



PARTNERSHIP PROBLEMS & THE PARTNERSHIP ACT

Many partnerships start out when two people already know each other; most often they are friends who shared a good business idea or are former colleagues. When two or more people start a business based on a partnership, that business is known as a firm.

In the heady days of concentrating and growing the new business and raising finance, one of the things most often overlooked is formalising the arrangements. Very often it is not until cracks start to appear in the business relationship that the parties ever wish they had spent time on a partnership agreement.

NO AGREEMENT?

So what happens when you don't have a partnership agreement in place?

In the absence of an agreement, the starting point is an 1890 Act (no misprint - it really is over 100 years old) which is the Partnership Act.

The act defines a partnership as being "the relation which subsists between persons carrying on a business in common with a view of profit". There are some complex rules for determining exactly when a partnership even exists (for example it's not enough that premises are in joint names) but it all depends on receiving a continued share of the profits of a business (as opposed to a one off payment in one year only, for example).

(1) Bind the firm

Starting at a practical level, any one partner can actually bind or commit the firm in most ways. For example, one partner can commit the partnership to a contract to purchase goods and services and, unless the party supplying those goods or services knows that the particular partner either doesn't have authority (generally because the firm has made him aware by serving a notice on him), or doesn't know or believe he is a partner, the whole partnership is bound to that contract.

(2) Jointly liable

Having established that one partner can actually bind/commit the firm, the act also makes all the partners jointly (as a firm) and severally (as individuals) liable for everything for the period they were a partner, but not for anything that occurred before they become a partner or after the date they leave the partnership.

Each partner of the firm will be liable for all the

- wrongful acts and/or
- omissions
- admissions and/or representations concerning the partnership affairs (such as to the Bank or HMRC)

by any one partner who is acting in the ordinary course of the business of the firm, or with the authority of the other partners in exactly the same way as if each partner

actually committed the act or omission. It follows that the firm will be liable for all the losses which follow because of such acts or omissions.

Taking this further, even if one partner, for example, takes a customer's money and misapplies the money, the firm needs to make good the loss to that customer.

Likewise if there is money outstanding the creditor can simply pursue just one partner and leave that partner to arrange reimbursement from the other partner(s).

Whilst it is true that they can still do this if you have a partnership agreement in place, you will at least have provided procedures and responsibilities to deal with problems within an agreement.

(3) Holding Out

Anyone who allows others to think he is a partner or conducts himself as if he is a partner is liable when it comes to being pursued by one of the firm's creditors.

(4) Property

In the absence of a partnership agreement, the following applies:

- All property either brought into the partnership or bought with partnership money is deemed to belong to the firm
- All partners are deemed to share equally in profits but be equally responsible for liabilities. Partners have access to all accounting records.
- All partners can take part in the management of partnership business
- Generally, day to day matters are dealt with on a majority basis, except that new partners can't be introduced, nor can the "nature of the partnership business" be changed, unless all partners agree.

(5) Removing a Partner

Even where a majority of the partners agree to remove a partner, that partner can't actually be removed unless "a power to do so has been conferred by express agreement between the partners", so if there is no partnership agreement the partners may be stuck with the partner they wish to remove unless the partnership itself ends.

(6) The End of the Partnership

So if the partners are stuck in a partnership they don't actually want to be in, what can they do? Unfortunately, the only option is to actually dissolve the partnership and bring it to an end which, in practical terms, is extremely hard when, aside from any problems between partners, the firm is otherwise profitable. The following all lead to dissolution:

- (a) **Leaving** - Any partner can leave simply by giving notice to the others.
- (b) **Death, Bankruptcy or charge over partnership share** – automatically ends the partnership
- (c) **Unlawful event** – "of any event that makes it unlawful for the business of the firm to be carried on"
- (d) **Dissolved by a Court** – the Court can dissolve a partnership where one partner
 - ✓ is "permanently incapable of performing his part of the partnership contract"

- ✓ carries out “such conduct as, in the opinion of the Court with regard being had to the nature of the business, is calculated to prejudicially affect the carrying on of the business”
- ✓ “commits a breach” or conducts himself in matters relating to the partnership business so that “it is not reasonably practicable for the other partner or partners to carry on”

OR

- ✓ the business can only be carried on at a loss
- ✓ Any other reason that the Court considers is “just and equitable” for the partnership to be dissolved

(7) What happens to partnership assets on dissolution?

The partnership is at an end and the business ceases. The monies are dealt with as follows:

Stage 1 - All debts and liabilities are paid first

Stage 2 - Pay any partners who are due to be repaid for any advances made

Stage 3 - Pay any capital due to partners

Stage 4 - Balance is divided between parties according to percentage of profits they are due

If there are only losses then all partners must contribute towards those in accordance with the percentage that they received from profits.

A PARTNERSHIP AGREEMENT

This can be a fairly straightforward document and will simply set out what the partners have agreed.

Most importantly it can set out the partner’s obligations and how the business will be managed. Putting into that agreement a clause which sets out what actions that one partner wishes to take but which needs the written consent of the other Partners can save many problems. Such a section can, for example, confirm when any partner can obtain credit for the partnership, place a monetary limit (e.g. £1000) on purchasing goods and services and prohibit the dismissal of employees without the agreement of one or more partners.

A partnership agreement can also deal with how the partners will be paid. Very often, when a partnership starts to go wrong some of the initial problems relate to the management of the business and one partner drawing so much money from the business that it impacts on the firm’s financial viability.

In addition, bearing in mind partners are self-employed, the agreement can cover such practical items as to how many holidays each partner can take together with provision for other leave such as sickness, maternity and paternity.

Perhaps some of the most important provisions in a partnership agreement can relate to when a partner wants to leave. As we have seen, in the absence of any agreement the

Partnership Act, means that the partnership is dissolved. A partnership agreement can provide for expelling the partners on bankruptcy etc but will also allow a partner to leave the partnership without the whole partnership being dissolved and the business ceasing. Provisions can be made so that any partner leaving can, for example, be repaid any monies due in stages so that the business can actually carry on without having an unexpected financial commitment that would cripple it.

Email us on advice@limeone.co.uk or phone on 01244 852550 for more information and help for your specific requirements.



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