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PARTNERSHIPS AND PARTNERSHIP LAW

What is a Partnership?

A partnership is defined, with misleading simplicity, in s 1(1) of the Partnership Act 1890 as 'the relation which subsists between persons carrying on a business in common with a view of profit'. All legal definitions have exceptions, however, and s 1(2) is quick to exclude all forms of company (from ICI plc to Jones the Butchers Ltd) which would otherwise fall within the definition. Also excluded are limited liability partnerships (or LLPs) formed under the Limited Liability Partnerships Act 2000, despite their name. Section 1 of the 2000 Act makes that clear, although some aspects of partnership law do apply to LLPs (see below). The definition in the 1890 Act, however, does provide the three essential ingredients for a partnership, namely, a business, carried on in common, and with a view of profit, and we will return to those later on in this chapter. For the moment, however, the key word in the definition is the word 'relation'. Partnership is a relationship: it is not, except in Scotland, an organization in its own right with a separate legal personality. Unlike a company, therefore, a partnership cannot of itself make contracts, employ people, commit wrongs, or even be sued, any more than a marriage can. Where we talk of a partnership (or frequently of a firm) we simply mean the partners who comprise the partnership. Rather like a marriage, a partnership is a relationship, or perhaps, as the Law Commissions suggested, an association founded on a contract, which if established governs the rights and duties between the parties and their relationships vis-à-vis the rest of society. 1.01

The other key difference between a partnership and a company is that a partnership does not confer any limited liability on the partners. Thus it is possible for each partner to be liable without limit for debts incurred by the other partners in the course of the partnership business. This is seen by the business community as an obvious drawback but an early attempt in 1907 by the Limited Partnerships Act to create partnerships in which some of the partners would have limited liability was doomed to failure as a general business medium. This was partly because of the weaknesses of the form itself (if the limited partner for example interferes in the management of the firm he loses his immunity) but also because private companies arrived at the same time, providing both limited liability and a separate legal personality to hide behind. The presumed advantages of Mr Salomon in the famous case of *Salomon v A Salomon & Co Ltd*[1] would not have been available to him under either of the true partnership forms currently available in the United Kingdom. Limited partnerships have, however, become a very important vehicle of choice for specialized purposes, eg for venture capital and, until recently, for Scottish agricultural leases. As such, that form of partnership fulfils a totally different role from the general partnership.[2] Limited partnerships, which are the subject of current reform proposals, are dealt with separately in Chapter 9.

Even after 1907, partnership, however, remained the preferred medium for the professions, initially due to the flexibility of both its financial and constitutional provisions when compared with a company, but also because of the tax and privacy advantages for the partners. It is also widely used in other areas of business such as the retail trade, agricultural, and tourist industries. In 2008, the Department for Business, Innovation and Skills (DBIS) figures show that there were 461,860 partnerships in the United Kingdom, compared with the number of private companies at over 2.2 million. The size of these partnerships also covers a wide spectrum and, although many are small, 38 per cent had employees.[3]

Limited liability partnerships

1.02 During the 1990s, however, the accountancy profession in particular became concerned about the potential liability of partners, often quite remote from the activity in question, for the substantial damages being awarded against the larger firms for negligence. In 1997, in response to this pressure and the creation of a potentially available limited liability partnership form in Jersey, the Department of Trade and Industry (DTI) published a consultation paper entitled *Limited Liability Partnership—A New Form of Business Association for Professions*. Following lengthy consultations a draft Bill was published in 1998 and the result was the Limited Liability Partnerships Act 2000, which came into force on 6 April 2001. This new form of business association, the LLP, became, however, as a result of the consultation process, open to all businesses and not just specified professions as originally envisaged. In effect it is a hybrid between a company and

1 [1897] AC 22, HL.

2 In March 2009 there were 16,487 limited partnerships on the register (Companies House, *Statistical Tables on Companies Registration Activities 2008–09*).

3 Small and Medium Enterprise Statistics for the UK 2008.

a partnership, although much more like the former than the latter, despite its name. It has legal personality and provides limited liability for its members, in return for which it must publish its accounts and comply with several other regulatory requirements adapted from company law. It is *not* based on the partnership form with limited liability added on; and thus should not be confused with a limited partnership formed under the 1907 Act, which is a true partnership.

The connection between an LLP and a partnership formed under the 1890 Act derives mainly from the fact that the relationship between its members (as opposed to its dealings with outsiders) may be modelled on partnership law and that it, or rather its members, will be taxed as if it were a partnership and not, as it really is, a body corporate. The major features of this new business form are set out in Chapter 10. Whilst there is clear evidence that it has been adopted by most of the professional firms,[4] the important thing to grasp is that in reality it has little in common with partnerships as set out in the rest of this book.

Law Commissions' review of partnership law

In general, partnership law has been allowed to develop organically through a **1.03**
steady stream of court decisions since the 1890 Act. But in 1998 the DTI, as part of its 'think small first' policy, also applied to company law reform, asked the Law Commissions of England and Wales and of Scotland to undertake a review of partnership law generally,[5] including limited partnerships. After a lengthy consultation process,[6] the two Commissions published a joint Report in November 2003, which made a considerable number of recommendations for changing the law and included a draft Bill to replace the existing legislation.[7] Some members of the legal profession were quite hostile in their immediate opposition to the Report, homing in on the issue of legal personality, and the response from Government was somewhat underwhelming. In April 2004 the DTI issued a consultation document seeking views not as to the merits of the recommendations as such but as to the economic and business costs and benefits of those changes.[8] In 2006, the Government baldly announced that it was not proposing to take forward any of the Law Commissions' proposals on general partnership law. In response, however, to favourable comments from the

[4] In March 2009 there were 38,438 registered LLPs (Companies House, *Statistical Tables on Companies Registration Activities 2008–09*).

[5] Excluding insolvency.

[6] See the Law Com Consultation Papers Nos 159 (2000) and 161 (2001). All of these documents are available on the Law Commission's website: <http://www.lawcom.gov.uk>. See also Morse, 'Partnerships for the 21st Century—Limited Liability Partnerships and Partnership Law Reform in the UK' [2002] SJLS 455.

[7] Cm 6015 (Law Com No 283; Scot Law Com No 192)—referred to as 'Law Com' hereafter.

[8] *Reform of Partnership Law*: *The Economic Impact*, April 2004.

venture capital industry, it said that it would consult with a view to enacting the, quite separate, proposals on the reform of limited partnership law.[9] That process has proved to be rather more complicated than supposed and is, at the time of writing, still ongoing. The current state of play is set out in Chapter 9.

But in the main the reform proposals are dead in the water. Many of these related to the process of resolving partnership disputes and dissolution where the current law often produces litigation costs out of all proportion to the amounts involved.[10] In a fit of optimism they were set out in some detail in the 5th edition of this book, but they must now be confined to highlighting some of the unresolved difficulties of the existing law. Perhaps in another hundred years or so there will be another attempt. The Report foundered, above all, on its pervasive recommendation that partnerships should have legal personality,[11] an issue which the Commissions were specifically invited to address. Although the other proposals were largely independent of that, they were predicated on the basis of legal personality and would have to be rewritten if it were abandoned. As such, however unfortunate the result, they fell with it. It is appropriate therefore to consider this issue and its linked issue of continuity at this point.

Legal Personality and Continuity

1.04 English partnerships do not have legal personality.[12] They are only relationships, but the confusion which arises from this lack of legal personality is not helped by the fact that in common usage a partnership often looks like and is regarded as a separate entity. The words 'and Co' are sometimes found at the end of the name used by a firm. This signifies nothing in legal terms and does not make the firm into a company. Most private limited companies use the word 'limited' or the abbreviation 'Ltd', at the end of their names. Further, partners can sue and be sued in the firm's name and tax assessments are raised on the firm, although the fact that the latter is a smokescreen is shown by the decision in *Sutherland v Gustar*[13] that an assessment may be challenged by any partner irrespective of the

[9] Written Ministerial Statement 20 July 2006.

[10] See, eg *Sahota v Sohi* [2006] EWHC 344 where a dispute over £50,000 incurred costs of over half a million pounds.

[11] Although for the benefit of venture capitalists, limited partnerships could have opted out of this as special limited partnerships: Law Com, para 19.22.

[12] The reasons for this are historical, reflecting the common law's separate development from the law merchant applicable in continental Europe and in Scotland: see Holdsworth, *A History of English Law*, Vol V, p 84, Vol VIII, pp 194–8.

[13] [1994] 4 All ER 1.

wishes of the other partners. Further s 4(1) of the Partnership Act itself provides that:

> 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.

But this provides nothing more than a useful shorthand to describe the partnership. The word 'firm' is in effect no more than a collective noun. At all times remember that an English partnership is in law a relationship which affects the rights and duties of those concerned and no more.

Continuity

There are many problems associated with this lack of legal personality. Not least **1.05** are the practical difficulties in relation to the ownership of property and the continuation of contractual rights and obligations of the partners when there is a change in the membership. If X contracts with A, B, and C as partners, how does that continue if, say, either A leaves the firm or D joins it? That is the related issue of continuity. The Law Commissions recommended that, in addition to legal personality, there should be a default rule[14] that in such a case the partnership should continue so long as two partners remained.[15] Continuity of contractual liability could therefore have been achieved without legal personality. The problems associated with an outgoing partner are dealt with in Chapter 4 so far as third parties are concerned, and in Chapter 7 as to dealings between the partners.

Contractual and statutory problems

There are many other problems associated with this lack of legal personality, **1.06** however, and the following may serve as examples. In the South African case of *Strydom v Protea Eiendomsagente*[16] a firm of estate agents sold a property for another firm on terms that the vendor firm would pay the commission unless the purchasers defaulted, in which case the purchasers would be liable. The purchasers duly defaulted and the estate agents now sued them for the commission. It transpired, however, that the same people were the partners of both the vendor and estate agent firms and the court held that since a person could not contract with himself neither could the two firms in this case so that the contract was a nullity. The court did, however, point out that there was no evidence that

[14] This is one that applies unless the partnership agreement provides otherwise: Law Com, para 4.58.

[15] Law Com, para 8.30. The draft Bill would not have made a change of partner a ground for breaking up the firm.

[16] 1979 (2) SA 206 (T).

the two firms were conducting separate businesses and hinted that if they had been then the position might have been different. It is difficult to see why that should be. The position is unclear in English law; one firm can bring an action against another even if they have partners in common (see Chapter 3) but in *Rye v Rye*[17] it was held by the House of Lords that partners who owned some premises could not lease the property to themselves since they could not contract with themselves. But since one partner can clearly lease premises (although paradoxically he cannot grant a licence) to the firm, including himself, is he not in that case contracting at least partly with himself? In the case of identical contracting parties it is arguable that if ABC contract with ABC, then A is contracting with B and C, and so on, which is only what they are doing in forming and conducting a partnership.

A second example occurred in the case of *Sheppard & Cooper Ltd v TSB Bank plc*.[18] A company appointed a firm of accountants to conduct a financial investigation into its affairs. Under the terms of the contract, signed by one of the partners, the firm agreed that it would never become involved in the management of that company. The bank now proposed to appoint two partners of that firm as receivers of the company (which would amount to managing it). The question was whether one of those partners was excluded by the earlier agreement since he had not been a partner at the time when it had been made. The Court of Appeal actually decided the issue on the basis that it was a joint appointment and the other partner, who had been a member of the firm at the date of the contract, was clearly bound by the agreement; but it also said that to construe the agreement as only applying to persons who were partners at the time it was entered into would not be realistic in accordance with modern commercial practice in the case of large professional firms. This might be thought of as amounting to de facto legal personality.

A compromise approach was taken by the House of Lords in an appeal from Northern Ireland in *Kelly v Northern Ireland Housing Executive*.[19] The issue was whether a partner in a firm of solicitors, who applied unsuccessfully for her firm to be included on a panel to act for the Executive and who had named herself as the designated solicitor to be responsible for the work, could complain to the relevant body on the grounds of discrimination under s 17 of the Fair Employment (Northern Ireland) Act 1976. Such a complaint required Mrs Kelly to be seeking 'a contract personally to execute any work'. The Court of Appeal in Northern

[17] [1962] AC 496, HL. Nor can they guarantee their own debts: *IAC (Singapore) Pte Ltd v Koh Meng Wan* (1978–1979) SLR 470.
[18] [1997] 2 BCLC 222.
[19] [1999] 1 AC 428, HL.

Ireland refused her application on the ground that it was the firm which was seeking the work and a firm cannot contract personally to do anything, but the House of Lords (only by a majority of three to two) reversed that decision. Two members of the majority thought that the relevant legislation was wide enough to include a firm acting personally through a designated partner and only Lord Griffiths thought that in fact there was in law no contract with the firm as such but one with each of the partners so that each partner could be said to be seeking the contract personally. One anomaly of that construction is that if Mrs Kelly had been an assistant solicitor and not a partner there could have been no complaint since there would have been no contract with her.

The interface of partnerships with modern regulatory and invasive statutory law also throws up problems associated with the lack of legal personality. In *Dave v Robinska*,[20] the Employment Appeal Tribunal allowed one partner to bring an action against her only other partner under the Sex Discrimination Act 1975 on the basis that that other partner could be 'the firm' as required by s 11 of that Act for that purpose. If it had been a ten-partner firm she could have sued the other nine and there should be no difference for a two-partner firm.[21] This is another example of the solution being a de facto legal personality. A similar solution was adopted in the Corporate Manslaughter and Corporate Homicide Act 2007. That Act applies to some partnerships, but only the firm and not its members can be prosecuted.[22]

The final example concerns the all too familiar imposition of value added tax. Under s 22 of the Finance Act 1972 (now s 45 of the VAT Act 1994), registration for VAT could be in the firm name and no account was to be taken of any change in the partnership. But Glidewell J in *Customs & Excise Commissioners v Evans*[23] was forced to conclude that, since a partnership was not a person but only a group of taxable persons trading jointly, an assessment could only be made against the individual partners and further that such assessments must be notified to each partner. Since the particular firm involved, which ran a wine bar known as the 'Grape Escape', had had a change of personnel during the year and not all the partners had been so notified, the assessment was, therefore invalid. The authorities were forced to change the law in the Finance Act 1982 to cover the specific case. But it has since been held by the VAT Tribunal in *British Shoe Corporation Ltd v*

20 [2003] ICR 1248.

21 That situation could not arise under the Race Relations Act 1976 since that does not apply to firms with less than six members. These Acts are considered in Ch 3, below.

22 The 'firm' may thus also be convicted. See s 14 of the 2007 Act and Ch 4, below.

23 [1982] STC 342.

Customs and Excise Commissioners[24] that a summons served on a partnership to produce documents for VAT purposes had no effect—the relevant rules required service either on a body corporate or an individual and neither could include a partnership. Problems involving VAT and partnerships continue to occur.[25] In *HMRC v Pal*[26] it was held that the registration of a partnership could have no effect on individuals who, although they had been represented as such, were not in fact partners at all.

Legal personality in Scotland

1.07 The position in relation to Scottish partnerships is on the face of it very different. In accordance with Scots common law s 4(2) of the Partnership Act provides: 'In Scotland a firm is a legal person distinct from the partners of whom it is composed.' It might be thought therefore that none of the problems associated with the lack of legal personality of a partnership in England would apply. Following the case of *Major v Brodie*,[27] however, this seems to be far from the case. The case was actually heard in England but concerned a question of the income tax liability of partners in a Scottish partnership. The taxpayers carried on a farming business in Scotland in partnership under the name 'Skeldon Estates'. They each borrowed money which was used partly to acquire another farm owned by the Murdoch family. The Skeldon Estates partnership then entered into an agreement with Mr Murdoch to carry on a farming business on both farms under the name 'W Murdoch & Son'. The balance of the loans was then used as working capital by W Murdoch & Son.

The taxpayers claimed tax relief on the interest paid on the loans. That could only be done, under the tax legislation, if the loan were used 'wholly for the purposes of the business carried on by the partnership'. The Revenue refused to allow the claim for tax relief on the basis that the money had not been used wholly for the purposes of the business of the Skeldon Estates partnership but for the business of W Murdoch & Son. In other words they argued that each partnership was a separate legal entity which owned the business carried on by it so that the two could not be merged.

The Special Commissioner who heard the taxpayers' appeal was therefore faced with the question as to what exactly were the consequences of the separate legal personality of a Scottish partnership. He was presented with two contradictory opinions by eminent Scots lawyers. In one opinion it was said that the Revenue

24 [1998] V & DR 348.
25 See [2000] BTR 406.
26 [2008] STC 2442.
27 [1998] STC 491.

were correct and that the partners in Scotland only acted as agents for the firm. The business is always carried on by the firm and not by the partners as such. The other opinion was that, whilst the firm owned the business, it was carried on by the partners as principals. This was because s 4(2) is subject to s 1 of the Partnership Act, ie that the firm, which is only defined as being a collective noun for the persons who have entered into partnership by s 4(1) and to which legal personality has been attributed in Scotland under s 4(2), is only created by the fact of persons carrying on a business with a view of profit.

It was this latter opinion which found favour with the Commissioner. The persons who are carrying on the business as required by s 1 of the Act are the partners in Scotland and they are not mere agents of the legal persona, even if 'given a quasi-corporate veneer, since if they are not, there can be no partnership'. Thus either the Skeldon Estates partnership or the taxpayers as partners of it were carrying on the business of farming in partnership with Mr Murdoch under the firm name of W Murdoch & Son. The taxpayers' claim would be allowed.

On appeal to the High Court the Revenue did not dispute that finding by the Commissioner but reserved the right to argue it before the House of Lords if the case proceeded that far. The position on the status of partners under a Scottish partnership remains therefore to be resolved. The real problem is that if s 4(2) of the Act does indeed create full legal personality for Scottish partnerships, which would seem to be the clear intention on its wording, this sits very uneasily with s 1 and other sections of the Act which are designed for the English situation. For example, as we shall see in Chapter 4, every partner is an agent 'of the firm and his other partners'. If the firm has full legal personality how can a partner be an agent for his fellow partners? The firm would be the sole principal and all the partners mere agents of it. The alternative construction, adopted in this case, would allow the Act to apply fully in Scotland but at the expense of regarding 'legal personality' as a type of 'bolt-on' extra to the other concepts of partnership law.

Instead, before the judge, the Revenue argued that the position would have been different under English law, ie that the two businesses would have had different partners so that they would have to have been regarded as two businesses, the first business having the taxpayers as partners and the second the taxpayers and Mr Murdoch. On this basis since tax law must be applied uniformly in England and Scotland it was argued that the claim should be disallowed. The judge disagreed. In his opinion the taxpayers under English law would be partners in the second partnership in their capacity as partners in the first partnership so that the partnership business of the first would include that of the second.

Another difficulty with reconciling the legal personality of a Scottish partnership with other parts of the Act arose in the criminal appeal case of *Balmer v HM Advocate*.[28] The question was whether the firm, as a separate entity, could be prosecuted after it had been dissolved. The court held that it could not as the legal personality ended on dissolution and the relevant sections of the Act only applied to secure the necessary contractual and other obligations associated with a winding up.[29]

Partnership Law

Partnership Act 1890

1.08 Where then do we find the law relating to partnerships? Partnership law in fact developed in a very traditional way through the courts, both of common law and equity, particularly during the latter half of the nineteenth century. The Partnership Law Amendment Act 1865 (known as Bovill's Act) was a brief statutory incursion aimed at clarifying the distinction between partners and their creditors (of which much more in Chapter 2) but in 1890 the Partnership Act was passed, based on a Bill drafted by Sir Frederick Pollock in 1879. This short Act forms the basis of partnership law today and has remained virtually unscathed through over a century of change.

But it is far from being a straightforward Act in modern terms. It was, and is, largely declaratory of the law—there were virtually no 'new' rules (s 23 is an exception to this). But it is neither a codifying nor a consolidating Act. Large areas of the subject remain open to the vagaries, or delights, according to taste, of case law. Section 46 preserves all equitable and common law rules applicable to partnerships 'except so far as they are inconsistent with the express provisions of this Act'. Thus cases decided prior to 1890 will be authoritative unless they are inconsistent with the clear meaning of the Act.[30] Further, the ordinary rules of law and equity apply unless there is an express inconsistency with the Act. In the Canadian case of *Geisel v Geisel*,[31] the personal representatives of a deceased partner brought an action against the other partner under the Fatal Accidents Acts following an accident in the course of the firm's business. The defendant argued that in the Manitoba Act, which contained an equivalent of s 46, liability of a partner was limited in respect of injuries caused in the course of the firm's business to 'any person *not* being a partner in the firm'. (We have a similar

[28] 2008 HCJAC 44.
[29] See ss 38 and 43 in Ch 7, below.
[30] See, eg *Taylor v Grier (No 3)*, Case No 1995/8125, 12 May 2003, Ch, para 49 per Behrens J.
[31] (1990) 72 DLR (4th) 245.

provision in s 10.) Thus, it was argued, an action by one partner against another partner for such an injury was inconsistent with the Act and so not preserved by the equivalent to s 46. This argument was rejected on the basis that the Act was not intended to prevent such actions being brought.

The Partnership Act is again, also by modern standards, a short Act with short sections (fifty sections or seventy-nine subsections in total) with a total lack of modern legislative jargon and cross-referencing.[32] The draftsman rejected the temptation to define every conceivable concept and whilst this does occasionally cause difficulties (we shall for example agonize over ss 2(3) and 5 later on) it makes it readable. Turning from the Partnership Act 1890 to the Companies Act 2006 is to experience the culture shock of the time traveller. Like man and the apes they are cousins but the relationship is sometimes difficult to imagine.

Comparing the Partnership Act to the Companies Act also demonstrates another facet of the 1890 Act. It is on the whole a voluntary code.[33] Section 19 allows all its provisions as to the rights and duties of partners vis-à-vis each other to be varied by consent, express or implied (from a course of dealings). Other sections are also subject to contrary intention. This feature can be traced to the contractual nature of the relationship called a partnership. As with other contracts the parties can, within certain defined limits, agree to whatever terms they wish as between themselves (and thus the parts of the Act covering those areas are also subject to contrary agreement) but they cannot rely on any such agreement vis-à-vis third parties on the well-known principles of privity of contract (and thus those sections of the Act relating to third parties are not voluntary). The third type of section in the Act, by which the courts are allowed to interfere in the relationship, either to establish liability or to end the partnership, are, of course, also non-negotiable.

Common law and equity

Since the 1890 Act is both declaratory in nature and partial in scope, it follows **1.09** that the many cases decided before that date are relevant either to explain or amplify the Act itself or to cover areas outside its scope. It must be true that, for a declaratory Act above all others, earlier cases can be relied on to clarify the draftsman's (and also Parliament's) intentions. It goes almost without saying that cases decided since 1890 are of great importance in deciphering the law. In this context, however, it is important to realize that the Partnership Act 1890 applies equally to Scotland and that cases decided in Edinburgh are of strong persuasive

[32] The draft Bill proposed by the Law Commissions had fifty-three sections and five Schedules dealing with general partnerships.

[33] The Law Commissions' objectives included the preservation of partnership 'as a flexible, informal and private business vehicle'.

authority, although they must sometimes be read in the context of the fact that Scottish partnerships have legal personality. The English concept of partnership was also exported, among other countries, to Canada, Singapore, Malaysia, Australia, and New Zealand and their statutes bear a strong resemblance to our own. Several of the UK's partnership concepts were also adopted in South Africa although that country has no statute. Cases decided in those and other common law jurisdictions are therefore also important (and in many instances of a more recent vintage). Only in the USA has partnership developed along different lines.[34]

Although s 1 does not expressly say so, it is clear that unless there is a binding contractual relationship between the parties there can be no partnership.[35] Such a partnership agreement may be express or implied. In a recent case, the court held that if the evidence from the express conversations is that the parties discussed but failed to agree on forming a partnership, it is difficult, although not impossible,[36] to imply a partnership from conduct.[37] The common law rules relating to formation, variation, and vitiation of a contract all apply to partnerships (although it appears that acceptance of a repudiatory breach of the agreement will not actually dissolve the partnership as distinct from ending the agreement).[38] Tort also plays a part—in particular, the concepts of passing off and vicarious liability. But these are mainly areas where partnership is in one sense incidental—the problem arises from tort or contract not from the relationship between partners. In one area of the common law, however, the partnership concept is central. The liability of partners for partnership debts (the central issue of any firm) is based upon an understanding and specific application of the law of agency. Each partner is an agent of his fellow partners (and a principal in relation to the acts of his fellow partners). The application, not always consistent, of the agency concept to partnership is a problem that will be considered in Chapter 4.

Yet partners are more than contracting parties—they had been established by the courts of equity as owing a duty of good faith and subsequently fiduciary duties to each other by the time of the Act, and developments in the law of equity in recent times have strengthened rather than diminished such duties. In other

[34] See the Revised Uniform Partnership Act 1994.

[35] If there is such a binding arrangement the next question of course, dealt with below, is whether it is a contract of partnership embracing the criteria of s 1 or of something else such as a joint venture. See, eg *McPhail v Bourne* [2008] EWHC 1235 (Ch) explaining a dictum of Lord Millett in *Hurst v Bryk* [2002] 1 AC 185 at 194F.

[36] This is because a partnership may exist even if parties expressly agree that there is none.

[37] *Greville v Venables* [2007] EWCA 878.

[38] See Ch 7, below.

words, partners are expected to behave towards each other as if they were trustees for each other, making full disclosure and being scrupulously fair in their dealings. Equity does not require fault or dishonesty to establish a breach of such a duty (unlike the common law) and such duties can be enforced by the equitable remedies of account (which does not require proof of loss), equitable compensation and full restitution. The Act merely cites three examples of these 'higher' duties (in ss 28 to 30) and one of the largely untested areas in modern times is how some of the more venerable decisions on those and other duties should be read in the light of the recent expansion of the law of constructive trusts and fiduciary duties in other areas, especially of company directors (see Chapters 5 and 6). The existence of this fiduciary relationship also has an impact on the ending of the relationship beyond contract.[39]

Partners are, therefore, contractors, agents, principals, fiduciaries, and beneficiaries all at the same time. The potential chaos suggested by such an analysis is, however, for the most part lacking.

Other relevant statutes

Although partnerships are for the most part exempt from those aspects of public **1.10**
and EC control which have caused company law to expand in a geometrical progression since 1967 there are nevertheless areas where such control exists. Chapter 3 is concerned with such intrusions. The two most important for the purposes of this book, since they affect the creation and dissolution of partnerships *qua* partnerships, are, first, Part 41of the Companies Act 2006, which replaced the Business Names Act 1985. This regulates the use and disclosure of firm names. The other is the Insolvency Act 1986, as applied by the Insolvent Partnerships Order 1994,[40] concerning the insolvency of the firm and/or the partners. There are many other cases, of course, where partnerships cannot avoid the complexities of modern life—employment law and taxation, for example—but in general the problems that arise in such cases are caused by adapting the complex provisions of those areas of the law to partnerships—problems not helped, as we have already seen, by the schizophrenic nature of the concept of partnership as a relationship which is dressed up to look like a separate being. Insolvency law solves this conundrum by treating a partnership as if it were an unregistered company.[41]

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39 Thus acceptance of a repudiatory breach does not dissolve a partnership. See Ch 7, below.

40 SI 1994/2421, as amended by the Insolvent Partnerships (Amendment) Order 1996, SI 1996/1308, the Insolvent Partnerships (Amendment) Order 2001, SI 2001/767, the Insolvent Partnerships (Amendment) Order 2002, SI 2002/1308, the Insolvent Partnerships (Amendment) (No 2) Order 2002, SI 2002/2708, the Insolvent Partnerships (Amendment) Order 2005, SI 2005/1516, and the Insolvent Partnerships (Amendment) Order 2006, SI 2006/622.

41 See Ch 8, below.

Having established that a partnership is a relationship founded on contract and that we must find the law relating to it from many sources, we must now turn to those three legal criteria we ran into at the beginning which make the contract one of partnership—a business, carried on in common, and with a profit motive.

Essentials of a Partnership

1.11 Chapter 2 will deal in rather more detail with the rules governing precisely how and when a partnership is or is not established and the circumstances in which the question might be raised. For the moment it is sufficient to note that a partnership can arise by implying an agreement from an association of events as well as from an express contractual agreement and that the question of whether or not a partnership has been established can crop up in such varied areas as property law, employment law, taxation, insolvency, national insurance, and the statutory powers of corporations, as well as the more obvious example of making one person liable for the debts incurred by another. In all such cases, however, the courts must always bear in mind the three essential criteria contained in s 1 of the Act without which there cannot be a partnership.[42] In deciding such matters the courts will look at all the aspects of the relationship, applying the legal criteria to the facts. But as has been said by the courts for many years, most recently in the Scottish case of *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd*,[43] there is no one feature which is absolutely necessary to the existence of a partnership once the essential criteria have been established, although if those criteria are missing there cannot be a partnership.

Relationship with joint ventures

1.12 The term 'joint venture' was originally used in the USA to get round the then prohibition on companies there forming partnerships. In modern commerce it has no specific legal definition. Thus what the parties describe as a joint venture may or may not be a partnership, depending upon whether the criteria for a partnership are fulfilled.[44] It has been suggested that joint ventures are more commonly used for one-off adventures than for a continuing business;[45] or that they are more often used for the exploitation of a product than for a business

42 In some cases only s 1 is used: see, eg *Grant v Langley*, 5 April 2001, QBD.
43 1996 SLT 186, CS (OH).
44 Simply calling it a joint venture does not affect the issue. See, eg *Whywait Pty Ltd v Davison* [1997] 1 QdR 225.
45 See, eg *Rabiah Bee Bte Mohamed Ibrahim v Salem Ibrahim* [2007] SGHC 27 at paras 64–6.

at a profit.[46] But in reality the real question is whether or not they amount to partnerships. Only if the answer is no do the courts then have to decide on the legal consequences of a joint venture as distinct from those of a partnership.

Business

1.13 Partnerships are business media—they cannot, unlike companies, be formed for benevolent or artistic purposes. Section 45 of the Act defines 'business' for this purpose as including every trade, occupation, or profession, subject, of course, to those professions, such as the Bar, where a partnership is forbidden by professional rules. It was therefore established prior to the Act that the occupation of a landowner cannot form the basis of a partnership whereas that of a market gardener clearly can. In other words there must be some commercial venture—a selling of goods or services for a reward—before there can be a partnership. The relationship must arise in connection with that business. Difficulties arise when the parties are also in a personal relationship. Thus in the Canadian case of *Palter v Zeller*[47] Mr and Mrs Palter had been friends for a number of years with Ms Lieberman and through her had come to know Mr Zeller, a lawyer. Ms Lieberman also studied to be a lawyer and, having married Zeller, joined his practice. The Palters as a result engaged Zeller and, following a dispute, now sought to recover damages from Lieberman on the sole basis that she was in partnership with her husband. The judge found that there was no evidence that the spouses had been in partnership. The mere fact that they behaved in an equal social and marital relationship did not mean that their business relationship was the same. The fact that the Palters had wrongly made the assumption was of no consequence. For an alternative conclusion on the facts see *Taylor v Mazorriaga*[48] and *Ravindran v Rasanagayam*.[49] The latter case involved a brother and sister rather than spouses. In that case it was said that, in deciding whether a partnership existed, the closer the non-business relationship the less formality was to be expected in their business relationship. In some cases disentangling family and business relationships can be very complex.[50]

Contemplated partnerships

1.14 Similarly there will be no partnership if there is merely an agreement to set up a business activity which has not been implemented. Such an agreement is known

46 See, eg *Mackenzie v Richard Kidd Marketing Ltd* [2007] WSSC 41 and the cases referred to therein.

47 (1997) 30 OR (3d) 796.

48 (1999) LTL, 12 May 1999.

49 (2000) LTL, 24 January 2001.

50 eg *Mehra v Shah*, 1 August 2003, Ch. Similarly in tax cases: see *Vankerk v Canada* 2005 TCC 292.

as a contemplated partnership.[51] All that is required for an actual partnership, however, is the carrying on of some business activity by the persons involved. That includes anything which could be regarded as a business activity if done by a sole trader. There is no requirement that the business itself must actually be trading before a partnership can be said to have come into existence. This was the decision of the House of Lords in *Miah v Khan*.[52] Mr Khan and three others agreed that he would fund the opening of an Indian restaurant, to be run by two of the defendants. A joint bank account was opened, a bank loan obtained, premises acquired, furniture and equipment bought, a contract made for laundry, and the opening of the restaurant was advertised in the local press. Before the restaurant opened for business, however, the parties had fallen out. Mr Khan now sought a declaration that there had been a partnership in existence before the restaurant opened.

The majority of the Court of Appeal held that, although there was no need to show the actual receipt of profits, it was not enough to show that necessary preparations for the business had been made—the business itself, ie the restaurant, had to be up and running for there to be a partnership. The House of Lords disagreed (as did Buxton LJ in the Court of Appeal). They said that there was no rule of law that the parties to a joint venture do not become partners until actual trading commences. The rule is that persons who agree to carry on a business activity as a venture do not become partners until they actually embark on the activity in question. Setting up a business often involves considerable expense and such work is undertaken with a view of profit. It may be undertaken as well by partners as by a sole trader. It can be a business activity and if done by those involved in common there will be a partnership.

Applying that test to the facts of the case, Lord Millett said:

> The question in the present case is not whether the parties 'had so far advanced towards the establishment of a restaurant as properly to be described as having entered upon the trade of running a restaurant', for it does not matter how the enterprise should properly be described. The question is whether they had actually embarked upon the venture on which they had agreed. The mutual rights and obligations of the parties do not depend on whether their relationship broke up the day before or the day after they opened the restaurant, but on whether it broke up before or after they actually transacted any business of the joint venture. The question is not whether the restaurant had commenced trading, but whether the parties had done enough to be found to have commenced the joint enterprise in which they had agreed to engage. Once the judge found that the assets had been acquired,

[51] See, eg *Pine Energy Consultants Ltd v Talisman Energy (UK) Ltd* [2008] CSOH 10 at para 28 per Lord Glennie.

[52] [2000] 1 WLR 1232, HL, reversing [1998] 1 WLR 477, CA (sub nom *Khan v Miah*).

> the liabilities incurred and the expenditure laid out in the course of the joint venture and with the authority of all parties, the conclusion inevitably followed.

Although the decision in *Miah v Khan* has been accepted in other jurisdictions as well it is far from easy in practice to distinguish between acts which are preparatory to carrying on a business and those which are business activities in their own right. In the Australian case of *Goudberg v Herniman Associates Pty Ltd*,[53] the Court of Appeal in Victoria held that doing market research, making demographic studies, and travelling twice to the USA to study franchise models with a view to running a restaurant franchise business, could not reasonably amount to carrying on a business. Similarly in the Canadian case of *Blue Line Hockey Acquisition Co v Orca Bay Hockey Ltd Partnership*,[54] the British Columbian Court of Appeal held that an agreement between the parties to hold exploratory talks to acquire an (ice) hockey team and the making of expressions of interest to the vendor were not enough to establish the carrying on of a business. They only agreed to share their lawyer's fees; they neither established an office nor borrowed funds.

Self-employment and employees

The concepts of trade and profession are well known to income tax lawyers and two difficulties which have arisen in that context have also arisen in partnership law, ie the distinction between the self-employed trader or professional man and an employee, and the status of a single commercial venture. **1.15**

Partners are by definition self-employed. An employee is not a trader and thus cannot be a partner and the distinction is the common one between a contract of service and a contract for services. For example, the tax courts have had to decide whether an actress who undertakes several engagements on radio, film, and the stage etc is entering a series of employed posts or is simply carrying out her profession. The test evolved for tax purposes is whether the taxpayer has found a 'post' and stayed in it or was simply entering a series of engagements. Either conclusion is possible (see *Davies v Braithwaite*,[55] *Fall v Hitchen*,[56] and *Hall v Lorimer*[57]). There is no reason to suppose that the question is any different for partnerships but this is a complex issue which we will reserve for consideration in Chapter 2. For the moment let us take an example to demonstrate one area where this issue has arisen.

53 [2007] VSCA 12.
54 [2009] BCCA 34.
55 [1931] 2 KB 628.
56 [1973] 1 WLR 286.
57 [1992] 1 WLR 939.

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In *E Rennison & Son v Minister of Social Security*[58] a firm of solicitors employed various clerical staff. In 1966 the staff entered into contracts with the firm which described them as self-employed, being paid at hourly rates and having the right to hire out their services elsewhere. In 1967 the staff entered into a written 'partnership' agreement, the partnership business to be carried out at the office or elsewhere, the profits and losses to be divided among them on terms to be agreed, and with provision for other items such as the keeping of accounts and retirement. In fact the staff continued to work exactly as before at the same rate of hourly pay—payment being made in a weekly lump sum to one of the staff who then divided it out. The question arose as to whether the staff were employees for national insurance purposes, or in legal terms, whether they were employed under a contract of service. The judge, Bridge J, decided that the staff had never changed their original roles. The 1966 contracts were found to be contracts of service and the partnership agreement did not affect them. The method of paying a lump sum to the 'partnership' was no more than an agreement about the method of paying the amounts earned under the contracts of service.

The judge did not therefore have to decide whether a contract between two partnerships could be a contract of service or, in other words, whether one partnership can employ another partnership. Because partnerships can only exist to carry on a business the answer 'yes' would have to imply that an employment could be contracted in the course of carrying on the business of the employee partnership. There is some support for that proposition in the tax case of *Fall v Hitchen*,[59] and it is accepted that, for example, a firm of accountants who act as auditors of companies are theoretically to be taxed on the receipts of such offices as office holders and not as part of their business.

Single commercial venture

1.16 For tax purposes a trade can include an adventure in the nature of a trade and it now seems to be accepted that for a partnership a business can exist even if it is only for a single commercial venture. Thus, for example, when a lady found herself contracted to purchase two houses without having sufficient funds and so agreed with a local property dealer to purchase the houses jointly and share the profits equally: *Winsor v Schroeder*.[60] Woolf J admitted that where there was only one transaction involved it was less likely to be regarded as a partnership but that this situation had all the elements of partnership. In the Queensland case of

[58] (1970) 10 KIR 65; cf *Firthglow Ltd v Descombes*, 19 January 2004, EAT, where it was accepted that once a partnership was accepted as being genuine, its members could not be employees.
[59] See n 56 above.
[60] (1979) 129 NLJ 1266.

Whywait Pty Ltd v Davison[61] it was conceded that a single venture could constitute a partnership. The emphasis must be, as in the tax cases, not on whether it is a single venture but whether it is a commercial venture and not, for example, simply realizing an investment, eg buying a house, finding that one's spouse won't live there, and having the property improved and sold at a profit: *Taylor v Good*.[62] Factors used in tax cases have included a profit motive, a commercial organization, the subject matter of the transaction (some things are more likely to be held as investments than others), repetition, and the circumstances of the realization (eg insolvency).

Excluded relationships—co-ownership

This need for a business has excluded several relationships which might otherwise **1.17**
have been construed as partnerships. For example, most members' clubs and other non-profit-making associations cannot be said to be carrying on a business and are thus not partnerships: see *Wise v Perpetual Trustee Co*.[63] Nor does the simple co-ownership of property constitute partnership. One of the rules for determining the existence of a partnership in s 2(1) of the Act provides that no form of co-ownership (both the English and Scottish forms are set out) shall 'of itself' create a partnership as to anything so held or owned *whether or not they share any profits made by the use of the property*.[64] Co-ownership without a business attached does not create a partnership, it is simply co-ownership, which is, incidentally, not the position in most of our European neighbours.

An example of the operation of s 2(1) is the Court of Appeal decision in *Vekaria v Dabasia*.[65] Two individuals purchased a long lease and declared that they would hold any profits in the proportions they had contributed to the purchase price. The Court of Appeal upheld the judge's statement that co-owners who share profits are almost indistinguishable from partners and that in essence the issue comes back to the basic questions of s 1. The question was whether they were carrying on a business or simply making an investment with a view to profit. Co-ownership with a view to profit was not enough. In finding that this was a joint investment and not a partnership the Court of Appeal noted that: the two individuals only dealt with each other through an intermediary; one of them only put up part of the purchase price because the other had insufficient funds; and there was no agreement as to the carrying on of the business, merely as to the

61 [1997] 1 QdR 225.
62 [1974] 1 WLR 556, CA.
63 [1903] AC 139, HL.
64 In the Hong Kong case of *Fung v Heung* [2006] HKEC 631 it was said that, in particular, purchasing property as joint tenants mitigated against a partnership, which usually requires a tenancy in common to negate the right of survivorship.
65 (1998) LTL, 1 February 1998, CA.

distribution of profits. On the other hand the fact of co-ownership can be used as an indication of the existence of a partnership: see the South African case of *Buckingham v Dole*.[66] This distinction between co-ownership and partnership also creates many problems in the field of partnership property and we will return to it in Chapter 6.

A similar situation arises with an agreement for a joint purchase only of property (eg to achieve a discount). This equally cannot amount to a partnership. For example, if Mr Smith and Mr Jones agree to purchase a case of wine for their own consumption because it proves to be cheaper than buying six bottles each and Mr Smith sends in the order, intending to recover a share of the cost from Mr Jones, it is not suggested that they are thereby partners. It might, of course, be different if they intended to resell the wine at a profit. This basic distinction was made as early as 1788 in a case called *Coope v Eyre*.[67] Mr Eyre purchased some oil on behalf of what we would now refer to as a syndicate, dividing it up after purchase. Eyre failed to pay and the seller sought to recover from the other members. Gould J said no, there was no community of profit:

> But in the present case there was no communication between the buyers as to profit or loss. Each party was to have a distinct share of the whole, the one having no interference with the share of the other, but each to manage his share as he judged best.

Forming a company

1.18 Nearly 200 years later yet another relationship was excluded from a partnership by the Court of Appeal. It is not unusual for persons intending to set up a company to prepare the ground whilst waiting for the incorporation procedure to take place—in technical terms they are known as promoters. In *Keith Spicer Ltd v Mansell*[68] the question was whether, in carrying out these preliminary activities, the promoters could be regarded as partners. In that case one of the promoters ordered goods from the plaintiff company intending them to be used by the proposed company and the goods were delivered to the other promoter's address. The promoters opened a bank account in the name of the proposed company, omitting the all-important 'Ltd' at the end. The bank account was never used and the promoter who had ordered the goods became insolvent. The county court judge found that there was insufficient evidence of partnership and this was upheld by the Court of Appeal. Harman LJ said that the promoters were merely working together to form a company, they had no intention of trading prior to incorporation—they could not be partners because they had never carried on business as such. Another way of looking at such cases is to say that the parties

[66] 1961 3 SA 384 (T).
[67] (1788) 1 HBL 37.
[68] [1970] 1 All ER 462, CA.

have no immediate aim of making profits, the ultimate aim being to make profits for the company. (The profit motive is the third requirement of a partnership.) This is the view taken in South Africa: see *Mackie Dunn & Co v Tilley*.[69] Of course, if the parties abandon their intention to form a company and carry on, they may well form a partnership.

In the Australian case of *United Tankers Pty Ltd v Moray Pre-Cast Pty Ltd*[70] the intention was to convert an existing partnership into a company. Mr Savage, who was not a member of the existing partnership, agreed to invest some money into the business in return for a one-third interest in the company when it was formed. The court held that he did not thereby become a partner in the business prior to incorporation. He had taken an interest in the company when formed rather than an immediate interest as a partner. Thus, whereas in the *Keith Spicer* case the absence of a business was the key factor, in this case it was the non-participation of Mr Savage in the business prior to incorporation which decided the matter. This leads us into the next requirement for a partnership, involvement in the business.

Carried on in common

A partnership of necessity requires the involvement of two or more persons, how- **1.19**
ever limited,[71] in the business. With the singular exception of a limited partner under the Limited Partnerships Act 1907, it follows that one distinction in this context is between participation *in* the business and a connection *with* the business, such as that of a supplier of goods or services. In *Strathearn Gordon Associates Ltd v Commissioners of Customs & Excise*,[72] the company acted as a management consultant and was paid fees plus a share of the profits of seven separate developments. It argued that these were receipts of a partnership carrying out the various developments and that the company was not supplying services for the purposes of VAT. The VAT Tribunal rejected this argument. The parties had not made any agreement to carry on a business together. What the company had actually agreed to do was to supervise the carrying out of the work and in essence that was an agreement for the provision of services. The mere fact that the consideration was measured by reference to a share in the profits was not enough to convert it into a partnership. In other words they were not involved in the business, they simply provided services for the business. On a similar basis it has been held in

[69] (1883) HCG 423. See also *Ford v Abercromby* (1904) TS 87.8.

[70] [1992] 1 QdR 467.

[71] Thus a solicitor whose sole role is the supervision of a newly qualified solicitor, as required by law, and who has to be a partner, is carrying on the business in common: *Rowlands v Hodson* [2009] EWCA 1025.

[72] [1985] VATTR 79.

South Africa that a franchise agreement does not as such amount to a partnership: *Longhorn Group (Pty) Ltd v Fedics Group (Pty) Ltd.*[73]

Sometimes the question is whether two or more persons are carrying on separate businesses or a joint business. In the Queensland case of *Marshall v Marshall*,[74] the court found that there were two separate businesses being carried on, one by each of two builders who alleged that they were in partnership—they traded on their own accounts with their own stock. The so-called partnership was in fact a device intended to allow one of them to act as a builder although not licensed to do so since a licence was not necessary for someone in partnership with a licensed builder. In *Thames Cruises Ltd v George Wheeler Launches Ltd*,[75] a number of Thames boat companies set up an association to provide a single ticketing operation, available on any of the boats. They worked to an agreed timetable and the net profits were distributed according to the number of boats involved. The judge held that the companies each maintained their individual businesses—they were each responsible for their own costs. The association was simply one method of jointly contracting with the public. There was no single business carried on in common.

Participation in the business

1.20 If there is no joint participation in the common business then it seems that, even if there is an intention to draw up a partnership agreement and some discussion between the parties as to the consequences of it, the courts will not declare a partnership. In *Saywell v Pope*,[76] Mr Saywell and Mr Prentice were partners in a firm dealing in and repairing agricultural machinery. In January 1973 the firm obtained a marketing franchise from Fiat which expanded the work of the firm. Until that time Mrs Saywell and Mrs Prentice had been employed by the firm to do a small amount of work but they then began to take a more active part in the business. At the suggestion of the firm's accountant the four drew up a written partnership agreement but this was not signed until June 1975. The bank mandate in force before 1973 enabling Mr Saywell and Mr Prentice to sign cheques was, however, unchanged, and no notice of any change in the firm was given to the bank or the creditors or customers of the firm. Neither of the wives introduced any capital into the business and had no drawing facilities from the partnership bank account. A share of the profits was credited to them for 1973 and 1974 but they never drew on them. In April 1973 the wives had been informed

73 1995 SA 836 (W).
74 [1999] 1 QdR 173, CA. See also *Sri Alam Sdn Bhd v Newacres Sdn Bhd* [1995] 4 MLJ 73.
75 [2003] EWHC 3093 (Ch).
76 (1979) 53 TC 40.

that if they became partners they would become liable for the debts of the firm and they had not objected. The Inland Revenue refused to accept that the wives had become partners before 1975.

Slade J agreed with the Revenue. The written agreement could only apply from the date it was signed and even though it contained a statement that the partnership had actually begun earlier that could not make them partners during that period unless that was the true position. There was no evidence that in 1973 the parties had contemplated such an agreement and neither the partnership agreement nor the discussion of liability could be taken as creating an immediate partnership. There was no evidence that during the relevant time they did *anything in the capacity of partners*. The crediting of the net profits was of more significance and we shall return to this below at para 1.24. What is important is that despite the fact that there was a business and a 'sharing' of profits no partnership existed since in effect the wives had never been integrated into the firm.

That decision was approved by the Court of Appeal in *Bissell v Cole*.[77] The question asked in that case was whether an individual had an involvement in the business and it was said that undue reliance should not be placed on statements in brochures or letterheads.

On the other hand where there is participation in a business those involved will be partners even before they have drawn up the formal agreement to that effect. Thus in *Kriziac v Ravinder Rohini Pty Ltd*[78] an agreement to redevelop a hotel site with a formal agreement to be executed in due course was held by the Australian court to establish a partnership prior to that agreement (which never happened) because of the evidence of participation in a business such as the creation of a joint bank account, the joint engagement of an architect, and the joint application for planning permission.

Control

Another way of making the distinction between a partner and a business 'contact', for want of a better word, is whether the alleged partner has any control over the property or ultimate management control. In one sense neither of the wives in *Saywell v Pope* had either of these whereas the two developers in *Kriziac* clearly did. It is possible to enter into a business venture with another party without establishing a partnership, particularly if that other party is itself a separate business entity, whether incorporated or not. **1.21**

77 12 December 1997, CA.
78 (1990) 102 FLR 8.

In the Canadian case of *Canadian Pacific Ltd v Telesat Canada*,[79] the Telesat Canada Corporation had only those powers allowed to it by its founding statute and these did not permit it to enter into a partnership. A shareholder of the company sought to establish that an agreement between the corporation and the nine principal Canadian telephone companies setting up the Trans-Canada Telephone System had established just such a forbidden partnership. The Ontario Court of Appeal decided that, since the arrangement did not involve the corporation's abandoning control over its property or delegating ultimate management control, it did not amount to a partnership. Similarly, in *Mann v D'Arcy*,[80] Megarry J held that an agreement between a firm of produce merchants and another merchant to go on a joint account on the sale of some potatoes did not amount to a new and separate partnership. It was a single venture controlled by the existing firm in the ordinary course of its existing business. 'The arrangement was merely one made of buying and selling what [the negotiating partner] was authorised to buy and sell'. The position may, however, be different if the new venture effectively determines the partnership business and transfers control of it to others. This was suggested but not decided by the Full Court of the Supreme Court of Queensland in *Rowella Pty Ltd v Hoult*.[81]

Limited partners

1.22 The exception to this requirement of participation is a limited partner in a limited partnership. Such a person is forbidden to take part in the management of the firm.[82] What exactly that means in discussed in Ch 9, below.

With a view of profit

1.23 Most of the problems concerning the existence of a partnership revolve around the concept of profit motive and profit-sharing. It is impossible to establish a partnership if there is no intended financial return from the business—it would hardly be a business if no financial return was contemplated. Far more problems arise in practice in the reverse situation—ie when a financial return from a business is argued *not* to constitute the recipient a partner because, for example, it is really a wage paid to an employee, or interest paid to a creditor, or a contractual return for the supply of goods or services rendered. At one time a mere receipt of a share of the profits established a partnership: *Waugh v Carver*;[83] but this was repudiated by the House of Lords in *Cox v Hickman*[84] and that repudiation was

79 (1982) 133 DLR (3d) 321.
80 [1968] 1 WLR 893.
81 [1988] 2 QdR 80, SC.
82 See s 6 of the Limited Partnerships Act 1907.
83 (1793) 2 H BI 235.
84 (1860) 8 HL Cas 268.

codified into s 2(3) of the 1890 Act. It is now well established that mere receipt of a share of the profits of a business does not automatically make the recipient a partner. Thus the VAT Tribunal in *Strathearn Gordon Associates Ltd v Commissioners of Customs & Excise*[85] were able to declare in a sentence that: 'The mere fact that this consideration was measured by reference to a share of the net profit does not in our judgment convert the agreement into a partnership'. An agreement for the supply of services was exactly that and no more. Further, another VAT Tribunal in *Britton v Commissioners of Customs & Excise*[86] found that, although a wife took a share of the profits of her husband's business, this was a domestic as distinct from a commercial arrangement. The profits had been paid into their joint bank account which continued as both a domestic and business account. 'The profit was Mr Britton's and Mrs Britton as his wife had access to it.' Sharing profits did not amount to partnership. The precise circumstances under which the receipt of a share of the profits will turn an employee, creditor, or supplier into a partner are discussed in Chapter 2.

Need for agreement to share profits?

There must, however, be a profit motive[87]—but then all businesses are designed **1.24**
to make money and a simple requirement of a profit motive might not, at first sight, seem to add anything to the business criterion already discussed. It has been argued, however, that that is the only requirement as to profit imposed by s 1 of the 1890 Act. Returning to the words of that section, there must be a 'business carried on in common with a view of profit'. These words, so the argument goes, require only a profit motive and not necessarily a *share* in the profits for each partner, ie only the business need be carried on 'in common', not necessarily the profits. Another, equally appropriate interpretation, however, is that it is a business with a view to profit which must be carried on in common. A share of the profits must on that basis be contemplated for a partnership to be established. That was certainly the view taken by the pre-1890 cases such as *Pooley v Driver*.[88]

Academic commentaries have differed as to whether the wording of s 1 altered the pre-Act law, if indeed that was the position then. The matter in England was clarified to some extent by the Court of Appeal in *M Young Legal Associates Ltd v Zahid*.[89] The court held that a person receiving a fixed sum from a firm unrelated

85 [1985] VATTR 79.
86 [1986] VATTR 204.
87 See, eg *Franich v Harrison* [2006] NZHC 1059.
88 (1877) 5 Ch D 458, CA.
89 [2006] EWCA Civ 613, [2006] 1 WLR 2562.

to the firm's profits could nevertheless be a partner.[90] But only Hughes LJ expressly addressed the issue as to whether a person receiving no form of return from a firm could still be a partner. In his opinion, if the other essentials of partnership were present,

> the partners are free under the Act to arrange for remuneration of themselves in any manner they choose, including by agreement that one or more shall receive specific sums or that one or more receive nothing, in either case irrespective of profits.[91]

The Court of Appeal in *Rowlands v Hodson*,[92] however, took the view that the decision in *M Young Legal* etc was that the receipt of a share of profits was not a pre-requisite of a claim to partnership. In that case the person was entitled to receive a nominal share of the profits but had waived her claim in two successive accounting periods. It was held that she could still be a partner since all the criteria in s 1 had been complied with. The court was also unimpressed by the argument that if she had permanently waived her right to the money that would have ended the partnership.

This point is also relevant in tax cases where the partnership is formed to achieve a tax benefit, as in the case of *Newstead v Frost*.[93] David Frost, the television personality, formed a partnership with a Bahamian company to exploit his highly profitable activities in the USA. The major purpose behind this was the common one of tax avoidance, the general idea being to isolate the income produced from the individual and thus from the United Kingdom and the Inland Revenue. The latter attacked this partnership on two fronts—one, as to the capacity of the company to enter into such a partnership (of which more anon) and two, as to the existence of the partnership itself. The Revenue argued that this agreement was designed largely as a tax avoidance scheme and so did not constitute carrying on a business with a view of profit. The House of Lords, however, disagreed. The partnership was in fact formed to create a profit from the exploitation of the entertainer's activities and the fact that it was hoped such profits would avoid tax did not affect that basic idea. There was a view of profit.

The question of the influence of a tax motive on the existence of a partnership has been discussed in a number of cases in Canada. The Canadian Supreme Court has ruled in three cases that an ancillary profit-making purpose will suffice and that neither a tax motivation nor a short duration will invalidate a partnership if

90 Following the decision of Megarry J in *Stekel v Ellice* [1973] 1 WLR 191.That was a case as to whether a 'salaried partner', ie a person described as a partner but paid a fixed salary, was in fact a true partner or an employee. See Ch 2, below.

91 [2006] EWCA Civ 613 at [41].

92 [2009] EWCA Civ 1025.

93 [1980] 1 All ER 363, HL.

that purpose exists.[94] It is of course a question of fact in each case as to whether that purpose does exist.

Gross and net profits

So far we have been discussing the question of the intention to create and share in *profits*. In one sense that is not entirely accurate since it has long been clear that the profits in question must be *net* profits—ie those calculated after accounting for the expenses incurred in making them. Another of the rules for establishing the existence of partnership, in s 2(2) of the 1890 Act, makes this clear: '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 ... the returns are derived'. Thus an author who is paid 10 per cent royalty (at the least, one hopes) on the published price of his book is not a partner with his publisher—duties of good faith might well be stretched otherwise! **1.25**

Another example can be found in the case of *Cox v Coulson*.[95] Mr Coulson was a theatre manager who agreed with Mr Mill to provide his theatre for one of Mill's productions. Mr Coulson was to pay for the lighting and the posters etc, Mr Mill to provide the company and the scenery. Under the agreement Mr Coulson was to receive 60 per cent of the gross takings and Mr Mill the other 40 per cent. The play must have been heady stuff since the plaintiff in the case was shot by one of the actors during a performance. She sought to make Mr Coulson liable on the basis that he and Mr Mill were partners and so responsible for the outrage. The Court of Appeal had little difficulty in rejecting any claim based on partnership since s 2(2) made it quite clear that the sharing of gross returns did not create such a partnership.

Implicit in the idea of sharing net profits is the sharing of expenses and thus if necessary in net losses (except for our friend the limited partner of course). Sharing gross returns, as in the two examples above, cannot fall into this category since it is implicit in such agreements that each party has to bear his own separate liabilities in respect of the undertaking. It would be very rare for a publisher, for example, to share in the costs of writing and even rarer for an author jointly to sponsor the activities of his publisher.

Before we leave this topic two points should now be borne in mind. First that there are, in addition to the concepts just discussed, the provisions of s 2(3) of the 1890 Act which were intended to draw the often fine distinctions between a

[94] *Beckman v Canada* (2001) 196 DLR (4th) 193; *Spire Freezers Ltd v Canada* (2001) 196 DLR (4th) 210; *Whealy v Canada*, 2004 TCC 377.
[95] [1916] 2 KB 177, CA.

partner and a creditor where a share of the profits is undoubtedly being received. These provisions form the basis of part of Chapter 2 but they must always be read subject to s 1 of the Act and the essentials of a partnership. Second, it may perhaps occur to the reader that in this general area, as with others in the law, the result often seems to depend upon the question being asked and the consequences of the answer. It may well be that the emphasis may vary between, say, one case where the parties are trying to convince a doubting HM Revenue & Customs (HMRC) of the existence of a partnership, and another where an unpaid supplier is seeking to make someone liable as a partner of the person who ordered the goods.

Partnerships Then and Now

1.26 Before embarking on a more detailed study of the creation, operation, and extinction of partnerships it is useful to have some idea of the changing role of partnerships in the commercial life of the country. The nineteenth century, which saw the establishment of the partnership as a popular business medium, culminated in the Act of 1890 and the basic partnership rules which still apply today. By the turn of the century, however, the demise of the partnership as the universal form for small businesses was well under way, although, as we have seen, a surprisingly large number of partnerships still exist; whilst in more recent times the development of professional partnerships, especially those of solicitors and accountants, and the influence of taxation have presented new challenges and brought new uses for the partnership form. The introduction of the LLP has significantly lowered the number of professional partnerships but its effect on others is less clear. Another development has been the European Economic Interest Grouping (EEIG), which allows firms to cooperate across national boundaries within the European Union. This continuing change in the way partnerships have been and are being used help to put the law and its development in context.

Partnerships up to 1890

1.27 Partnerships, as we have seen, developed naturally (in the sense of slowly through the case law system) out of the laws of contract, agency, and equity. They were hedged in with few compulsory rules and since they conferred neither legal personality nor limited liability they rarely raised issues of a sufficient concern to merit the interference of Parliament. They provided freedom to operate on any terms which could be agreed and did not allow those responsible to avoid the consequences of their actions. The courts responded to any problem with an ease and calm assurance which typifies the so-called 'golden era' of English law.

Only rarely did they cause confusion—Bovill's Act of 1865 being the exception, since it was deemed necessary to clarify the distinction between partners and creditors following the volte-face, already mentioned, about whether simply taking a share of the profits meant an automatic partnership or not. But in general the fact that in 1890 only one real change was made by the Act to the existing case law rules is a testimony to the nineteenth-century judges who created much of the present law.

Partnerships thrived and multiplied. This was due in part to their compatibility with utilitarian philosophy, much in evidence in the early nineteenth century, as anyone with even a passing acquaintance with the novels of Charles Dickens must be aware. But it was also due to the fact that in the early part of the century there were really no alternatives for the small or medium-sized business. Companies could be formed with both legal personality and limited liability but only by a royal charter or a private Act of Parliament. This may have been ideal for the East India Company or the canal and railway companies and other vast enterprises but it was slow and very expensive and not at all in tune with the growing needs of the age. The earlier problems of the South Sea Bubble and other fiascos, however, prevented any easier form of incorporation. At common law, companies, known as deed of settlement companies, were in effect merely large partnerships.

The expansion of industrial and commercial life during that period, however, soon provided the pressure for legislation to provide a cheaper and quicker access to the twin benefits of incorporation and limited liability. Partnerships were inappropriate for entrepreneurs turning their attention to world markets. By 1855 the modern concept of the registered limited company was possible and the Joint Stock Companies Act 1856 allowed promoters to register and thus create a company simply by filing the requisite documents—a process still in force today. Decisions such as *Salomon v A Salomon & Co Ltd*[96] pressed home the benefits of limited liability; the concept entered into popular mythology, as can be discovered from listening to the Company Promoter's song from the Gilbert and Sullivan comic opera, *Utopia Ltd*. To explain the distinction between a company and its members, Gilbert invented the story of a monarch whose rule was absolute except that he could at any time be exploded by the 'Public Exploder' on the word of two 'Wise Men'. To avoid this the king turned himself into a limited company and confronted his tormentors with the thought that although they could wind up a company they could not blow it up.

[96] [1897] AC 22, HL.

The registered company was to be the major business medium from then on. Administratively and economically it was more attractive than a partnership and by the time of the Partnership Act itself partnerships were on the decline. There were, however, still some disadvantages for the small business in selecting the corporate form, such as increased formality and disclosure and less flexibility, especially if a dispute arose, but company law itself was to develop so as to negative most, if not all, of them.

The growth and development of private companies

1.28 One of the consequences of this growth in companies was the limited partnership, introduced by the Limited Partnerships Act 1907. We have already come across this 'commercial mongrel' and more will be said in Chapter 9. As an attempt to revive the partnership form as a general business medium, however, it was a dismal failure. By the Companies Act 1907 the private company was introduced and, initially, sank its rival almost without trace. A private company allowed management participation by the director-shareholders without loss of limited liability and it could raise money by means of a floating charge (ie a charge over all its assets, which can nevertheless be utilized by the company until disaster strikes)—a popular method of finance which for technical reasons has always been denied to partnerships.

As company law became more complex and above all more interventionist so that greater public disclosure was demanded of such things as accounts and exactly who owned what, it might have been expected that small businesses would return to the partnership fold. But this never happened on a large scale—partly at least because company law itself sought to protect the small private company from the more inconvenient aspects of this policy. In recent years the attractiveness of the small private company has been enhanced by two important developments. The first is a consequence of our membership of the EU. Most of our European 'partners' differentiate between the public and private company form to a far greater extent than we do—for example, they have separate codes for each form. The vast majority of EU-inspired changes to company law therefore have been applicable only to public companies, and to accommodate this approach the Companies Act 1980 created a much clearer distinction between public and private companies in the United Kingdom—one visible effect of which is the use of a different abbreviation at the end of a company's name. When writing a cheque for Marks & Spencer for example, the ending is not 'Ltd' but 'plc'. Many of the more Draconian rules are only applicable to public companies and the Companies Act 1981 exempted 'small' and 'medium-sized' companies from many of the accounting disclosure rules. Even those disclosure requirements which still exist are currently under review under the deregulation policy. More recently the Companies Act 1989 introduced the concept that private companies may elect to dispense with certain internal requirements such as the holding of an annual general meeting, the laying of accounts at a meeting, and the annual appointment of auditors. Further, private companies may pass resolutions without holding a formal meeting of the members. One of the major themes of the recent review of company law was to 'think small first'[97] and this policy was adopted by the Government.[98] The resulting Companies Act 2006 relieves private companies of many of the existing controls, not least from the onerous rules on the giving of financial assistance for the acquisition of its shares and the obligation to hold any formal meetings.[99]

At the same time the courts have evolved the concept of the 'quasi-partnership' company, that is, a company which, although legally a company, is in economic and management terms a partnership, particularly where there is an under lying right for the shareholder-directors to take part in the management of the company. In *Ebrahimi v Westbourne Galleries Ltd*,[100] the House of Lords decided that a breach of that underlying obligation, typically a dismissal of one of the directors, although perfectly in accord with the formal procedures of the Companies Act, could lead to a winding up of the company on the just and equitable ground. (Incidentally Lord Wilberforce in that case rejected the term 'quasi-partnership' as being misleading but the term has stuck and provided it is used only as a general description little harm will be done.) Since then that concept has been skilfully blended with the unfairly prejudicial conduct remedy for minority shareholders by Lord Hoffmann in *O'Neill v Phillips*.[101] Small companies are therefore protected one way or another from most of those areas of company law which would otherwise prove to be a drawback.

Partnerships today—impact of the LLP

Whilst the importance of the private company as a business medium should not **1.29**
be underestimated the fact remains that there are still very many small businesses which operate under the partnership form. There are undoubtedly some tax and national insurance advantages attached in some cases to the partnership form, not least in the areas of capital gains tax and the payment of retirement annuities. In other cases the tax advantages will go the other way. It is always a question of

97 The Company Law Review presented its Final Report to the DTI in July 2001.
98 *Modernising Company Law* (Cm 5553, DTI, July 2002).
99 See also *Company Law Reform* (Cm 6456, DTI, March 2005).
100 [1973] AC 360, HL.
101 [1999] 1 WLR 1092, HL.

balancing tax with other factors in choosing a business medium. Partnerships remain more flexible and private as a vehicle for owner-managed businesses and it is true that in practice the concept of limited liability for the owner-managers of a small company is more illusory than real since the bank will almost certainly require them to use their own houses as security for a loan to the company.

The impact of the LLP form on partnerships has been mainly restricted to professional firms. The advantages are legal personality and increased borrowing powers. But if it is seen merely as an attempt to avoid joint and several liability for partnership debts the benefits may be debatable.[102] The merits and otherwise of the LLP form have been debated in print.[103] The evidence so far is that there has been a substantial increase in the number of LLPs since it was introduced and that many professional firms have adopted it.[104] So far as partnerships are concerned, the change to an LLP will be largely tax-neutral.

There is a further point in that, by adopting the LLP form, with legal personality, large professional firms may possibly expose themselves to greater liability with regard to their fiduciary duties to their clients. Thus where a partner in one office has knowledge relevant to another partner in another office acting for a client, that knowledge could be imputed to the second partner, giving rise to an obligation to disclose that information and to liability for failure to disclose. Under the present law it is much less likely that such an obligation will be implied since it would be settled under the laws of agency: see, eg *Unioil International Pty Ltd v Deloitte Touche Tohmatsu*.[105]

One example of a solicitors' firm switching from the partnership to the LLP form was where the partnership had been appointed as executors under a client's will, but the client died after the change to an LLP. The question arose whether the successor LLP could still act as those executors. In *The Estate of Edith Lilian Rogers Deceased*,[106] a test case was brought after the local Probate Registry (following a national agreement) refused to allow the LLP to obtain probate of the will. Lightman J, taking a practical and common-sense view and noting that the Law Society had assimilated partnerships and LLPs of solicitors so far as clients were concerned, decided that the deceased's intentions would be best served by allowing the LLP to obtain probate as executors of the will.

102 See Freedman and Finch [1997] JBL 387.

103 Finch and Freedman, 'The Limited Liability Partnership. Pick and Mix or Mix-up?' [2002] JBL 475; cf Morse, 'Partnerships for the 21st Century—Limited Liability Partnerships and Partnership Law Reform in the UK' [2002] SJLS 455.

104 In 2001–2 there were 1,936 LLPs on the register. In March 2008 there were 32,066.

105 (1997) 17 WAR 98.

106 [2006] EWHC 753 (Ch).

The LLP form, which is based substantially on the corporate and not the partnership form, is the subject of Chapter 10, below.

The European dimension

We have already mentioned the fact that partnership law has largely escaped 1.30
the harmonization provisions of the European Community. The Community is, however, about more than standardization, it is about a single market available to all businesses in the Community, irrespective of national boundaries. Following the introduction of the single market, the Commission was concerned to make it easier for all businesses, including partnerships, to operate across frontiers. The many different forms of partnership within the national laws of the Member States make this difficult in practice, however, so that direct establishment of say an English firm in France is not feasible. All that can be achieved is the prevention of indirect discrimination based on nationality. The alternative solution so far is the availability of a legal entity, the EEIG, to which firms, amongst others, have access.

Despite the unprepossessing name of this creature it is worth exploring further as an effective method of cross-border cooperation between firms.

The EEIG is the creation of a 1985 EC Regulation,[107] which means that the basic law contained in that Regulation is directly incorporated into UK law. The Regulation does not cover all relevant aspects of control so that certain areas are left to the national laws to govern EEIGs subject to their domain. Thus additional rules exist in the European Interest Grouping Regulations 1989[108] for those EEIGs subject to UK control. The EEIG is based on a French concept and it is not intended as an independent organization. It cannot be used to pursue an economic activity independent from the activities of its members; it cannot, for example, assume a management function in respect of its members. It is neither a partnership nor a company, although it has several partnership characteristics and the applicable rules have a similarity to partnership law in that in many cases they are flexible and subject to contrary agreement between the parties.

In essence an EEIG may be formed by at least two or more persons, including firms, based in different Member States of the Community. It is based on an agreement within the Regulation and the relevant national law. The Regulation takes precedence over national law where there is a potential conflict. The participating members are fully liable for the debts, subject to their own limited liability,

107 Reg 2137/85 [1985] OJ L199/1.

108 SI 1989/638 as amended by the European Economic Interest Grouping (Amendment) Regulations 2009, SI 2009/2399.

but the EEIG has capacity to make contracts etc on its own behalf. It is envisaged that it will be used for collaborative ventures, eg joint research and development on a European scale. One has been formed by eight law firms with a view to developing their activities on a European basis.

The EEIG is based on contract and so a formation contract is necessary. This must include details of the name,[109] address, and objects of the EEIG, details of its members and its duration if specified. The address must be in a Member State where the EEIG has its central administration or where a member firm has its principal business. The importance of this choice is that it is the Member State in which the EEIG must be registered and so fixes the relevant national law for control purposes. Under UK law an EEIG registered here, with the registrar of companies, will have a separate legal personality (this was left to each Member State to decide). The names and service addresses of the managers must also be registered. The register is open to public inspection.

The Regulation makes provision for the division of powers between the managers and members of an EEIG, with all major structural decisions being reserved to the latter. Unlike partnerships, however, the managers have exclusive power to represent the EEIG in dealings with outsiders thus denying the basic UK laws of agency any application. Third parties are protected against the managers acting outside their powers unless they have actual knowledge of the defect. If an EEIG fails to pay a debt on the request of a creditor the members will be liable for that debt. Although an EEIG cannot have as its objectives the making of profits for itself, any profits arising will be paid to the members in accordance with the contract.

Apart from the restriction already mentioned that an EEIG cannot manage its members it is subject to other restrictions by the Regulation. It may not own any shares in its members, it may not employ more than 500 employees, it must not be used to circumnavigate national rules about loans etc to directors, and it may not itself, as distinct from its members, be a member of another EEIG.

There are many other detailed rules on the control of an EEIG, including its dissolution, and it brings its own problems of accountancy and tax. Further, it involves potential problems of interpretation by the courts of the different Member States. The take-up rate in the UK has been slow[110] and in 1997 the European Commission issued a communication pointing out its advantages in tendering for public contracts and seeking to clarify some of the perceived drawbacks to the use of the EEIG.[111]

[109] This is generally subject to the control regime as applicable to companies.
[110] In March 2008 there were 205 EEIGs registered in Britain.
[111] COM (97) 434 [1997] OJ C285.

Partnerships: Variations on a Theme

Group partnerships

Partnerships today serve a wider variety of economic functions than those at the 1.31
time of the 1890 Act. So flexible and successful are the provisions of that Act, however, that legal draftsmen have been able to adopt the form to meet the new demands of both the professions and taxation. It was only the perceived threat of substantial personal liability that led to the LLP alternative. For many years partnerships were limited in size—until recently the limit was twenty, but this limit had been waived since 1967 for most of the professional partnerships, including solicitors and accountants, and was removed completely for all firms in 2002. As we have seen many such firms are now extremely large. Clearly a single partnership of three or four-figure numbers is possible but not very workable and, prior to the arrival of the LLP, such firms often organized themselves into a group partnership which was in essence nothing more than a partnership between partnerships. In this way each branch office was in effect a semi-autonomous partnership but each one was linked by a partnership deed to the 'head' office, usually in London. Smaller firms and individuals carrying on independent businesses may also combine into a group association, often under a group management agreement. Such an association may or may not amount to a partnership, since members may not share the profits of the individual businesses.

Much care must be taken, of course, in the drafting of the particular agreements: voting and financial matters are obvious areas of concern. But it is essentially a matter for agreement. There are potential problems: for example, as to the liability of a partner in one branch for the debts incurred by the head office or by another branch, but many of them will be capable of solutions based on the ordinary principles of agency. Thus, in *Bass Brewers Ltd v Appleby*,[112] liability was fixed by the application of the 'holding-out' principle, ie that the defendant had been held out as a partner by another firm in the same 'group'. It was therefore unnecessary to decide whether the group association agreement itself constituted a partnership.

Extension of fiduciary liabilities

Similar problems may well arise in connection with the potential fiduciary liabili- 1.32
ties of partners in a professional group partnership. Such professional partners, eg solicitors or accountants, owe fiduciary duties to their clients, so that they must not put themselves in a position where their duty to the client and their

112 [1997] 2 BCLC 700, CA.

personal interest conflict. Similarly they are under a duty to disclose all relevant information to their client. The potential problems with a group partnership are shown by the Australian case of *Unioil International Pty Ltd v Deloitte Touche Tohmatsu*.[113]

Unioil had engaged a firm of accountants and a firm of lawyers to report on another company with a view to investing in that company. The lawyers were based in Perth but there were other offices under the same name in each of the main centres in Australia, including Sydney. It transpired that one of the partners in the Sydney office was acting in another capacity for the company under investigation and that there was contact between the two individual partners. Each office of the firm was a separate 'profit centre' and a separate partnership. Nevertheless the judge found that the group were able to practise de facto as a national firm and that the partners of one firm regarded themselves as de facto partners in the others. He was not required to decide whether all the partners of each firm were also legally partners of the others, although he doubted whether they were, following the Canadian case of *Manville Canada Inc v Ladner Downs*,[114] where every effort was made to keep the various firms apart in terms of clients etc.

But the judge did decide that the partner advising Unioil, being aware of the Sydney office's work for the company being investigated, would have been tempted, consciously or unconsciously, to deal with the matter in a way which was least embarrassing to the Sydney office. Thus there was a conflict of interest and duty on his part and consequent liability (despite a favourable report being made to Unioil the investment proved to be disastrous). On the other hand the judge rejected an alternative claim that all the information known to the Sydney office should be imputed to the partner in Perth so that he should have told Unioil about it. But the judge did that, even on the assumption that the group partnership was one partnership, by reference to the law of agency. It would be impracticable and even absurd to suggest that in large firms (whether as groups or a single entity) partners were under a duty to reveal to each client and use for that client's benefit any knowledge possessed by any one of their partners or staff.

The internal issues arising from group partnerships will also fall to be resolved by reference to the law of agency and the fiduciary duties which partners owe to each other.

Identifying single or multiple firm—multi national firms

1.33 If litigation is brought against a firm it may be important to establish that the firm is subject to the jurisdiction of the court and whether any other court may

[113] (1997) 17 WAR 98.
[114] (1993) 100 DLR (4th) 321.

also/instead be seised of the case. That issue is considered generally at the end of this chapter, but one side effect may be to determine whether a firm is a single multi national firm based in a particular country or a series of separate firms working in their own jurisdictions. This was the situation before the Grand Court of the Cayman Islands in *Touche Ross and Company v Bank Intercontinental Ltd*.[115] The defendant bank had sued the plaintiffs in Florida in relation to an alleged negligent audit in Cayman and the plaintiffs now asked the Cayman court to issue an injunction against the bank preventing it bringing proceedings anywhere but Cayman. The actual decision of the court was that there were separate substantive issues triable in both jurisdictions and so it refused to make the order.

One of those issues, however, which was before the Florida court, was the exact nature of the firm or firms known as Touche Ross International. That organization's brochure included the phrase: 'The parties in each country are joined together through membership in Touche Ross International, a legal entity formed under Swiss law'. The judge commented that:

> I think it has to be said (whatever the 'Touche Ross' label may eventually be held to mean in law in any given situation) that these materials undoubtedly convey and must be taken to convey, at first sight, the impression not only that there is a multinational entity called 'Touche Ross' but also that it is one which at least has a professional relationship with its constituent elements and more than that ... one which controls in terms of *quality* and *financial responsibility* the work done in the Touche Ross name.[116]

Consequently the judge held that the allegation of there being a worldwide firm was not unsustainable.[117] This case shows not only the case-by-case approach which has to be taken in such situations but also the potential exposure to liability within a group partnership where such responsibility has been assumed. On the facts of that case much may have depended on the precise nature of the Swiss *Verein* at the centre of affairs.

Subpartnerships

A similar variation on the partnership theme is the subpartnership, that is, a partnership where one of the partners agrees to divide his share of the main partnership profits and losses with others. There are in effect two partnerships, one of which is a partner of a 'head partnership' together with individual partners. Thus a partnership of A, B, and C can have a subpartnership if C agrees to subcontract his profit and losses from the head partnership with D and E. The questions **1.34**

115 1986 CILR 156.
116 At 170.
117 See also the US case of *Armour Intl Co Ltd v Worldwide Cosmetics Inc* 689 F 2d 134 (1982).

which arise are whether this is possible; if it is, what are the liabilities of D and E with respect to the debts of the head partnership, and what are the fiduciary duties of A, B, and C towards D and E? Rather surprisingly the answer to the first question is yes. Whilst it might at one time have been possible to argue that C, D, and E are not actually carrying on a *business* (whereas in a group partnership it is envisaged that each 'branch office' will be doing so), such arrangements have been accepted by the courts of England, Scotland, and Australia. Presumably the business is the management of the interest in the principal partnership.

The answer to the second question was given by Connolly J in the Queensland case of *Australia & New Zealand Banking Group Ltd v Richardson*.[118] The bank had lent $30,000 to a newsagents' firm of which Mr Gary and Mr Richardson were partners. They later discovered that a Mrs Vernon had an association with the business in that she had advanced $25,000 to Richardson, her son-in-law, to fund his half-share of the partnership. In 1976 Mrs Vernon and Richardson agreed in writing that they would be equal partners in the half-share and were each entitled to withdraw $200 per week from the business so long as the cash flow of the business allowed. She played very little part in the affairs of the business itself. The bank now sought to recover the debt directly from Mrs Vernon. The judge, having ruled that in no way could she be regarded as a full partner in the business, had to decide whether her subpartnership with Richardson nevertheless made her fully liable for the debts of the head partnership.

In short the judge's answer was no. The liability of a subpartner is limited to the extent of his subcontract with the subpartner who is also a full partner in the head partnership:

> [A] subpartner's only interest in and relationship with the partnership lies in his right to a share of such of its profits as reach his partner. He has no rights against the partnership and can only enforce his right to profits which have actually been received by his subpartner. ... He has no say in the running of the business for that would involve rights which cannot be conferred on him by one partner alone. It follows that he cannot be liable for the partnership debts on the footing that they were authorised by him.

In effect, therefore, a subpartner will simply suffer loss in revenue arising from main partnership losses but if the principal partner is liable to contribute further to the debts he may be able to call on a contribution from the subpartner.

Since the only conceivable business of the subpartnership is the management of the interest in the main partnership, few fiduciary problems will arise as between the subpartners since their interests are solely financial, consequential on the

118 [1980] QdR 321.

success or failure of the main partnerships. On the other hand it is possible that if the main partner were to involve the subpartners in the management of the main firm he would be in breach of his duties to the other main partners. At least on a formal level, therefore, the subpartnership will simply be a vehicle for the economic consequences of the share in the main partnership.

By way of postscript it should, however, be remembered that if the subpartner is regarded as a full partner by a third party, such as the bank in this case, he will be liable as such whatever the agreements involved. It is significant that in this case the bank had no knowledge of Mrs Vernon's existence until they commenced the proceedings. At no time did they rely on her being a partner when the credit was being extended.

Corporate Partners

It is perfectly possible for a company to be a partner. (Section 1 of the Partnership Act relates to persons and the Interpretation Acts have always defined a person as including a company unless the contrary is provided.) This is so, even though some sections of the Act refer to the bankruptcy of a partner[119] rather than to the insolvency of a partner. Since companies cannot become bankrupt it has been said that such a provision cannot apply to them.[120] There is in fact nothing to prevent a partnership being composed entirely of companies. Companies as partners can fulfil many roles. For example, they were used to enable the former size limits of a partnership to be overcome[121]—partnerships which were limited to twenty by having, say, twenty companies as partners, each company having as many members as it wished. Companies also provide some means of limited liability for partnerships since although the company partner would be liable for all the partnership debts without limit, the partnership creditors in pursuing their debts could only recover from the company's own resources and not those of its members. Tax planning has also involved the use of such corporate partners and even those professions which cannot form a company to practise their profession can involve a corporate partner as a service company. **1.35**

Capacity issues

There are problems, however, as always. Companies are artificial legal persons and there are historically two limits on their ability to do things. As an eminent **1.36**

119 See, eg s 33.
120 *Anderson Group v Davies* (2001) 53 NSWLR 401 at 404, SC.
121 These have been abolished: see Ch 3, below.

judge once remarked, 'A company cannot eat nor sleep'; or, in other words, there are those physical things which a company simply cannot do.

In *Newstead v Frost*[122] the Revenue attacked the partnership between David Frost and the Bahamian company on that ground. Mr Frost and the company formed the partnership to exploit 'the activities of television and film consultants and advisers ... and of producers, actors, directors, writers and artistes'. In fact the only entertainer so exploited was Mr Frost himself. The argument put forward by the Revenue, who needed to negative the partnership, was that physically a company cannot be a television entertainer or an author and so could not form a partnership for such purposes since the only other partner could not exploit his own skills. The House of Lords rejected this. There was nothing in the agreement which required the company to entertain or write books and there was nothing to prevent the company and the individual jointly agreeing to exploit the individual's skills. The Court of Appeal had earlier commented that even if a company cannot 'do' the act in question, if the partnership as a whole could do it then it would be part of the partnership business and would have to be brought into account between the partners accordingly.

Traditionally, companies were also limited by their constitution. They had no capacity to act outside their objects. The 2006 Companies Act, however, abolishes the need for any objects. In any event, this second restriction had been removed so far as the capacity of a company to enter into a partnership is concerned, by what is now s 39(1) of the Companies Act 2006, which provides that:

> The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum.

Further, if the directors by agreeing to bind the company into a partnership, act contrary to the company's constitution, that act will still be valid unless the other partners have acted with actual understanding that it was contrary to the company's constitution. Even then the agreement may be ratified by the company. Section 40 of the 2006 Act which so provides is subject only to s 41. That section would apply where the company entered into a partnership with one or more of its directors, and even in that case the agreement would only be voidable at the instance of the company. Restrictions in the company's constitution are therefore largely an internal matter between the directors and the members. The right of a member to prevent a company acting outside its constitution by seeking an injunction is in practice theoretical only.

122 [1980] 1 All ER 363, HL.

Other issues

Other problems have arisen as a result of the increasing growth of corporate partners and no doubt will continue to do so. We have already referred to the fact that if all the partners are limited companies then there is in effect indirect limited liability for the firm's debts. This prompted the EU to extend the accounting requirements (both as to content and publication) imposed on companies by the Fourth and Seventh EC Company Directives to such partnerships by an amending Directive of 1990.[123] A further Directive of 2006 also applied the requirements as to the appointment and dismissal of auditors, the signature of auditors' reports, and disclosure of auditors' remuneration to corporate partners.[124] These requirements are set out in the Partnership (Accounts) Regulations 2008.[125] In effect the requirements of the Companies Act 2006 as to the format and content of accounts and as to auditors[126] are applied to partnerships each of whose partners is either a limited company or an unlimited company or Scottish firm, each of whose members is a limited company. **1.37**

Other examples may serve to indicate the type of problem which can arise from having a corporate partner. In *Scher v Policyholders Protection Board*,[127] the House of Lords had to interpret the application of the Policyholders Protection Act 1975 to a partnership with some corporate partners. That Act is designed to provide a safety net for those who take out policies with insurance companies which subsequently fail to pay out on a claim because they have become insolvent. This protection applies, however, only to private individuals and not to companies. Section 6(7)(b) of the Act accordingly provides that a partnership is to be treated as a private individual if, but only if, it consists of private individuals. The problem with that approach is that in legal terms an insurance policy taken out by a partnership is a bundle of contracts between the insurer and each of the partners. The House of Lords decided that the section must nevertheless be interpreted as treating a partnership as a single entity so that if any partner is a company then the Act cannot apply to the firm's policies. Lord Mustill spelt out the consequences of this decision as follows:

> This undoubtedly leads to harsh results in some cases and also creates a distinctly unsystematic regime, since the same partner may during the life of the policy gain the protection of the Act, or lose it, according to whether a single corporate partner leaves or joins the firm.

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[123] Dir 90/605/EEC, OJ L317/90, amending Dir 78/660/EEC [1978] OJ L222/78 and Dir 83/349/EEC [1983] OJ L193/83.

[124] Dir 2006/43/EC [2006] OJ L157/06.

[125] SI 2008/569.

[126] Including those relating to statutory auditors.

[127] [1994] 2 AC 57, HL.

That case demonstrates the problems of corporate partners under the general law (apart from being yet another example of the problems caused by the lack of legal personality). Two further examples show the problems that can occur from the nature of companies themselves. As we shall see a partnership is automatically dissolved by the death of an individual partner. The equivalent for a corporate partner would be its liquidation and dissolution. But, unlike an individual, the court may declare the dissolution of a company to be void so that it is in effect restored to life. The question arises therefore as to the effect of such a restoration on the partnership. Under the law of Ontario it was held in *Alton Renaissance I v Talamanca Management Ltd*[128] that the effect was to revive a limited partnership. It is arguable that this is also the position in England since on the restoration of a dissolved company by the court under the Companies Act 2006, ss 1028 and 1032, the court may make such provision as if the company had not been dissolved. The nature of a company is also relevant to the question as to whether it is a partner at all. A company has no existence until it is formed so that it cannot be regarded as a partner on the basis of evidence as to the acts etc of individuals prior to formation. Further there must be evidence of actual partnership activities by the company itself after formation, eg making contracts etc in its own name.[129]

A final example arises from the fact that a company, unlike individuals, can raise money on the security of a floating charge, ie a charge over all its assets, present and future, including its stock in trade, and not just a fixed charge on its fixed assets. For various reasons it may be important to decide whether a charge is a fixed or floating charge. What is the position therefore when a corporate partner creates a charge over its partnership interests? This is a very complex issue, requiring an analysis of the nature of a partner's interest, which we will return to in Chapter 6, and it has not yet come before the English courts. In Australia the distinction has been made between a charge over the corporate partner's interest in the partnership which creates a fixed charge (*United Builders Pty Ltd v Mutual Acceptance Ltd*[130]) and a series of charges by all the corporate partners, where there are no individual partners, over all the assets of the firm which creates a floating charge (*Bailey v Manos Breeder Farms Pty Ltd*[131]).

The International Dimension—Jurisdiction

1.38 We have already seen in relation to group partnerships the problems which can arise where there is an allegation as to the existence of a multi national firm,

128 (1993) 99 DLR (4th) 707.
129 *Frauenstein v Farinha* [2007] FCA 1953.
130 (1980) 144 CLR 673.
131 (1990) 8 ACLC 1119.

especially as to the issues of whether a particular national court has jurisdiction to hear the case and whether any other court may also be properly seised of the issue.[132] But such issues can arise in far less glamorous surroundings. This is a very complex and specialist area, part of the conflict of laws, and reference should be made to the specialist works on the subject. But put simply the question is when will the English courts have jurisdiction to hear a partnership dispute,[133] given that a partnership is not an entity and in reality it is the partners who are involved. The answer depends entirely upon whether it is a case which falls within the scope of the EU Judgments Regulation 2001 or not, that Regulation being of course automatically part of United Kingdom law. In very general terms the answer in turn depends upon whether the defendant is domiciled in a Member State of the EU.[134]

Cases where the Judgments Regulation applies

The basic rule under the Regulation is that the court has jurisdiction only if **1.39** the claim is made against a partner domiciled in England.[135] But under Art 22(2) of the Regulation, the English court will have exclusive jurisdiction, whatever the domicile of the defendant, in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies, or other legal persons or *associations of natural or legal persons*, or the validity of the decisions of their organs, if the company, legal person, or association has its seat in England.

It has recently been held in the case of *Phillips v Symes*[136] that this applied to English partnerships. In that case a claim by the executors of a Greek domiciliary to recover movable assets in England was brought in England. The defendant, an English domiciliary, now resident in Switzerland, had brought proceedings in Greece seeking to establish his ownership of those assets and he now sought to have the English proceedings stayed. One of the issues was as to whether the disputed assets were in fact assets of a partnership between the deceased and Mr Symes. It was assumed that the 'seat' of any such partnership was in England.

132 See, eg *Touche Ross and Company v Bank Intercontinental Ltd* 1986 CIR 156.

133 Similar rules apply to the Scottish courts. There are also special rules for establishing the jurisdiction of the English and Scottish courts in relation to partnerships located entirely within Britain: see Sch 4 to the Civil Jurisdiction and Judgments Act 1982, as amended by SI 2001/3929. In essence the court where the defendant is domiciled will have jurisdiction with exceptions for proprietary issues. For more details see Dicey and Morris, *Conflict of Laws* (14th edn, with supplements, London: Sweet & Maxwell 2006) 11.109–11.114.

134 Excluding Denmark, but that has a parallel agreement with the UK in similar terms. Again for detailed analysis, see Dicey and Morris, ch 11.

135 Reg 44/2001, Art 2.

136 [2002] 1 WLR 853.

Having decided that Art 22(2) could apply to a partnership,[137] the further issue was whether the ownership dispute fell within 'the validity of the constitution ... or dissolution' of a partnership. The judge decided that it did, on the basis that dissolution included also the winding up of a partnership's affairs consequent on a dissolution.[138] Consequently he granted an injunction preventing the defendant from pursuing the partnership issues before the Greek court.

In establishing where a partnership has its seat for this purpose the Regulation allows the court to apply its own rules. These are contained in s 43 of the Civil Jurisdiction and Judgments Act 1982,[139] whereby a partnership has its seat in the United Kingdom if, and only if: (a) it was formed here; (b) its head office is here; or (c) its central management and control is exercised here.

Cases where the Judgments Regulation does not apply

1.40 If the defendant is domiciled in a State not subject to the Regulation, process can be served on any person, wherever domiciled, who is in England at the time of service, partnership being no exception to this basic rule. In addition since any two or more persons, wherever domiciled, carrying on or alleged to be carrying on business as partners in England can sue and be sued in the firm name, and service can be at the firm's business, it seems that a partner outside England at the time will be caught, although only the assets within the jurisdiction will be involved.[140] There are also provisions for service on partners abroad, but only with the permission of the court, and on restricted grounds.[141]

137 The case was actually fought on Art 16 of the Brussels Convention but the wording was the same.

138 It is reasonable to assume that this could also include a partial dissolution of a partnership, where the dispute would be as to the outgoing partner's share. That could also fall under the heading of the constitution of the partnership. It seems sensible to apply Art 22(2) to any issue where partnership law, as opposed to the general law, is in issue. On this point see the company cases of *Newtherapeutics Ltd v Katz* [1991] Ch 226 and *Grupo Torras SA v Sheikh Fahad Mohammed Al-Sabah* [1996] 1 Lloyd's Rep 7, CA, where an issue as to excess of authority by the board was held to fall within this article, but there was some doubt as to whether the scope of the fiduciary duty of the board did so.

139 As amended by SI 2001/3929.

140 The defendant can apply for a stay of proceedings by showing that there is a better forum, unless the claimant can in turn show that it would be unjust to deprive him of the right to sue here: *Spiliada Maritime Corp v Consulex Ltd* [1987] AC 460.

141 See Practice Direction B to CPR 6, para 3.1.