

# Scottish Law Commission

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## PARTNERSHIP LAW FOR THE NEW MILLENNIUM

The Law Commission and the Scottish Law Commission are consulting on a thorough shake-up of the law governing 680,000 businesses run as partnerships in this country.<sup>i</sup> The current law was passed in 1890 and has failed to keep up with the expectations of those running and dealing with the businesses concerned.<sup>ii</sup>

### ECONOMIC IMPORTANCE OF PARTNERSHIPS

1. Partnerships encompass the full spectrum of business and industry. As well as providing a vehicle for professional business, partnerships are prominent in the retail trade, and in construction, manufacturing, agricultural and tourist industries.
2. These are not just micro businesses: 852,000 of the 2.77 million persons employed by partnerships are in firms with at least 10 employees.
3. The main rules of partnership law are set out in the Partnership Act 1890 which has hardly been amended since its enactment. As partnerships play an important role in the UK economy the reform of partnership law may make a real contribution to both efficiency and competitiveness.

### MAIN PROBLEMS WITH EXISTING PARTNERSHIP LAW

4. The Commissions address the three main problems with existing partnership law which are:
  - the gulf between commercial perception of the firm as an entity which continues regardless of changes in membership and the legal reality;
  - the danger of unnecessary discontinuance of the business caused by dissolution of the firm when such dissolution can be easily avoided;
  - the need to provide a more efficient cheaper mechanism for the dissolution of a solvent partnership.

#### The firm as an entity

5. Many business people dealing with a firm assume that the firm is the entity with whom they are transacting business. Partners joining or leaving may make no practical difference to the way in which a firm transacts its business, yet English law treats a firm following a change in membership, as a new firm different from that which existed before the change. Even in Scotland, where a separate entity is recognised, the law is not clear as to whether it continues on a change in membership.

#### Unnecessary closure of the business

6. Unless the partners have an agreement to the contrary, and many do not, when a partner leaves or dies it may be necessary to wind up the business. This may be contrary to the wishes of a majority of partners who are able and willing to carry on the business.

#### Procedure for winding up a solvent partnership

7. Former partners may be unable to agree as to how a solvent business should be wound up and this can result in repeated court applications to resolve problems. This leads to expense and unreasonable delays which may exhaust the assets or destroy a business which could otherwise have been sold as a going concern.

### LAW COMMISSIONS' SUGGESTIONS FOR REFORM

- introduction of separate legal personality
- continuity of partnership
- new mechanism for solvent dissolution

#### Separate legal personality

8. To remove the gulf between commercial perception and legal reality the firm would become an entity which could enter into contracts, undertake obligations and own property in its own right.

9. Continuity of personality would involve the firm continuing as an entity notwithstanding changes in membership.<sup>iii</sup> Partnerships could, if they wished, opt out of continuity of personality.
10. The Commissions considered whether personality should only be granted on registration but suggest that it should not be dependent on registration because of the administrative burdens which that would involve.<sup>iv</sup>

#### Continuity of the partnership

11. Even if there were to be no reform introducing independent personality, there are ways of achieving continuity of the business.<sup>v</sup>
12. Instead of dissolution of the whole partnership on a change in membership, the Commissions suggest that it should be possible to dissolve only the relationship between the departing member and the other partners. They could then carry on the business.<sup>vi</sup>
13. Any partnership which did not want to continue in business after departure of one of its members could enter into an agreement providing for dissolution of the entire partnership.

#### Mechanism for solvent dissolution

14. The Commissions propose the creation of a new system which would involve the appointment of an individual with full powers to deal with the assets of the partnership as agent for the former partners. With some exceptions, there would be no need to obtain the sanction of the court or the approval of former partners to the exercise of the powers.
15. The powers would include bringing and defending legal proceedings, selling or transferring property, borrowing against security of partnership property and gathering in and distributing assets.

#### Other reforms

16. The Commissions suggest a number of other modernising measures in relation to actions to enforce partnership obligations and statutory statements of partners' duties.<sup>vii</sup> They also seek views on a number of issues as to which they make no proposals including improving the availability of information about the membership of a firm and extending the availability of floating charges.

The Chairmen of the Commissions, Mr Justice Carnwath CVO and Lord Gill, agree that:

“While attention has recently been focused on the reform of company law it is no less important that the rules which govern partnerships are clear and sufficiently address the needs and current practices of today’s market.”

The Commissions invite comments on this joint consultation paper by 12 January 2001. The full text, together with a summary, is available on the Internet at

<http://www.lawcom.gov.uk> OR <http://www.scotlawcom.gov.uk>

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<sup>i</sup> Partnership Law: A Joint Consultation Paper – LCCP159 / SLCDP111 – published on 13 September 2000, and available from The Stationery Office, £24.50, and on the Internet at <http://www.lawcom.gov.uk> or <http://www.scotlawcom.gov.uk>. The period for responses will end on 12 January 2001.

<sup>ii</sup> 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.

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The paper published on 13 September 2000 reviews the Partnership Act 1890. The Commissions plan to publish a further paper reviewing the 1907 Act.

iii Persons dealing with the firm could pursue their remedies primarily against the continuing firm. If it were unable to meet its liabilities then they could claim against those who were partners at the time their cause of action arose.

iv The disadvantages of independent personality without registration are that it would not provide a historical record of partnership information. People joining or doing business may be unaware of whether its personality continues on a change in membership. Current partnership law gives rise to similar difficulties as to the identity of a partnership. In case consultees wish to consider registration the Commissions have worked out a scheme in some detail.

v The following two reforms could also apply to partnerships with independent personality.

vi Such a regime would significantly alter the rights of the outgoing partner. The Commissions suggest that the outgoing partner's share in the continuing partnership should be transferred to the continuing partners who would owe its value as a debt to the outgoing partner. That partner would no longer be able to wind up the partnership unless allowed to do so under the partnership agreement or unless there is a substantial likelihood that the remaining partners could not afford to pay the debt or could not indemnify the outgoing partner against the firm's liabilities.

vii The firm would have primary liability for its obligations but the partners' subsidiary liability would be unlimited. Creditors could enforce a judgment against the firm upon the assets of the firm or of the partners. It is suggested that the duties owed by the partners to the firm and to each other should be clearly set out in statute. Currently there is, for example, no statutory statement of skill and care.