnership does not have a separate legal personality. (9.7)
6	Partners bound by acts on behalf of the firm	9.9 – 9.12	We suggest that the reference to “all the partners” at the end of section 6 is unnecessary and should be deleted. (9.11)
7	Partner using credit of firm for private purposes	9.13 – 9.15	We suggest that section 7 should be amended to remove the reference to a partner being “specially” authorised and to amend the statement that authorisation comes from “the other partners” in cases where a partnership has a separate legal personality. (9.15)
8	Effect of notice that firm will not be bound by acts of partner	9.16 – 9.19	We suggest no change to section 8. (9.19)

<b>Section</b>	<b>Title</b>	<b>Dealt with in Paper at paragraphs</b>	<b>Suggested reform</b>
9	Liability of partners	10.3 – 10.20	<p>We suggest that:</p> <p>The liability of a partner under section 9 should be joint and several. (10.10)</p> <p>In the context of the liability of a deceased partner’s estate, the postponement to separate creditors should be removed. (10.12)</p> <p>We also make suggestions to determine the precise nature of the partners’ liability where the partnership has a separate legal personality. (10.20)</p>
10	Liability of the firm for wrongs	10.21 – 10.26	We suggest that a partnership should be liable for loss or injury wrongfully caused by one partner, acting with authority or in the ordinary course of the firm’s business, to another partner. (10.26)
11	Misapplication of money or property received for or in custody of the firm	10.21 – 10.26	We see no need to amend this section as it applies equally to firms with legal personality and firms without legal personality. (10.23)
12	Liability for wrongs joint and several	10.21 – 10.26	We note that this section would be unnecessary if, as suggested at paragraph 10.10, liability for the firm’s obligations in general were to be joint and several. (10.24)
13	Improper employment of trust-property for partnership purposes	10.27 – 10.30	We suggest a minor amendment to this section to make it clear that, in the case of a partnership with a separate legal personality, liability does not attach to the other partners or to the partnership. (10.30)
14	Persons liable by “holding out”	10.31 – 10.37	We suggest that section 14 (2) (the effect of the continued use of a firm name) should apply not only to a deceased partner but also to any other outgoing partner. (10.37)

15	Admissions and representations of partners	9.20 – 9.21	We suggest no change to this section. (9.21)
<b>Section</b>	<b>Title</b>	<b>Dealt with in Paper at paragraphs</b>	<b>Suggested reform</b>
16	Notice to acting partner to be notice to the firm	9.22	We suggest no change to this section.
17	Liabilities of incoming and outgoing partners	7.27 - 7.29  10.38 – 10.48	We consult on the introduction of a default rule that an outgoing partner should receive the benefit of an indemnity from the remaining partners. (7.29)  We suggest no change to section 17(1). (10.41)  We suggest that sections 17(2) and (3) (on the liability of a retiring partner) should apply to all outgoing partners. (10.44)  We suggest that it should be made clear that the reference in section 17(3) to an “agreement” does not mean a contract supported by valuable consideration. (10.47)
18	Revocation of continuing guaranty by change in firm	23.2 – 23.6	We invite views as to whether it should be provided that section 18 should not apply where the partnership is the creditor in the primary obligation. (23.6)
19	Variation by consent of terms of partnership	23.22	We suggest no change to this section. (23.22)
21	Property bought with partnership money	11.2 - 11.20	We suggest that section 21 should not apply to partnerships with a continuing legal personality. (11.20)
20	Partnership property	11.2 - 11.20	We suggest that section 20 should not apply to partnerships with a continuing legal personality. (11.20)
22	Conversion into personal estate of land held as partnership property	11.2 - 11.20	We suggest that, in Scotland, section 22 should not apply to partnerships with a continuing legal personality. (11.20)

<b>Section</b>	<b>Title</b>	<b>Dealt with in Paper at paragraphs</b>	<b>Suggested reform</b>
23	Procedure against partnership property for a partner's separate judgement debt	18.5 - 18.7	<p>We suggest no change to this section. (18.6 – 18.7)</p> <p>Note: section 23 does not apply in Scotland. We suggest a number of provisions to clarify and reform Scots law on putting into effect an arrestment of a partner's share in the partnership. (18.18)</p>
24	Rules as to interests and duties of partners subject to special agreement	12.13 - 12.42	<p>We ask whether in light of a recent Court of Appeal decision, there is a need to amend section 24(1). If so, we invite views as to whether partners should be entitled to the return of their capital contributions in the same proportions as they were contributed. (12.18)</p> <p>We invite views as to whether section 24 should provide that losses are to be borne in the same proportion as the ultimate residue of assets would be shared under section 44. (12.25)</p> <p>We suggest no change to section 24(2). (12.27)</p> <p>We suggest that the rate of interest specified in section 24(3) should be a “commercial” rate, and not a fixed rate of five per cent. (12.28)</p> <p>We suggest no change to section 24(4). (12.29)</p> <p>We suggest no change to section 24(5). (12.31)</p> <p>We invite views as to whether section 24(8) should be amended so that, subject to agreement to the contrary, the consent of all the partners is necessary for a change in the location of the partnership premises and for any specific restriction on the authority of one partner. We also ask whether unanimity should be required for any other decisions. (12.39)</p> <p>We suggest that there should not be new statutory rules as to special majorities for votes on ‘extraordinary’ decisions. (12.42)</p>

<b>Section</b>	<b>Title</b>	<b>Dealt with in Paper at paragraphs</b>	<b>Suggested reform</b>
25	Expulsion of partner	13.1 – 13.9	We invite views as to whether there should be a power of expulsion, other than that suggested in relation to section 35. Our provisional view is that there should not. (13.9)
26	Retirement from partnership at will	6.16 – 6.20	We suggest that where the partnership is of undefined duration any partner should be able to withdraw from, rather than determine, the partnership by giving notice. (6.19)  We suggest that a partner should not have the right to withdraw from a partnership of defined duration, subject to agreement to the contrary. (6.19)
27	Where partnership for term is continued over, continuance on old terms presumed	23.7 – 23.10	We ask whether, in line with our policy on section 26, the term “partnership at will” could usefully be revised. (23.10)
28	Duty of partners to render accounts, etc	14.3	We suggest no change to this section. See the discussion of partners’ duties in Part 15.
29	Accountability of partners for private profits	14.4 – 14.6	We ask whether the court should be empowered to grant relief where the partner has acted honestly and reasonably. (14.6)
30	Duty of partner not to compete with firm	14.7 – 14.8	We suggest no change to this section. (14.8)
31	Rights of assignee of share in partnership	23.11 – 23.16	We invite views on whether the principle of section 31 should be extended to anyone acquiring a partner’s share by operation of law while the partner remains a partner. (23.16)

Section	Title	Dealt with in Paper at paragraphs	Suggested reform
32	Dissolution by expiration or notice	6.8 – 6.20  6.54 – 6.55	<p>We suggest that drafting changes are necessary to section 32(c) in light of our suggestion to revise the terms used in sections 26, 27 and 32(a). (6.20)</p> <p>We also suggest that there should be a general provision that a partnership comes to an end as regards all the partners at the time, or on the occurrence of any act or event, provided for in the partnership agreement as having this effect. (6.55)</p>
33	Dissolution by bankruptcy, death or charge	6.21 – 6.25  6.49 – 6.53	<p>We suggest that the effect of a death or bankruptcy of a partner should be only to dissolve the relationship between that partner and the others and not, unless the partnership agreement so provides, to dissolve the partnership as regards all the partners. (6.25)</p> <p>We invite views as to whether an equivalent of “death” should be referred to in the case of a partner which is a legal person, and whether the meaning of “bankruptcy” should be clarified. (6.25)</p> <p>We ask whether the rule in section 33(2) should be extended to other similar situations, such as an arrestment in execution of the share under the Scots common law. (6.53)</p> <p>We also suggest that the other partners should have an option to expel the partner concerned, in addition to the option to dissolve the partnership. (6.53)</p>
34	Dissolution by illegality of partnership	6.26 – 6.27	<p>We suggest that the effect of illegality affecting only the ability of one partner to carry on the business of the partnership should be only to dissolve the relationship between that partner and the others, and not to dissolve the partnership as regards all the partners. (6.27)</p>

<b>Section</b>	<b>Title</b>	<b>Dealt with in Paper at paragraphs</b>	<b>Suggested reform</b>
35	Dissolution by the Court	6.37 – 6.43	We ask whether in certain circumstances provided for in section 35, the court should have an additional power 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. (6.42)
36	Rights of persons dealing with firm against apparent members of the firm	10.49 – 10.53	We suggest no change to this section. (10.53)
37	Right of partners to notify dissolution	23.22	We suggest no change to this section. (23.22)
38	Continuing authority of partners for purposes of winding up	8.5 – 8.28  10.54 – 10.61	<p>We suggest that in relation to partnerships without separate personality, it should be made clear that the former partners of a dissolved partnership can carry on the business of the partnership for the beneficial winding up of the firm. (8.17)</p> <p>In relation to partnerships with a separate personality, we suggest that the dissolved partnership should be deemed to continue for the purposes of winding up its affairs and completing unfinished transactions. (8.28)</p> <p>We suggest that it should remain to be the case that former partners continue to be liable for the obligations of a dissolved partnership. (10.61)</p> <p>We also suggest that it should be made clear that, where the partnership has a separate legal personality, the liability of the former partners ceases to be subsidiary and becomes the primary liability when the partnership is dissolved. (10.61)</p>

<b>Section</b>	<b>Title</b>	<b>Dealt with in Paper at paragraphs</b>	<b>Suggested reform</b>
39	Rights of partners as to application of partnership property	7.6 – 7.12  8.29 – 8.60	<p>We suggest that an outgoing partner should not have the right to require the business to be wound up unless (1) this right has been conferred by the partnership agreement or (2) there is a substantial likelihood that the remaining partners would not be able to pay out the share of the outgoing partner or that the outgoing partner would not be indemnified against the liabilities of the firm. (7.12)</p> <p>We suggest the introduction of a new system for winding up the affairs of solvent dissolved partnerships under court supervision. The key feature of the new system would be the appointment of an officer with powers and duties modelled on those of the liquidator in a members' voluntary winding up of a company. (8.60)</p>
40	Apportionment of premium where partnership prematurely dissolved	23.22	We suggest no change to this section. (23.22)
41	Rights where partnership dissolved for fraud or misrepresentation	6.34 - 6.36	<p>We suggest that rescission on the grounds of fraud or misrepresentation should not terminate the contract or dissolve the partnership but “innocent” partners must apply to the court for an order of rescission. (6.35)</p> <p>Note: see also our proposals in respect of section 35. (6.42)</p>
42	Right of outgoing partner in certain cases to share profits made after dissolution	7.18 – 7.26	<p>We suggest that an outgoing partner should no longer have a right to a share of the profits attributable to his share in the partnership assets. Instead there should be a right to interest upon the value of his share. (7.26)</p> <p>Note: see also our proposals in respect of section 43. (7.17)</p>

Section	Title	Dealt with in Paper at paragraphs	Suggested reform
43	Retiring or deceased partner's share to be a debt	7.13 – 7.17	<p>We suggest that in a continuing partnership the outgoing partner's share should be transferred to the remaining partners by operation of law. (7.17)</p> <p>We propose that the counterpart should be that the outgoing partner becomes entitled to the value of the share and that the outgoing partner should be bound to transfer any title to partnership assets held by him. (7.17)</p>
44	Rule for distribution of assets on final settlement of accounts	8.67 – 8.79	We ask whether section 44 operates in a satisfactory way, in particular, in cases where one former partner is insolvent and where the so called rule in <i>Garner v Murray</i> applies. (8.79)
45	Definitions of “court” and “business”	5.10	We see no need to amend the definition of “business”.
46	Saving for rules of equity and common law	23.17 – 23.18	We suggest that the rules of equity and common law should be expressly preserved in the new Partnership Act. (23.18)
47	Provision as to bankruptcy in Scotland	-	We do not consider reform of the law of insolvency as it is beyond our terms of reference. (see paragraph 2.47, n 102)
50	Short title	-	-

# APPENDIX C

## VALUATION OF BUSINESSES CARRIED ON BY PARTNERSHIPS

Adapted for partnerships by Mr Peter Holgate and Mr Emile Woolf of Kingston Smith, Chartered Accountants from Appendix D in *Litigation Support*.<sup>1</sup>

### General

1. Businesses or professions in the United Kingdom are generally carried on through the medium of a limited company or by the proprietors acting together in partnership. The choice of medium depends on a number of circumstances and may have regard to regulatory, liability, tax or other factors. The partnership medium has, in the past, been the more usual vehicle for certain professional businesses, notably lawyers and accountants, and until relatively recently was the only medium available. However, now that corporate status is available to most professional firms there should be little difference in the method of valuation applied to businesses carried on through any particular medium although specific adjustments may be required in any valuation assessment to ensure comparability amongst the various accounting bases applied and, in particular, for the different methods of accounting for proprietors' remuneration and working capital costs. It is however proposed that in principle there is no difference between the valuation of, say, a newsagents business carried on via a limited company and a similar business carried on by a partnership.

2. Although some asset backed businesses such as property companies and/or investment companies will have their underlying net asset values as the main valuation component, most of which can be supported/confirmed by reference to recognised market prices or yields, the majority of businesses will be valued by reference to the likely future maintainable earnings of that business and the level of return which a third party investor would expect to receive on the acquisition of the business or a share thereof.

3. In assessing the valuation it is also necessary to take account of the size of the prospective investor's stake in the business. In the case of an investment in a business operated as a limited company an investor with a minority shareholding would expect to pay a discounted price for that minority interest in order to reflect his lack of voting power and his reduced or, possibly, total inability to influence decisions on such matters as remuneration, dividend policy and the like. Such a discount is less relevant in the case of a partnership whereby an investor acquiring for example a 25% stake in a partnership business would expect to receive a return of 25% of the profits and is likely in practice to have a greater influence on the policy and running of the business than a 25% minority shareholder in a limited company. It is suggested therefore that the discounting factor generally accepted in the valuation of minority shareholdings is not necessarily appropriate for valuations of minority stakes in partnership businesses. The acquirer of a stake in a partnership business, however big or small that stake, has an opportunity at the outset to ensure that the ground rules are set out in a partnership agreement. Legally enforceable shareholder agreements

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<sup>1</sup> PricewaterhouseCoopers, C J Lemar & A J Mainz (eds), *Litigation Support* (4th ed 1999), published by Butterworths, a Division of Reed Elsevier (UK) Ltd.

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that run in parallel with the Articles of Association are, in the case of companies, somewhat rarer.

## **VALUATION METHODS**

### **Capitalisation using the Price/Earnings Method**

4. This is by far the most common method of valuation of any business carried on by an unquoted company and is the primary valuation method behind the market values of listed company shares although many other factors affect market prices. The price/earnings method applies equally to the valuation of quoted and unquoted company shares. The price earnings method operates for unquoted companies where the shares have no day-to-day market price established by a stock exchange or equivalent. It is, however, equally relevant to the valuation of a business carried on by a partnership.

5. The capitalisation of future maintainable earnings is the most frequently used method of valuing an interest in any entity and there is no reason why such a method, with appropriate refinements, should not be used to value a partnership business. The use of this method for unquoted companies has generally been well supported by the Courts. The method is particularly applicable to businesses with relatively steady growth histories and forecasts of future earnings and regular capital expenditure requirements.

6. This methodology multiplies expected future maintainable accounting profits after tax by a ratio called the price/earnings ratio, and often referred to as the P/E ratio, in order to establish market value. The P/E ratio therefore represents the number of years' post tax earnings (assuming a constant level of profitability) it would take the share to earn an amount equal to its current price. Thus, the application of this methodology involves two main tasks:

- a) assessing the future maintainable earnings; and
- b) determining an appropriate rate of capitalisation, or P/E ratio.

### **The Assessment of Maintainable Earnings**

7. The assessment of future maintainable profits and their stability will normally involve reviewing the reliability of past accounts as a guide to future results, assessing budgets, isolating trends and results and, in appropriate cases, averaging those results.

8. The specific sources of profits and the nature of the income and expenses comprising them are important. The nature of the business from which profits flow and the relative risks associated with the business will influence the valuer's choice of a capitalisation rate (see below).

9. We emphasise that it is the future profit stream that the business can expect to maintain in real terms that is being valued, not the past results. The extent to which past profits are relevant will depend upon circumstances; the objective of the review will be to establish broadly whether the pattern is one of growth or decline. In practice, there is seldom need to review profits for more than the previous five years and a three-year period is more usual. Where there have been major changes in the way in which the business is conducted, dependence upon the most recent year, together with some reliable budgets, is often more useful than going back over the more distant past.

10. A particular problem in the assessment of future maintainable profits arises with the valuation of 'early stage' investments. These vary enormously by industry. They usually have the following in common:

- a) a short period of earnings, or none at all;
- b) high uncertainty and variability in the levels of future earnings and sales predictions; and
- c) a plan projecting good growth 'if all goes well'.

11. In assessing maintainable profit by reference to past performance, it is appropriate to adjust for extraordinary and non-recurring items of income and expenditure to provide a better guide to the future. Experience suggests however that some items classified as such are in fact more regular and common than proprietors care to admit and it is questionable whether any adjustments should be made. Particular circumstances must be assessed on their merits.

### ***Review of Accounting Policies***

12. In reviewing any calculations of future maintainable profits it is important to assess the suitability and consistency of the accounting policies used both in arriving at past results and for forecasting the future. Clearly consistency in accounting methods and policies is necessary to achieve comparability and it is particularly important in the case of partnerships where the more closely prescribed accounting rules and principles applied by limited companies, by virtue of the Companies Act 1985 and various accounting and financial reporting standards, are not necessarily applied in the preparation of partnership accounts. Adjustments must thus be made for any significantly untoward or lax accounting policies.

13. This review and evaluation of accounting policies will be important when assessing past performance. Adjustments may be necessary for any inappropriate accounting policies, in particular:

- a) those which in the opinion of the valuer are unsound, misleading or inapplicable to the circumstances of the business under examination; or
- b) those which are inconsistent with the expectations of the person for whom the valuation is being prepared.

14. Adjustments will typically arise out of a review of accounting policies where the accounting treatment adopted does not fit comfortably with the generally accepted principles of prudence and consistency nor with the methods of measurement set out in Accounting or Financial Reporting Standards. Typical adjustments include those relating to inadequate or excessive depreciation charges, the treatment of deferred expenses, and unacceptable methods for the valuation of stocks or work in progress, lack of accounting fully for debtors and creditors and the treatment within the accounts of proprietors' benefits and own consumption.

15. The treatment of accumulated unused tax losses is potentially contentious. On the assumption that the losses will be deductible against future assessable income, the practical solution is to calculate future maintainable profits and to give some credit for the tax relief which can be obtained against past losses. There can be no rules for this. It depends on the particular circumstances of each case.

16. Examples of adjustments that might be required are:-

- the past or future foreign exchange gains and/or losses;
- the inclusion of income from, or expenses incurred in relation to, assets which are surplus to the requirements of the business and which may be disposed of without affecting the core activity, or new or discontinued income sources;
- the amortisation of any purchased goodwill and other intangibles, such as patents etc., appearing in the balance sheet to ensure that these items are written off over their useful lives which are likely to be of limited duration;
- changes in the nature of the business including acquisitions, divestments, upgrade of plant and equipment or change in core activities;
- the existence of abnormal or extraordinary items;
- the current stage of the product cycle and outlook for the industry;
- external factors such as economic indicators;
- the real cost of the use of proprietors' assets in the business such as the real rental value to the business of premises owned by a partner;
- other non-recurring items such as fixed asset sales, penalties, trade union disputes and the like.

17. Consideration should also be given to making relevant adjustments to reflect expected industry developments and future economic conditions, anticipating changes in such areas as market regulation, technological change, the entrance of new competitors, the introduction of new products and services, interest rates and foreign exchange rates.

### ***Partnership Remuneration and Funding Costs***

18. Two of the essential differences between the accounts of a limited company and those of a partnership are the treatment of the proprietors' remuneration and the costs to the business of financing the working capital provided by the partners. Whereas the remuneration of the managers or the directors of a limited company is normally paid by way of a salary and, together with associated national insurance benefits and pension costs, is an expense of the company charged in arriving at its pre-tax profit, the remuneration of partners is not an expense but is simply the balance of profit or loss left after charging all other business expenses. Similarly any interest paid to partners on the capital funds which

they have provided to the business is also an allocation of profits rather than an expense deducted in arriving at such profits, as would be the case with a company. Because of this and in order to achieve comparability it is necessary for any valuation to take into account as an expense of the business the financing costs and management remuneration which a prospective investor in the partnership business would expect to be borne by that business. Only by making such an adjustment will the balance of profits available for the investor be determined. It is, for example, quite normal for a potential investor when assessing the ongoing profitability of the business to assume:

- i) that the existing funds provided by the partners will be replaced by arm's length bank borrowings with an appropriate interest cost; and
- ii) that outgoing proprietors, or partners, will be replaced by competent managers, with the managers' total remuneration cost further deducted in arriving at the ongoing maintainable profit.

19. It makes no difference if the new investor is actually intending to operate or take part in the management of the business himself as any valuation of the business should not be inflated by that part of the profit representing a return for his own efforts in managing the business.

20. Based on any of the relevant factors listed above, and the valuer's assessment of their relative importance, a judgement is then made on the underlying profitability of the business or entity being valued. It should be evident that the process of determining maintainable earnings is not a mechanical exercise and requires commercial judgement.

### **Determining the Appropriate P/E Ratio**

21. Having arrived at a figure for the likely maintainable earnings (pre or post-tax) it is necessary to arrive at the P/E ratio to be used as a multiplier to arrive at the capital value of those maintainable profits. This is undoubtedly the most subjective aspect and would normally be arrived at by using one of two methods. The "comparable company" method and the "investment" method.

#### ***The "comparable company" method***

22. The objective of using this method is to find P/E share ratings in a relevant sector of the AIM or the listed securities market, on the basis that two businesses in the same industry with broadly similar records, earnings prospects and risk would command similar stock market ratings as expressed in their P/E multiples. However, if their rates of growth are significantly different the P/E ratios will differ also.

23. The choice of multiple is, of course, decisive. This is where the judgement of the valuer is required. He must look for a comparable business with a stock exchange or similar listing to arrive at an objective result. The starting point is to see what range of multiple the market accords to shares of businesses with similar characteristics.

24. The reliability of comparisons will vary considerably. Arriving at a sensible answer requires research into the history of the "comparable company"; only then will the differences and similarities be appreciated. Differences will inevitably distort or destroy comparability. In valuation disputes, research into comparable situations needs to be

exhaustive and comprehensive. The valuer may have to defend himself against accusations of upward or downward bias. Obviously, the more unusual the business, the harder it is to extract helpful criteria from published investment statistics.

25. The type of questions to consider about a suitable company to use as a comparison are listed below:-

- a) Is it in the same sector?
- b) Is it of comparable size?
- c) Are the managements equally competent?
- d) Is the financial leverage, the capital structure, broadly similar?
- e) Are parts of the business under-exploited?
- f) Do the companies have a similar or dissimilar history of earnings trends over the previous years?
- g) Have the shares been subject to recent special influences (for example, takeover or rumoured takeover)?
- h) What special factors (if any) make either business unique?

26. The sources of information to answer these questions will typically include:

- published accounts;
- brokers' reports;
- the Financial Times market statistics;
- Bloomberg;
- The Estimates Directory;
- the Stock Exchange Daily Official List; and
- the Investors' Chronicle.

27. Although it may be possible to find a market value of a comparable listed company to use as a yardstick for the valuation, many of the partnership businesses for which a valuation will be required will be considerably smaller in size than anything listed on any stock exchange. The valuation must therefore take this into account, as well as the lack of marketability of the proprietorial interest in the business, unlike a shareholder in a listed company whose shares are readily marketable, and must also assess the benefits or disadvantages of the size and vulnerability of the smaller business.

28. In some business sectors an alternative market exists and in businesses such as those involved in the hotel and catering trade, public houses and bookmaking, specialist agents may be a readily accessible source of information on recent transactions giving a much more accurate guide to valuations in those particular sectors.

### **Other Valuation Methods**

#### ***The Investment Method***

29. In using the investment method a prospective purchaser attempts to compare the rates of returns available from other forms of investments and to link this with the perceived risks and rewards associated therewith.

#### ***The Discounted Cash Flow Method***

30. This method is much more suitable for investment in businesses where the perceived useful life of the business is limited such as, for example, investment in a business operating a quarry or coal mine where the current value will be assessed by reference to future cash recoveries over the life of the business including those anticipated on closure or ultimate sale of the worked-out asset.

31. We suggest that the above two valuation bases will not generally be relevant to ongoing business activities and that valuations of any highly specialised businesses will require individual assessment.

### **Professional Partnerships**

32. Although most of the valuation considerations applicable to commercial activities carried on in partnership are also relevant to professional partnerships, particularly those where corporate entities are regularly used, care has to be taken to recognise the impact of professional restrictions on management and in many cases the very personal relationship built up between partners and the clients thereof.

33. Many professional practices, such as estate agents, surveyors and stockbrokers are now carried on as limited liability companies and a valuation yardstick can be obtained using the methods indicated earlier.

34. More “personal” partnerships such as solicitors and accountants, although in some instances permitting outside non-professionally qualified investors, are likely to find that much more of the goodwill, and thus the valuation of the business, is vested in individual partners and the risk of a slice of the partnership’s business activities being lost on the occasion of a partner retiring or selling up has to be taken into account as a factor in the valuation. In practice, however, this is not normally a problem if the retiring or departing partner’s share is to be acquired by one of his colleagues, by the remaining partners or by someone else within the firm. In assessing the valuation account must clearly be taken of any part of the client base etc at risk on the departure of a partner either by retirement or otherwise including the risk that he will attract clients by setting up in practice in opposition.

### **Goodwill**

35. One of the most misunderstood concepts in valuation is the term “goodwill”. The accountancy definition of “goodwill” is the difference between the cost of an acquired business and the aggregate of the fair values of that business’s separable assets and liabilities. In other words it is not itself an asset but rather a reconciling bridge between the cost of a business and the values attributed to its separable net assets.

36. It will be readily appreciated that professional entities and other “people” businesses in the services sector will have relatively few separable net assets of a tangible nature other than premises, office furniture and IT hardware and software. The value of such a business as a whole will therefore exceed materially the value of the net assets, giving rise to large sums for goodwill.

37. It is often argued that the value of a business’s goodwill is affected by factors such as its trading name, its location, quality of management and staff, products and brand image. This is undoubtedly so, as these are all factors to be taken into account in assessing the maintainable earnings of a business and the appropriate P/E ratios to use, as discussed earlier. They are all components in assessing business profitability. Thus it is possible that two businesses with identical products and profitability may be valued similarly even though one is a household name and the other is not.

### **Conclusion**

38. With the exception of certain specialised, short-term business activities such as quarries and subject to adjustments for comparability, the valuation of partnership businesses can proceed along the well-established lines of the valuation of businesses carried on by unquoted limited companies. It does, however, behove the valuer to ensure that the accounting policies and treatments are brought into line and that due weight is given to the size and marketability of the investment.

# **APPENDIX D**

## **LIST OF THOSE WHO SUBMITTED COMMENTS ON PRELIMINARY CONSULTATION PAPERS**

### **Scottish Law Commission**

Roger Adams, Ernst and Young  
David Bennett, Bennett and Robertson  
James Birrell, Shepherd and Wedderburn  
Gordon Brough, Brough Skerrett  
Neil Cochran, Dundas and Wilson CS  
Craig Connal, McGrigor Donald  
Stuart Cross, University of Dundee  
David Guild, Brodies WS  
The Honourable Lord Hamilton  
Alastair Kinroy  
The Law Society of Scotland  
Professor Bill McBryde, University of Dundee  
John Macfie, Bennett and Robertson  
James McCann, Legal Defence Union  
Malcolm McIver, Bird Semple  
James McNeill, QC  
David Nicol, Allan McDougall and Co SSC  
Paul Pia, Burness WS  
The Honourable Lord Penrose  
Professor Robert Rennie, University of Glasgow  
Derek Scott, Stagecoach Holdings plc  
Malcolm Scott QC  
Ian Watson, Hughes Dowdall  
Campbell White, Wright Johnston and MacKenzie

### **Law Commission**

Keith Baker, John Venn  
Roderick Banks  
Jonathan Blake, S J Berwin  
Richard Coleman, Clifford Chance  
David Cooke, Pinsent Curtis  
J P Davies, ACCA  
Department of Trade and Industry  
The Insolvency Service

J M Dyson, Chief Chancery Master  
Judith Freedman, LSE  
Christopher Gibbons  
Paddy Gregan, Linnells  
Andrew Hicks, University of Exeter  
Graeme Jump, Mace and Jones Grundy Kershaw  
Alan Magnus and Colin Joseph, D J Freeman  
Geoffrey Morse, University of Nottingham  
John Northam, Eversheds  
Nick Openshaw, Openshaws  
Mr Justice Rattee  
Giles Ridley, Slaughter and May  
Tony Sacker, Kingsley Napley  
Len Sealy, Gonville and Caius College  
Richard Whitehouse, Lovell White Durrant  
Robert Willott, Willott, Kingston Smith  
G C Wintle, Institute of Chartered Accountants  
Nicholas Wright, Wright, Son and Pepper

# APPENDIX E

## STUDY OF SCOTTISH PARTNERSHIP DEEDS

### SCOTTISH LAW COMMISSION

#### I. INTRODUCTORY

This report is based on a study by Ross McClelland, a legal researcher at the Scottish Law Commission, of 100 partnership deeds recorded in the Books of Council and Session in Edinburgh in 1997 and 1998. Initially it was intended to select a random block of 100 deeds. The block chosen included, in two block registrations, approximately 30 virtually identical deeds, where the partnership was used as an investment vehicle. This is a specialised use of the partnership, and the large number presented the risk that the figures produced by the study would be skewed. Accordingly, at the possible expense of the purity of the random nature of the study, only four examples of the investment partnership have been included.

#### II. CLASSIFICATION OF ACTIVITY

<b>CLASSIFICATION OF ACTIVITY</b>	
Investment:	4
Retail:	13
Professional / service:	27
Agriculture:	26
Various trades:	15
Catering / tourism:	9
Land / property:	6

The professional category consisted of doctors, veterinary surgeons and solicitors. The veterinary and medical partnership deeds tended to be much more detailed than the average deed, covering sick pay, maternity leave, provision of locums, entitlement to lecturing fees and similar matters. About a third of the agriculture category were limited partnerships, entered into by a landowner with a farmer, with the partnership being the tenant of the landowner. The land / property category generally consisted of partnerships for managing land, or for regulating the business relationship between landlords.

The partnerships generally concerned a very small number of partners, usually 2 or 3. The professional partnerships tended to be larger. No deed referred to more than 6 partners.

### III. OUTGOING PARTNER PART I: WAYS FOR PARTNER TO LEAVE FIRM

PART I: WAYS FOR PARTNER TO LEAVE FIRM		
a) Notice of dissolution		73%
i) Of which, alternative retirement procedure		44%
b) Expulsion by notice		55%
i) Of which, suspension period?		7%
c) Deemed retirement?		38%
d) <u>Ipso facto</u> disqualification		11%

Most deeds state that the partnership will endure at least for a set period or until dissolved by notice. Thus an express reference to the power of dissolution is made. Some deeds provide for an alternative retirement procedure. By this is meant a provision for a partner leaving the firm without serving a notice of dissolution. Some deeds which referred both to notices of dissolution and retirement did so without elaborating on the difference.

It is relatively common to find a clause stating that a notice of dissolution is to be treated as a notice of retirement. This “deemed” notice of retirement device is also sometimes used in the event of a partner being expelled.

The use of a retirement procedure distinct from dissolution is probably intended to provide a means for a partner to leave the firm without dissolving it. The use of the “deemed retirement” device seems aimed at the same result.

The power of partners to expel a colleague invariably referred to a list of grounds on which it could be exercised. These grounds did not differ much, but some deeds contained more comprehensive grounds than others.

It is sometimes difficult to distinguish an expulsion procedure from the notice of dissolution procedure, because some deeds allow the remaining partners to serve a notice of dissolution on a defaulting partner.

Expulsion is virtually always to take effect by written notice from all other partners, sometimes on a date chosen by the partners and sometimes after the expiry of a notice period. The following list is typical of the grounds justifying expulsion:

1. Becoming notour bankrupt, granting a trust deed for behoof of creditors etc;
2. Grossly neglecting partnership business;
3. Bringing name of partnership into disrepute;
4. Acting contrary to agreement or good faith of partners;
5. Performing one of the acts listed in the deed as being prohibited without the consent of all partners. That list would normally include:

- a) Signing a bill of exchange or contract a debt on behalf of firm outwith normal course of business;
- b) Granting credit or loan money contrary to prohibitions of other partners;
- c) Granting caution on behalf of partnership;
- d) Knowingly permitting anything to be done whereby partnership property may be subject to diligence;
- e) Assigning or charging share in partnership;
- f) Taking management decisions not in accordance with partnership policy;
- g) Releasing, compounding or compromising partnership debts;
- h) Guaranteeing payment other than in ordinary course of partnership business;

A few of the more detailed deeds provide for the suspension of a partner alleged to be in default pending an investigation into his conduct or circumstances. A few deeds provide that the simple existence of certain specified circumstances will result in the partner immediately ceasing to be such. Commonly included is bankruptcy, and in professional partnerships, ceasing to be qualified to practise the business of the firm.

#### IV. OUTGOING PARTNER PART II: CLAUSES ON CONTINUITY

<b>CLAUSES ON CONTINUITY</b>	
a) Of business and/or name	22%
b) Of contract	16%
c) Of partnership	23%
d) Specified event expressly to result in termination:	<u>19%</u>
Causes of termination <sup>1</sup> :	
1. Admission of new partner:	1 instance
2. Power to one partner:	2 instances
3. Termination of partnership lease:	2
4. Death:	8
5. Expulsion:	1
6. Incapacity:	4
7. Insolvency:	4
8. Retirement:	6
9. Breach of contract:	1
10. Absence:	1
11. Professional misconduct:	1
12. Insufficient funds to pay salary:	1
13. Irreconcilable differences between partners:	1

<sup>1</sup> Some deeds provided that one of a number of specified events could bring about termination.

The “deemed” retirement device may have the result that the partnership continues as between the remaining partners when a partner leaves. Some deeds contain clauses expressly continuing an aspect of the partnership. Sometimes, the remaining partners can elect to continue the partnership. Usually continuity clauses start by describing the circumstances in which the partnership is not to end. Some deeds contain provisions on continuity where that would seem impossible, e.g. in the event of a partner leaving a two partner firm.

It is difficult to know precisely what is the intention behind some clauses on continuity. The most persistent problem is in knowing what it is intended to continue. Some deeds are clear: they state that when a partner leaves, “this contract” or “this agreement” is to continue between the other partners. Less clear is the meaning of the term “partnership”. In some contexts, it seems to mean the “partnership relation”. For example, in the phrase “partnership as between the continuing partners”, the word “between” seems to suggest a relation. So also when the reference is to the partnership being continued by the remaining partners on the same terms. In other cases, there is reference to the partnership continuing “in being”. This could refer to the partnership as a legal entity. It is likely that drafting has been influenced by the definition in the 1890 Act that “[p]artnership is the relation which subsists between persons carrying on a business in common with a view of profit”.<sup>2</sup> If so, a reference to the partnership continuing in being might mean no more than that the remaining partners agree to continue their relationship and to continue to be bound after the departure of the outgoing partner by the terms of the existing contract.

## V. OUTGOING PARTNER PART III: HOW IS PARTNER’S INTEREST DETACHED FROM PARTNERSHIP?

<b>HOW IS PARTNER’S INTEREST DETACHED FROM PARTNERSHIP?</b>		
a)	Automatic transfer to remaining partners <sup>3</sup>	
	i) of partner’s share:	13%
	ii) of partnership property:	<u>27%</u>
	Total:	<u>40%</u>
b)	Pre-emption right in favour of remaining partners <sup>4</sup> :	38%
c)	Option <sup>5</sup> to sell to third party, subject to approval:	5%
d)	Obligation on outgoing partner to transfer heritage:	18%
e)	Pre-emption rights over partnership heritage:	1%
f)	Personal representatives of outgoing partner	
	1. Expressly excluded:	21%
	2. Included:	3%
g)	Obligation on remaining partners to settle liabilities of firm:	23%
h)	Winding up expressed to be alternative:	41%

<sup>2</sup> Section 1(1).

<sup>3</sup> Or in one case, to the spouse of the surviving partner. Also included here are deeds that refer to transfer of “control”. Also those deeds which place an obligation on remaining partners to buy the outgoing partner’s share.

<sup>4</sup> Also included here are deeds which, rather than framing the transfer as a sale, simply provide for the option to transfer the share to the remaining partners (compensation being provided in a later term)

<sup>5</sup> In event of pre-emption right not being exercised.

Clauses providing the mechanism for separation of an outgoing partner's interest from the firm are very common. Usually there will be a clause detailing how to calculate the sum due to the outgoing partner. This is dealt with in the next section. A large percentage of deeds precede that with an automatic transfer of property to the remaining partners. Sometimes it is the outgoing partner's share in the partnership that is transferred, sometimes it is the "assets of the partnership" and sometimes both the partner's share in the partnership and his share in the assets. This transfer is said to occur at the moment the outgoing partner ceases to be a partner.

The wording of these clauses can be confusing. An example is included here:

"The continuing partner shall have an option to call on an outgoing partner to transfer the partnership interest or share of the outgoing partner to the continuing partner to the effect that the whole assets of the partnership shall become the exclusive property of the remaining partners."<sup>6</sup>

A common variation is for the remaining partners to have a pre-emption right over the outgoing partner's share in the partnership. In some deeds, the right is exercisable over the interest of the outgoing partner in the partnership assets.

A few deeds allow the outgoing partner to find a willing buyer to nominate as a replacement partner (although always subject to the agreement of the other partner) and a few limited partnerships provide that the limited partner's share can be freely assigned to another who will thereby be admitted as a partner. It is relatively common to find a clause expressly preventing the representatives of a deceased, incapable or bankrupt partner from replacing the partner in the firm.

The way in which the statistics are presented here may exaggerate the practical differences between deeds. It is likely that similar effects are achieved in practice by differently structured deeds. For example, a pre-emption right over an outgoing partner's share combined with a continuity clause is likely to operate in the same way as a right to remaining partners on receipt of a notice of dissolution to elect to continue the partnership. Both would allow the remaining partners to continue the partnership business unhindered by their colleague's departure. Both also result in payment to the outgoing partner, since the election clause will invariably be followed later by a clause on payment to the outgoing partner.

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<sup>6</sup> This is confusing from the point of view of Scots law because the partnership can own property. It thus does not necessarily follow from a transfer of the outgoing partner's share in the partnership that the recipient will own all property previously owned by the partnership.

## VI. OUTGOING PARTNER PART IV: VALUATION OF OUTGOING PARTNER'S SHARE

<b>VALUATION OF OUTGOING PARTNER'S SHARE</b>		
a)	different procedures depending on circumstances of leaving:	10%
b)	new accounts to be prepared:	46%
c)	most recent accounts (sometimes with adjustment <sup>7</sup> ):	20%
d)	revaluation:	
	i) automatic	11%
	ii) option of outgoing partner:	19%
	iii) option of any partner:	9%
	iv) no revaluation:	5%
e)	interest:	
	i) above base lending rate:	26%
	ii) at or below base lending rate:	19%
	iii) explicitly no interest:	1%
	iv) level of interest not specified:	2%
f)	Goodwill to be valued?	
	Yes <sup>8</sup> :	7%
	No <sup>9</sup> :	<u>41%</u>
	Total:	<u>48%</u>

Some deeds provided a different means of valuation if a partner was expelled rather than leaving for any other reason.<sup>10</sup> Usually this means the outgoing partner is not to benefit from his right to have partnership assets revalued, but in some cases means the remaining partners can take longer to pay.

References to goodwill are relatively common, although usually to state it is not to be valued. It is very rare for there to be any basis for valuation of goodwill.<sup>11</sup> Where a deed places a valuation on goodwill, the value of an outgoing partner's share is sometimes not to include goodwill if the partner is leaving the firm by reason of bankruptcy.

The statistics on interest are included because such provisions are likely to have an impact on the delay before an outgoing partner receives full payment.

About 40% of deeds provide for revaluation of assets when a partner leaves the firm. Most conferred the right to demand a valuation on only the outgoing partner. If an asset was originally overvalued, or depreciated since its last valuation, the remaining partners would be left to bear that difference with no right to revalue.

<sup>7</sup> Some deeds provide that retirement is only possible on the firm's accounting date. Thus, some deeds falling in this category will actually in effect allow new accounts to be prepared at the date of the partner leaving.

<sup>8</sup> Sometimes excluded if bankruptcy the reason for leaving.

<sup>9</sup> Included here are deeds where the proceeds from goodwill, if sold, are to be shared according to a specified formula. Such deeds imply that, in calculating the value of an outgoing partner's entitlement, no value is to be placed on goodwill.

<sup>10</sup> For example, death, insolvency, retirement or incapacity.

<sup>11</sup> One deed valued goodwill and work in progress at "one third of annual gross fee income of the firm for the three preceding years".

VII. OUTGOING PARTNER PART V: TIMING OF PAYMENT TO OUTGOING PARTNER

<b>PART V: PAYMENT TO OUTGOING PARTNER</b>		
a) By a particular date?		
1. Within 6 months:		4%
2. Within 12 months:		3%
3. Within 24 months:		5%
4. Within 10 years:		<u>1%</u>
	Total:	<u>13%</u>
b) Instalments?		
i) Monthly:		1%
Number of instalments		
A. 2-6:		1%
B. 7-10		
C. 10+		
ii) Three monthly:		
Number of instalments		
A. 4:		1%
B. 8:		2%
C. 12:		<u>1%</u>
Total:		4%
iii) Four monthly:		1%
(15 instalments)		
iv) Six-monthly:		
Number of instalments		
A. 2-6:		13%
B. 7-10:		8%
C. 10+		
D. Unspecified:		<u>2%</u>
Total:		23%
v) Yearly:		
Number of instalments		
A. 2-6:		7%
B. 7-10:		3%
C. 10+		
Total:		<u>10%</u>
vi) By amount: £2000:		<u>1%</u>
	<b>TOTAL by instalments:</b>	<b><u>40%</u></b>
c) right to accelerate payments:		17%

The range in payment periods is very wide: from 6 months to 10 years. An unusual variation on payment by instalments was the provision of a pension for the outgoing partner.

An acceleration clause allows the remaining partners to make payments to the outgoing partner ahead of the due date. Such acceleration clauses are generally found in the same deeds as interest clauses.

## VIII. PARTNERSHIP PROPERTY

The following are examples of clauses on partnership property. They demonstrate the way in which deeds respond to the provisions of the 1890 Act and the common law concerning partnership property.

### **Type 1**

This is an example of a clause that seems intended to override s 22 of the 1890 Act.

“[A]ny land or any heritable interest in land which becomes Partnership property”, is to be “treated as between the Partners from time to time and their respective executors, successors and personal representatives whomsoever and for the purposes of succession to the estate of such partners (including claims for legal rights) as real or heritable estate and not as personal or moveable estate.”

### **Type 2**

“Notwithstanding any rule of law or presumption to the contrary and notwithstanding the terms of any titles of the heritable property of the partnership, or any destination contained therein the parties hereby agree” followed by details on which partners owned partnership heritage.

### **Type 3**

This appears to suggest that the partnership holds property in trust for the partners. This may well be what was intended, but it is unusual.

“The beneficial interest in the premises and all furniture, fittings and fixtures therein shall belong to the partners in the proportions to which they are entitled to share in the capital of the firm and such assets shall be treated as having a value no greater than the value attributed to them in the partnership accounts.”

### **Type 4**

- (a) “The premises shall be held by the partners as partnership property”.
- (b) Heritable property owned by one partner declared to be asset of partnership, and held on trust for firm.
- (c) Quotas “whether held in the names of the individual partners or in the name of the partnership” deemed held in trust for partnership.
- (d) Premises from which business conducted “shall not be included in the partnership assets, but shall remain the property of...”
- (e) Quotas held by partners in trust for the firm. Sheep flocks owned by individuals.

- (f) Inventions and discoveries deemed those of the firm.
- (g) Tenancy of premises held by partner in trust for firm.

## IX. MISCELLANEOUS CLAUSES

<b>MISCELLANEOUS</b>	
a) Arbitration clause:	77%
b) Specified acts prohibited without unanimous consent: <sup>12</sup>	56%
c) Restrictive covenant	13%
d) Governing law:	5%
e) Jurisdiction:	1%
f) Examples of phrases used in relation to valuation:	
1. "True and fair"	
2. "Open market value"	
3. "Just value"	
4. "Market value"	
5. "Fair market value"	
6. Willing buyer and seller in open market on basis of vacant possession	
7. Acquisition and building basis, on payment out; different, unspecified valuation system for balance sheet purposes	
8. Price for outgoing partner's share set at 40% of open market value	

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<sup>12</sup> An example list of such acts appears above.