Partnerships 2019

Contributing editors
Tina Williams and Daniel Sutherland
Fox Williams LLP

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Lexology Getting The Deal Through is delighted to publish the first edition of *Partnerships*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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TYPES AND FORMATION OF PARTNERSHIPS

Sources of partnership law

1 **What is the statutory basis for partnerships, and partnership-like structures in your jurisdiction? To what extent do these laws overlap or share features with company law?**

General partnerships (often referred to as traditional partnerships and colloquially described as firms) are governed by the Partnership Act 1890 (the 1890 Act). The term 'partnership' describes the relationship between two or more persons (natural individuals, corporate entities or a mixture of both) 'carrying on a business in common with a view of profit' (see section 1(1) PA 1890). Because a general partnership is no more than a collection of individual partners (without separate legal personality), each partner has unlimited liability for the firm's debts and other obligations.

There is no significant overlap between the law governing general partnerships and UK company law. The rights and obligations of the partners are usually set out in a written partnership agreement but can be agreed orally. In the absence of agreement on certain basic matters (such as how profits are to be shared), the 1890 Act sets out default rules that apply.

Limited partnerships (LPs) are governed by the Limited Partnerships Act 1907 (the 1907 Act). They are similar to general partnerships in most respects, and the Partnership Act 1890 applies to LPs to the extent that the 1907 Act is silent on any matter. However, an LP may designate certain of its partners as limited partners. Limited partners must not be involved in the day-to-day running of the business (such as investors who take a share of the profits but have no management role) but in return are only liable up to the sum of money they have agreed to contribute to the LP as capital. Partners involved in the running of the business are known as 'general partners' and they (like all partners in a traditional partnership) have unlimited liability for the LP's debts and other obligations. The rights and obligations of the partners in an LP can be agreed orally but are almost invariably set out in a written partnership agreement.

Limited liability partnerships (LLPs) are in essence a hybrid between a traditional partnership and a company. They are governed by the Limited Liability Partnerships Act 2000 and the Limited Liability Partnership Regulations 2001 (which set out default rules governing the LLP and its members in the absence of agreement to the contrary) as well as certain provisions of UK company and insolvency law. Although the Companies Act 2006 and Insolvency Act 1986 are not of general application to LLPs, the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 apply certain aspects of company and insolvency law (with certain variations), such as the obligation to file statutory financial statements, restrictions on the use of certain names, trading disclosure requirements and the keeping of a register of 'persons with significant control'. With certain exceptions, the liability of members of an LLP (referred to hereafter as 'partners' save where sought to be differentiated from partners in general partnerships) is limited.

Types of partnerships

2 **Identify the types of partnerships or other partnership-like structures permitted in your jurisdiction. What are they typically used for?**

As described above, English law recognises three different types of partnership:

- General partnerships, once overwhelmingly the most common vehicle for professional services businesses, such as legal and accountancy firms, until such firms were allowed to practise through the vehicle of LLPs (see below). General partnerships remain popular for smaller trading businesses and it is estimated that they greatly outnumber LLPs (although, given that general partnerships are not registered, it is not possible to know with certainty how many there are). Partnerships are also sometimes used for joint ventures between two or more corporate businesses.
- LPs, which are less common than general partnerships but have a valuable role in investment fund structures.
- LLPs, which are commonly used by professional services businesses, as they combine the organisational flexibility and tax transparency of general partnerships with the limited liability that was previously only available through the use of a limited liability company. In addition to their use for professional services businesses, LLPs are commonly used in real estate joint ventures and within the group structures of businesses operating in the financial services sector.

There are a number of reasons partnerships and LLPs are popular among professional services businesses such as legal and accountancy firms. These reasons include historic regulatory restrictions on operating through companies, as well as the freedoms that partnerships and LLPs offer as to internal management arrangements and capital maintenance. Tax transparency (ie, that profits are only taxed in the hands of the partners rather than within the partnership or LLP) has been a key driver for the use of partnerships and LLPs for investment purposes.

Differences between types of partnership

3 **What are the key differences between the various types of partnerships (and similar entities) available in the jurisdiction? Are partnerships treated as bodies of persons or bodies corporate?**

A general partnerships is a description of the relationship between a collection of persons who carry on a business together. There is no legal entity separate from the partners comprising the firm from time to time.

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In a general partnership, each partner in the firm is deemed to be the agent of each other partner in relation to the firm's business and has ostensible authority to bind each of the other partners, so that contracts entered into by one partner are deemed entered into and are binding on the body of persons forming the partnership as at the date of the contract. All partners are jointly liable for the contractual debts and obligations of the firm incurred while they were partners. They are also jointly and severally liable for loss arising from any partner's wrongful or negligent act or omission: a third party suffering loss can sue and recover damages from any one or more of the partners. The partners have unlimited liability: if the firm does not have sufficient assets to pay its debts or other liabilities, then the partners will be required to make good any deficit out of their own personal assets.

All of the above characteristics apply to LPs, save that limited partners (members of the firm who do not engage in the day-to-day management of the business) will have limited liability. Recent legislation has introduced a type of LP known as a 'private fund limited partnership', which, subject to certain qualifying criteria, permits limited partners to not contribute capital to the LP and permits limited partners to undertake certain activities within the LP with greater certainty that in doing so they will not lose their limited liability status.

An LLP, on the other hand, is a body corporate with a legal personality separate from its members (commonly and hereafter referred to as partners save where the position of members is sought to be differentiated from that of partners in general partnerships). Save in specific circumstances, the partners enjoy limited liability. The 1890 Act does not apply to LLPs, which are governed by the 2000 Act and certain provisions of the Companies Act 2006 and the Insolvency Act 1986. An LLP is akin to a company in that each can sue and be sued and hold property in its own name, and both are required to file financial statements and register changes in membership and in persons with significant control with Companies House. The key differences between an LLP and a company are that:

- an LLP does not have registered shares: a partner's interest in it is simply the contractual rights (as to profits, capital, voting, etc) provided by the members' agreement (or, in the absence of a members' agreement, the rights provided by the statutory default rules);
- where the rights of partners are governed by a members' agreement, this is not publicly available (unlike company articles of association); and
- LLPs, unlike companies, do not pay tax on their profits: they are tax-transparent entities. Partners pay tax on the share of the profits of the LLP allocated to them respectively.

Reasons for choosing a partnership structure

4 What are the typical reasons that businesses choose to operate through a partnership structure in your jurisdiction? Do any factors discourage adopting a partnership structure?

The key reasons for operating via a partnership structure are tax transparency, privacy, organisational flexibility and, in the case of LPs and LLPs, the ability to trade with limited liability.

All general partnerships, LPs and LLPs (except for certain non-trading LLPs) are 'tax transparent'. The general partnership, LP or LLP is not liable for tax on the profits generated by its business. All such profits are liable to tax in the hands of the partners themselves. This is in contrast to UK companies, which are liable to corporation tax on their profits, after which the profits may be distributed (in the form of dividends) to shareholders who, assuming they are individuals, are liable to income tax on any such dividends.

A partnership also benefits from a greater degree of privacy in respect of its business than a company does: general partnerships and LPs are not required to file public financial statements, and their constitutional arrangements (including the partnership agreement) remain private. Equally, LLPs may keep their members' agreements private, but are required to submit financial statements annually to Companies House.

General partnerships, LPs and LLPs benefit from a greater degree of organisational flexibility than a company. Whereas a company is (almost always) owned via shares, which are subject to formalities and, usually, restrictions on their issue, transfer and redemption, partnerships, LPs and LLPs do not have share capital. A partner's interest in the business is purely contractual and entirely a function of the terms set out in the partnership or members' agreement. This makes it much less onerous administratively to vary partner profit shares, voting and the amount of capital that partners are required to contribute.

Moreover, the mechanics involved in exiting a partner from the business are much more straightforward: rather than any formal share transfer and valuation provisions (which would be necessary in a professional services firm operated via a company), a retiring partner will simply receive what is specified in the partnership or members' agreement, and his or her partnership share will accrue automatically to the remaining partners. His or her sole entitlement will usually be a a proportion (calculated by reference to his or her date of retirement) of his or her annual profit share for the financial year in which he or she retires and a return of any sums contributed by him or her as capital. Usually, no provision is made to compensate a retiring partner for his or her share of any increase in the value of the business during the period in which he or she has been a partner.

Formation (formalities and bars to formation)

5 How are partnerships and the similar structures available in your jurisdiction formed?

A general partnership comes into existence without the need for registering with an external authority. Instead, a partnership arises where two or more persons begin carrying on 'a business in common with a view to a profit' (see section 1(1) of the 1890 Act).

Whether a partnership has been established in respect of any two or more persons is a question of fact: the parties cannot simply determine among themselves that a partnership exists between them. A partnership agreement is only an indication that a partnership relationship has arisen, and is not of itself conclusive. It is possible, for example, that a partnership agreement may be considered by a court or tribunal to masquerade what is truly an employment relationship. Equally, sharing returns from a jointly owned asset does not of itself indicate a partnership. A partnership can arise before trading commences, though two or more persons who jointly devise a business concept will most likely not, without carrying on the business itself, be bound together as partners.

LPs must be registered at Companies House. The registration requirements are set out in section 8A of the 1907 Act, which requires the submission of Form LP5 to Companies House (in respect of which a fee is payable) setting out various matters including the name of the firm, the nature of its business, its proposed principal place of business and the names of each general and limited partner. If a proposed LP fails to register, it will simply be a general partnership and no partners will enjoy limited liability.

An LLP is formed by incorporation at Companies House, by submitting form LL IN01. The form contains various details relating to the LLP, such as its name (which must be compliant with the requirements of the Companies Act 2006), the initial members (of which there must be at least two), and its registered office. The LLP is incorporated once Companies House has issued a certificate of incorporation. Although an LLP is not required to have a board of directors, two or more of its members must be 'designated members'. Their function is to deal

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with various administrative matters required by statute, such as annual filings and the maintenance of registers. They discharge a role similar to that of company secretary and do not have any greater management powers internally than any other member, except to the extent that the LLP's members' agreement confers these powers on them.

LLPs must have a registered office in England or Wales and must have two or more members. Should an LLP have a single member for more than six months, that member loses limited liability status and the LLP may be struck off (dissolved). General partnerships and LPs must, by definition, consist of at least two partners. No partner in a general partnership, LP and LLP is required to be UK resident.

There are no restrictions as to the types of business that can be conducted by any of these three vehicles, provided the business may lawfully be carried on; although, some are more commonly used for particular businesses than others.

REGULATION

Taxation

6 | How are partnerships taxed?

General partnerships and LPs are tax-transparent: any profits generated by the firm are taxed as income in the hands of the partners.

LLPs are also tax-transparent but only where they are used as a vehicle for a 'trade, profession or business' rather than for holding investments (see section 863 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA)).

Because of their tax-transparency, it is rare for general partnerships, LPs or LLPs to be funded through retained profits, since partners will have been taxed in full on those profits and so typically expect them to be distributed in full. One solution to this problem was available in which an LLP or partnership could admit a private company, owned by the partners, to its membership. The company would then be allocated a share of the profits as a means of 'warehousing' sums for reinvestment, suffering corporation tax but avoiding being taxed as income for the other partners. However, the 'mixed members rules' set out in section 850C ITTOIA, introduced in 2014, have effectively removed the benefits of doing so, as any profits allocated to a corporate member of an LLP will be deemed to be allocated to the other partners for tax purposes to the extent that those other partners also beneficially own the corporate partner.

Individual partners receiving profits are self-employed for tax purposes, meaning that they pay income tax (at up to 45 per cent depending on earnings) and class 2 or 4 National Insurance contributions (NICs) (subject to change, with the current government seeking to harmonise NICs between the employed and the self-employed).

LLPs and partnerships do not pay their own NICs in respect of the profit shares of their partners, in contrast to employers that are required to deduct income tax from gross salaries and pay employer's NICs, presently charged at 13.8 per cent of salary.

However, the 'salaried members rules' (introduced in 2014) require LLP members to be taxed as though they were employees where those members do not have at least one of the 'hallmarks' of LLP membership (variable remuneration dependent on profits, significant influence over the LLP's affairs, or a substantial contribution of capital). The tests required are set out in sections 863A to 863G ITTOIA. The legislation seeks to minimise the avoidance of an LLP's liability to pay income tax and NICs on a members' behalf via Pay As You Earn, which requires employers to deduct such sums at source.

Reporting and transparency requirements

7 | To what extent must partnerships, LLPs and similar structures file accounts and other documents and information with a government agency?

General partnerships do not need to file financial statements publicly or even need to maintain a formal register of partners. However, regulatory requirements will apply (for example) in respect of legal and accountancy firms which may require the keeping of formal partners' records. Moreover, the Partnerships (Accounts) Regulations 2008 require partnerships consisting entirely of corporate bodies to file financial statements.

In practice, however, general partnerships will advertise the retirement of partners from the firm in the London Gazette, as this is deemed to be sufficient notice to third parties dealing with the firm that the retiring partner no longer has authority to bind the firm and is no longer liable for new debts incurred by the firm.

LPs also do not need to file financial statements publicly. However, they are required to:

- update Companies House in respect of certain changes to their business, membership or capital; and
- advertise where any general partner in the LP is to cease being a general partner and become a limited partner.

The financial statements of LLPs, on the other hand, are public and must be submitted to Companies House on an annual basis, as is required under the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

Companies House must be notified of changes to the LLP, including the admission and retirement of members and changes to the LLP's designated members and persons with significant control. However, unlike companies, no resolutions of the members need to be filed upon being passed. Likewise, the members' agreement of an LLP is a private document and cannot be obtained via Companies House, in contrast to companies' articles of association, which are public documents.

The business letters and certain other business documents of general partnerships, LPs and LLPs must state the names of partners or where a list of the partners may be inspected.

Ownership and membership

8 | Can anyone be a partner, and, if not, who can and cannot? Can bodies corporate or other partnerships own a partnership?

There is no general restriction on who can be a partner in a general partnership or LP. There is no particular legal ground that prevents a general partnership from coming into existence, or that entirely excludes the possibility of someone being a partner. Individuals and corporate bodies (including LLPs) can be partners in a general partnership or LP, though a general partnership and LP cannot (given its lack of legal personality) be a partner in another general partnership, LP, LLP or company. In practice, however, there are restrictions on the ability of certain individuals to carry out business in partnerships, such as minors or undischarged bankrupts. A partnership that is formed for an illegal purpose would suffer from an inability to enforce a partnership agreement, but the illegality does not prevent the partnership from coming into existence.

Conversely, members of LLPs are subject to the disqualification regime applicable to company directors, as set out in the Company Directors Disqualification Act 1986. The Act empowers the courts to make an order that any individual be banned from being a company director or member of an LLP if, for example, he or she:

- is convicted of certain criminal offences relating to a company or LLP;
- has been persistently in default under legislation requiring any return, account or other document to be submitted to Companies House;

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- has been guilty of fraudulent trading;
- has been involved in a company or LLP insolvency in circumstances which makes him or her unfit to be concerned in the management of a company or LLP; or
- has been found liable to make a contribution to a company's or LLP's assets as a result of fraudulent or wrongful trading.

Execution of documents

9 How do partnerships and LLPs execute documents? Must all partners sign? Can the partnership or LLP sign in its own name?

Each of the partners in a general partnership is the agent of each of the other partners in matters relating to the firm and, as such, has authority to bind all the partners to any obligation. A single partner may execute a simple contract on the firm's behalf, subject to limits on that partner's authority that may be imposed by agreement of the partners.

Similarly, members of an LLP are agents of the LLP and can bind it to obligations subject to agreed limits on authority.

Deeds can be executed either by two partners or by a single partner where a third party witnesses that signature and adds his or her own signature as witness.

Partners can agree limits on their authority. For example, a partnership or members' agreement can specify that undertaking obligations of a certain value requires authorisation by a vote of the partners, or by agreement of one or more other partners. Where the partnership or members' agreement requires such authorisation but it has not been obtained, the firm or LLP will still be bound by the obligation undertaken to a third party, unless that third party knew that the partner who purported to bind the firm or LLP did not in fact have authority to do so.

BENEFITS, EMPLOYMENT RIGHTS AND PARTNERS' DUTIES

Remuneration and benefits

10 To what extent are partners free to agree how to share profits and what are the most common types of profit-sharing arrangements?

The default rule in the case of both partnerships and LLPs is that profits are to be shared equally among the partners or members. However, it is very rare in practice for firms knowingly to adopt a 'parity model' of equal profit shares without regard to any performance measures such as billing or client originations, and it is open for partners to agree to share profits in whichever way they choose.

In professional services firms, the most common profit-sharing models are:

- The 'lockstep' model, where a partner's proportionate share of the firm's profits grows in line with the time he or she has served as a partner, until it reaches a plateau. The system, therefore, rewards seniority and does not otherwise take performance into account. A pure lockstep model may evolve into the parity model (or something close to it) if all partners achieve the lockstep plateau and no new partners are admitted at lower rungs on the ladder. An advantage of pure lockstep is that it gives no incentive to hoard clients or firm resources and allows for more partners to be admitted to the partnership at a level that reflects their likely lower contribution in their early years of partnership. However, the pure lockstep model does not take into account any over- or underperformance in a given year and it can be too slow to reward high-achieving new partners. 'Pure' lockstep models are rare, with most firms having some element of variability to partner remuneration, according to performance.
- A 'formula' system, whereby the size of a partner's share is wholly determined by data collected by the firm in relation to matters such as billings to clients originated by him or her and fees collected for work carried out by him or her personally. The formula may also give a degree of credit for hours spent on certain non-billable projects. The 'eat what you kill' approach is a type of formula model. This model can be appropriate where the partners are not in the habit of cross-selling (eg, where their practices are highly diversified or represent personal client followings) and otherwise are not collegiate in nature. The main advantage of the formula model is that it is wholly objective and mechanical in its application, meaning that (once the formula is agreed) it does not need to take up management time in making the division. However, the performance criteria may not fairly capture all of a partner's contribution nor take into account extenuating circumstances. It is also prone to manipulation where a partner may modify his or her contributions, to the detriment of less lucrative but still important work that is for the benefit of the firm as a whole (eg, management, training and mentoring less experienced staff), to maximise his or her profit share.
- A 'subjective' system is where a partner's profit share is assessed against a set of criteria or behaviours. The judgement may be exercised by an individual (such as the managing partner) or a group of individuals. In the latter case, the body that determines the profit share of each partner may be the firm's management board or a subcommittee of it, or a dedicated remuneration committee of certain members of the management along with certain other elected or appointed partners. Subjective models tend to be suitable for larger firms, which have the management bandwidth to set objectives and judge partners against them. The key advantage of this system is that (unlike a strict formula model) it can take into account a broad range of objective and subjective performance factors for each partner. However, it tends to be the most difficult and time-consuming system to implement, and determinations of profit share are open to allegations of bias or of failing to take into account key aspects of a partner's performance.
- Hybrid models, which combine two or more aspects of the models described above, such as the partial lockstep model, where a proportion of a partner's profit share depends on seniority, with the remainder being divided on the basis of a formula or at the management's discretion. Hybrid models are increasingly popular, given the perceived shortcomings of pure lockstep, formula or subjective models. Traditionally, there was a distinction between UK firms, which often favoured locksteps, with US and other firms that favoured formula models such as 'eat what you kill'.

Many professional services firms used to provide annuities (pension benefits) to retired partners under the terms of their partnership agreements. These are increasingly rare, with partners being required to make provision for retirement on an individual basis out of their profit shares.

Employment rights

11 To what extent are partners considered employees? Do they benefit from statutory employment rights?

It is not possible for an individual to be both a partner in and an employee of the same firm. For different legal reasons, the same applies for members of LLPs.

However, partners and LLP members do enjoy certain workplace rights enjoyed by a wider class of persons than employees (known as 'workers' in the legislation) such as a right not to be discriminated against, rights under the Working Time Regulations (relating to hours of work and annual leave), rights under the national minimum wage

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legislation, and protection against detriment following a public interest disclosure under whistle-blowing legislation.

Although an individual cannot be both a partner and employee of a firm simultaneously, simply being referred to as a 'partner', or even registered at Companies House as a member of an LLP, is not conclusive and such individual may be an employee. If he or she does not have all of the hallmarks of partnership (such as a right to share in equity profits or a requirement to contribute capital), a court or a tribunal could consider the arrangement to be a 'sham', in which case it could infer that an employment relationship had arisen (which would entitle the individual to a greater array of rights, such as the right to not be unfairly dismissed).

An LLP member may be treated as an employee for tax purposes; see 'Taxation'.

Partners' duties

12 | Is there a statutory or common law concept of good faith among partners, and what are its implications? What are typical contractual duties between partners or owed by partners to their firms?

Partners in a general partnership owe each other a duty of good faith in relation to all of the firm's dealings. The duty also applies between the partners and persons who are negotiating entry into partnership and between the partners and outgoing partners. The duty requires each partner not to place him or herself in a position where his or her interests conflict with duties owed to his or her partners and not to make a personal profit from his or her position. Sections 28 to 90 of the 1890 Act expressly set out the following additional duties:

- to render true accounts and full information of all things affecting the partnership to the firm;
- to account for any profit obtained without the consent of the other partners from any transaction concerning the firm or from the use of its property, name or business connections; and
- not to compete with the firm without the consent of the other partners.

Members of an LLP owe a duty of good faith to the LLP only, analogous to those described above, but not to each other, unless expressly agreed otherwise.

ENTERING AND LEAVING THE PARTNERSHIP

Joining the partnership

13 | How do prospective partners typically enter the partnership? Are there any formalities?

Unless otherwise agreed, the admission of a new partner or LLP member requires the unanimous consent of the other partners or members. Typically, a partnership or members' agreement will set out a formal mechanism to approve admission of a new member, perhaps with the vote of a majority of the existing partners.

An incoming partner to a general partnership does not have liability for anything done by the firm before admission, though he or she may (as is common) agree with the other partners as between themselves to take on the existing liabilities of the firm.

There is no need for any written formalities, though, in practice, a new partner or member will sign a deed of adherence that expressly binds him or her to the partnership or members' agreement. This may be supplemented by an offer letter setting out commercial terms as to profit sharing, capital, votes or other matters. The appointment of a new LLP member must be recorded in that LLP's statutory register of members and notified to Companies House.

In a general partnership, if a new partner is admitted without agreeing to be bound by a partnership agreement that caters for the admission of new partners, then the firm will be a partnership at will, the consequence of which is that the firm may be dissolved by any partner at any time.

Leaving the partnership

14 | Can partners leave a firm without the agreement of the other partners, and must they serve a notice period? Will a partner receive back any capital invested, a share of the value of the partnership or any other payments on leaving? In what circumstances can a partner be required to leave a firm?

A partner may not leave a general partnership without the agreement of all other partners or an express entitlement to give notice of retirement. The default rule for LLPs is that a partner may retire after giving reasonable notice. In practice, notice periods of between three and 12 months (or longer) are commonly agreed among partners. A partner will usually be entitled to return of his or her capital contribution without any payment for any increase in the value of goodwill generated during his or her membership.

A partner or LLP member may not be expelled unless there is an express power of expulsion agreed among the partners. In practice, partnership or members' agreements typically include a right to expel a partner with immediate effect for certain acts or breaches and compulsorily to retire a partner for no stated reason following a period of notice (typically three to six months).

DISPUTES AND REDRESS

Recovering losses caused by partners

15 | May partners sue for loss caused by another partner?

Partners are entitled to recover losses sustained by the firm or LLP from partners causing the loss. It is usually the case that each partner will agree to indemnify the firm for material breaches by him or her of the partnership or members' agreement. However, this indemnity usually excludes actions brought against the firm or LLP for professional negligence committed by a partner, and partners and the LLP itself normally agree to waive any right to recover from a partner losses caused by his or her professional negligence.

Disputes

16 | How are disputes among partners and between individual partners and the partnership itself typically handled?

The majority of professional services partnerships and LLPs will agree to resolve disputes by arbitration (with, occasionally, mediation as an interim step). However, employment legislation applicable to partners and LLP members (such as discrimination law) enables disputes to be brought before an employment tribunal, whose jurisdiction cannot be ousted by contractual provisions for the arbitration of disputes.

Misconduct by partners in professional services firms may give rise to an obligation on the firm to report the issue to the relevant regulator.

DISSOLVING THE PARTNERSHIP

Dissolution

17 | How are partnerships voluntarily dissolved?

The partners in a general partnership may agree a fixed duration for the firm, which has the effect of automatically dissolving the firm at the expiry of the term. In practice, however, partnerships are normally

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expressed to be for so long as two partners remain and in such cases the partnership agreement normally provides a procedure for earlier dissolution of the firm. Where there is no written partnership agreement, the partnership will be a 'partnership at will'. Such a partnership is terminable at any time by any partner giving notice of dissolution to the other partners.

In the case of general partnerships, a 'technical dissolution' also occurs when there is a change of membership, as the firm is then constituted by a new collection of individuals or bodies corporate. When the partnership ceases entirely, there is a 'general dissolution'. Most partnership agreements will provide that, on a change in the identity of the partners occurring, there is no winding-up or 'general' dissolution of the partnership.

A general dissolution can be brought about by agreement of the partners, automatically (eg, upon the expiry of an agreed fixed term or the bankruptcy of a partner) or by the intervention of the court at the request of any partner (or any creditor in the case of insolvency). Under section 35 of the 1890 Act, any partner may apply to the court for an order that a partnership be dissolved if:

- there has been conduct that prompts a severe and irretrievable breakdown in the relationship between some or all of the partners;
- a partner has committed a wilful or persistent breach of the partnership agreement;
- business of the partnership can only be carried on at a loss; or
- the court considers dissolution to be just and equitable.

The court may make such order as it thinks fit, including an order that the share of a partner in the firm be bought out by the remaining partners.

After dissolution, any partner may apply to the court to have the firm's affairs wound up, which involves all property of the partnership (including its name, goodwill and other assets) being sold to pay any outstanding liabilities of the firm, after which the surplus assets are divided between the partners in accordance with the partnership agreement (or section 44 of the 1890 Act in the absence of agreement).

On dissolution, the partners' authority to bind the firm and other rights and liabilities continue, but only insofar as is necessary to wind up the partnership's affairs and to complete any outstanding transactions. A partnership in dissolution should therefore avoid commencing new matters or entering into new contracts.

The term 'dissolution' in the context of LLPs has a different meaning. An LLP ceases to exist in a manner similar to that of a company. Any assets held by the LLP are distributed to its members in accordance with the terms of the members' agreement (or equally in the absence of agreement) after payment of any third-party creditors. Following such distribution, the LLP will cease to exist by the striking-off of the LLP from the register of companies. This is usually done by application of the members, by submitting form DS01 to Companies House.

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