

PARTNERSHIP DISPUTES AND REMEDIES

by

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A DIFFERENCE OR DISPUTE: THE BASICS

When a difference or dispute arises then a partner may wish to consider his rights and duties. Where should he look ?

There are two documents which he should have to hand :

- (1) the Partnership Act 1890;
- (2) the partnership agreement.

The 1890 Act provides the default rules for the mutual rights and duties of the partners.

Where there is no partnership agreement the Act is an obvious port of call. But the default rules can be important for cases where there is a partnership agreement as sometimes – indeed often - the agreement may not be comprehensive. The gaps are inevitably filled in by the Act (as encrusted by the case law).

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The Act, though written in 1890, was written as a code of partnership law and the language is intended to be relatively user-friendly.

The default rules can be varied only with the consent of **all** of the partners which consent can be express or inferred from a course of dealing (s. 19)

The course of dealing provision is important, particularly in relation to any practice in the accounts that is accepted, e.g. the allocation of profits, payment of a salary (prohibited under the default rule (s. 24 rule (6))).

DECISION MAKING

(A) The general default rules

“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”. (s. 24 (rule (8)))

“Every partner may take part in the management of the partnership business” (s. 24 (rule (5))).

That last rule is an expression of the principle that partnership is a relationship of “*uberrima fides*” – utmost good faith.

“ . . . the Court presupposes in every contract, and if there can be a difference, more especially in every contract of partnership, a basis of good faith, upon which all the stipulations contained in the deed must rest.” **Blisset v. Daniel** (1853) 10 Hare 493, 522 per Sir W. Page Wood V.C.

“This [a fiduciary duty to fellow partners] is elementary in contracts of partnership. “*In societatis contractibus bona fides exuberet*”; partners must act in the utmost good faith. “For a majority of partners to say: We do not care what another partner may say, we, being the majority, will do what we please, is ... what this Court [of Equity] will not allow”—Lord Eldon in Const v. Harris, (1824) Turn. & Russ. 496, at p. 525. In Beveridge's case (1872) 10 M (H.L.) 1 —a co-partnership case—the same law was laid down by Lord Justice-Clerk Patton. The Court may interfere “if there was not the exercise of discretion” but “something done plainly beyond and in excess of what was right for the administration of the company.” In the leading case of Blisset v. Daniel related to the expulsion of one partner by the partners holding a majority of the copartnership shares, Vice-Chancellor Page Wood (afterwards Lord Hatherley) stated (at p. 524) that “A power so conferred by the co-partnership articles exercised by partners holding a majority of shares must be understood to exist, not for the benefit of any particular parties holding two-thirds or more of the shares, but for the benefit of the whole society.” The purported expulsion was held by the Vice-Chancellor, at the instance of the expelled partner, to be in the equity sense “a fraud upon the power” vested in the majority of the partners.” **Harris v. A. Harris Ltd** 1936 S.C. 183, 204 – 205 per Lord Murray.

So if a partnership meeting is to be held all partners must be invited to attend. To fail to do so is to breach the utmost duty of good faith contained in the default rules.

At the meeting the partners must be heard out – the power of the majority must be exercised in good faith for the benefit of the partnership and taking account of minority views

Minority does not have a right to talk to obstruct the meeting (**Const** (above); and **Wall v. London and Northern Assets Corporation** [1898] 2 Ch 469).

(B) Introduction of a partner

For introduction of a partner the default rule is that the consent of all partners is required (s. 24 (rule (7))).

(C) Expulsion of a partner

For expulsion the default rule is that “no majority of the partners can expel any partner” (s. 25). In practice this means that there must be an express provision in the partnership agreement providing for expulsion before a partner can be expelled.

For expulsion utmost good faith and fairness requires

- The power to be exercised only for the benefit of the partnership, and not other motives;
- the partner in question to be given notice of the general grounds of proposed expulsion (**Blisset** (above)), and
- the partner in question to be given an opportunity of a hearing or to make representations.

REMEDIES FOR BREACH OF MANAGEMENT RULES

(A) Interdict and Specific Implement

Partnership is a contract. Future or ongoing breach involves a wrong which can be interdicted, if urgent, by interim interdict.

Will be unusual for the court to grant specific implement but in principle it is possible.

(B) Suspension, Reduction, and Declarator

If a decision has been already taken, then its effect can be suspended by an order of interim suspension and permanently annulled through raising an action for reduction of the decision.

An action of declarator may be another flexible remedy to have the unlawful conduct declared null and void e.t.c..

(C) Dissolution

“On application by a partner, the Court may decree a dissolution of the partnership . . .
...

(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:

...

(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.”

(s. 35 of the 1890 Act)

“just and equitable” can include the loss of mutual confidence between the partners rendering continuation of the business impossible (**Atwood v. Maule** (1868) 3 Ch.App. 369, 373)

e.g. where the partners disagree over the handling of a serious court action against the firm (**Harrison v. Tennant** (1856) 21 Beav. 482)

e.g. breach of duties of utmost good faith mentioned earlier

Some guidance can be had from quasi-partnership company cases.

Procedure is by petition (Court of Session) or summary application (sheriff court)

(D) Appointment of Judicial Factor

“On the dissolution of a partnership every partner is entitled, as against the other partners in the firm, . . . 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.”

(s. 39 of the 1890 Act).

This can be sought at the same time as dissolution or later. Winding up is by means of the appointment of a judicial factor. But court will only appoint the factor if there is no other satisfactory means of winding up the affairs of the firm e.g. fear of dissipation of or damage to assets, or deadlock between the partners. Court will view this a judicial factor as a last resort.

An interim judicial factor may be appointed (**McCulloch v. McCulloch** 1953 S.C. 189) in situations of urgency.

(E) Damages

Unclear if this is competent since the loss from a decision will affect principally only the partnership property (the firm being a separate entity from its partners) and only indirectly the partner's share.

RETIREMENT/RESIGNATION AND DISSOLUTION BY NOTICE

The default rules for retirement/resignation are in s. 26.

The default rules for dissolution by notice are in s. 32.

Relationship between them is not entirely clear. Often they are viewed together. It may be that notice of intention to determine under s. 26 relates to a wish not to

have the partnership as a whole dissolved and wound up but simply to have his role terminated and his share paid out while allowing the partnership to continue.

A right to retire or resign from a partnership may be excluded by agreement (**Moss v. Elphick** [1910] 1 K.B. 846 – excluded for lifetime of the partners)

A right to dissolve under s. 32 may be excluded in the partnership agreement by provisions providing for termination “by mutual agreement” (**Maillie v. Swanney** 2000 S.L.T. 464)

Default rules draw distinction between –

- “fixed term” partnerships
- “no fixed term” or “undefined time” partnerships.

For the “fixed term” partnerships resignation/retirement and dissolution are excluded.

For “no fixed term” or “undefined time” partnerships the default rule allows retirement/resignation with a written notice. The notice should be given to all of the other partners.

Thus important that these default rules be remembered when drafting or considering the effect of a partnership agreement, to see (a) whether they should be excluded; or (b) whether they have in fact been excluded.

DEATH AND BANKRUPTCY

The default rule (s. 33) is that death and bankruptcy dissolves the whole partnership. As a result it is often excluded to the extent of allowing the surviving partners to buy out the executor or trustee of the deceased or bankrupt partner.

However, if these alternative provisions are not activated, (or other settlement with the executor or trustee reached) then it must be remembered that the default rule will apply and the dissolution of the firm will take place – with consequent restrictions on carrying on business - and winding up must begin (if not by the partners then by a judicial factor).

LEAVER’S RIGHT TO CAPITAL AND INTEREST/PROFIT SHARE

In this type of situation, the partnership is continuing (because the default rules have been excluded and activated) and is not dissolved. The default rule is :

“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.”

(section 43)

This right to capital/obligation to pay capital also applies to a retiring partner (**Sobell v. Boston** [1975] 1 W.L.R. 1587, **Beckman v. I.R.C.** [2000] S.T.C. (SCD) 59). It will apply to an expelled partner unless it is excluded. The continuing partners will be obliged to pay it unless there the expelled partner owes a debt to the firm under the partnership agreement that has become due before the departure.

If this right to receive the capital is to be excluded clear wording to that effect is required in the partnership agreement.

(A) Capital

That sum of capital must be ascertained by reference to the accounts as at the date of departure.

General default rule is that accounts be “true” (s. 28) and therefore the assets must be revalued as at that date.

Default rule reflected in many partnership agreements by words such as “Proper books shall be kept and balanced” (**Noble v. Noble** 1983 S.L.T. 339 (appendix to **Thom’s Executrix** 1983 S.L.T. 335)).

This means that if assets are not to be revalued the default rule must have been excluded by express agreement or a course of dealing giving rise to the inference that non-market values are to be used for asset valuations at dissolution (as in **Thom’s Executrix**).

(B) Interest/Profit share

The default provisions are in section 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 5 % 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 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.”

The default provision is thus generally of interest for departing partners/their representatives in non-dissolution situations. However even in dissolution situations this provision can be important where some of the partners have (wrongfully) continued to trade without winding up the firm.

The right to capital can be enforced by means of an action for production of the dissolution account and then payment of the capital account.

RIGHTS TO CAPITAL AND INTEREST/PROFIT SHARE ON DISSOLUTION

In this type of case the partnership has been dissolved. On dissolution the expectation of the law is that the partnership should be wound up by the partners and that it should cease to trade.

Therefore the firm should be wound up as a whole, its assets sold, its debts paid, and then the capital divided in accordance with the default rule in s. 44.

In the dissolution situation, the true value of assets and liabilities (and thus of capital) will not be known until the assets have been sold and debts paid. Thus the extent of the partners’ entitlements will in general not be in terms of the accounts as at the date of dissolution (**Duncan v. The MFV Marigold** 2006 S.L.T. 975).

It will be contained in the accounts at the end of the winding up.

However usually, if the business is profitable, someone will wish to continue with it despite dissolution. In that case an early settlement with any partner who wishes to leave (or his representatives) is essential. Otherwise if instead of the

firm being properly wound up, one or more of the partners continues the business without a partner being paid his share, the default rule is that the innocent partner will be entitled to make an informed election on the basis of accounts, to receive from the continuing partners either interest at 5%/annum or a share of the profit as provided for in s. 42 from the date of dissolution until he receives his capital.

He may raise an action to force the production of the accounts to allow him to make the election. Often there will be some provision in the written partnership agreement as to arbitration and the question of what should be paid to the partner wishing to leave. In that case arbitration may be invoked, but interest or a share of the profits will continue to apply (e.g. **Purewal v. Purewal** Court of Session 21st Oct. 2008; affirmed 2nd October 2009, www.scotcourts.gov.uk)

As an ultimate threat the innocent partner (or any partner seeking payment) can petition for the winding up by the court and the appointment of a judicial factor, with further expense to all concerned, not to mention the loss of a functioning business. The factor would then liquidate the business, carry out the sales, payment of creditors e.t.c..

For that reason if unwelcome dissolution is threatened, early and informed action and agreement, at least on the means to resolve any dispute, is always desirable to preserve the business, its goodwill and the value of partners' shares.

INSPECTION OF THE BOOKS

An important remedy, often overlooked by silent partners. Section 24 rule (9) contains the default rule that the books are to be kept at the principal place of business of the partnership and that every partner may when he thinks fit, have access to and inspect and copy any of them.

Right may be enforced by action of exhibition for production to the court or for an order to allow inspection (order of implement/*ad factum praestandum*). The right of inspection can be exercised by an agent.

The right in rule (9) is in addition to the right of the partner and his legal representatives to full information (Section 28).

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