Partnership Law

A Joint Report

Summary

Law Commission
Law Com No 283

Scottish Law Commission
Scot Law Com No 192

PARTNERSHIP LAW

A Joint Report of the Law Commission of England and Wales and the Scottish Law Commission

SUMMARY

Partnership is the simplest form of combination to carry on a business. It arises when two or more people carry on business together with the object of making a profit.

It requires no formalities and no registration. It is very flexible.

Partnerships have existed for many centuries.

The rules of partnership law fall into two parts: external rules, which govern relations between the partnership and those dealing with it (customers, etc); and internal rules which govern relations between the partners themselves.

In 1890 the law of partnership in the United Kingdom was substantially but not completely codified in the Partnership Act. We consider that it is now due for replacement.

Partnership as a legal entity

Under English law partners are agents of each other, but the partnership does not exist as a legal entity. As mutual agents, the partners share unlimited liability for all obligations incurred to other people in the course of the partnership. They also owe each other a duty of good faith (but, provided that they act honestly, they are otherwise free to regulate their affairs between themselves as they wish).

Under Scots law a partnership is a legal entity, but the partners have the same unlimited liability towards those who deal with it, and have the same duty of good faith towards each other, as they would under English law.

We think that it would be much more satisfactory in today's world that a partnership should be a legal entity. In 1890 all partnerships were small concerns. Twenty was the maximum number of partners permitted by the law. That restriction has been removed, and partnerships now vary in size from two to many hundreds. But the framework of partnership law was simply not devised for larger partnerships.

Many people would be astonished to learn that a firm is automatically dissolved whenever there is a change of partner, or that it cannot own property, but that remains the law in England and Wales (although not in Scotland). In practice, firms habitually operate as if they were legal entities and are regarded as entities by those who deal with them. The fact that they are not presently recognised as such by the law is a throw back to the nineteenth century. We believe that it is time to end this anomaly.

The Law Commissions propose that there should be a new Partnerships Act under which partnerships in England and Wales would become legal entities, so that their legal nature would reflect their role in the commercial life of Britain today. Partnerships would able to enter contracts and hold property; they would not be automatically dissolved on any change of partner; but partners would continue (as in Scotland) to be personally responsible for the obligations of the partnership and would continue to owe duties of good faith to each other. The result would be a largely uniform law of partnership in England, Wales and Scotland.

Legislation will be needed to ensure that this change does not result in any change in the treatment of partnerships under UK tax law. We have received confirmation from the Inland Revenue of its intention that (subject to ministerial approval) the necessary legislation will be included in a Finance Bill.

Need for flexibility

Because of the great difference in size and nature of partnerships, it is vital that partnerships should retain the maximum flexibility in the way they organise themselves. Larger and more sophisticated partnerships have formal partnership agreements, but many small partnerships do not. Small partnerships play an important role in the economy. The 1890 Act contained a number of default provisions, ie provisions which would apply unless the partners agreed otherwise. We have extended this approach in the proposed legislation by providing default clauses which together form a code of government for partnerships that will apply unless the partners choose to vary it (as they are free to do).

"Think small first"

In drafting the default code we have followed a policy of "think small first". Large partnerships are likely to have their own tailor made agreements. Small partnerships are not. The default code is intended to make life simpler for them by providing a suitable ready made set of rules, which they can change if they wish, and to reduce likelihood of litigation (with its uncertainty, delay and cost) in the event of the partners falling out, because there will be an applicable set of rules in place.

The end of a partnership

The proposed Bill sets out a list of things which will cause the break up of a partnership. There is then a winding up process. If the partnership is solvent, the

winding up will normally be carried out by the partners, but there needs to be a simple and cost effective way of resolving differences between partners which may arise at this stage. It is a serious weakness of the present law that the systems for winding up a partnership under the supervision of the court in England and Wales, or through a judicial factor in Scotland, are often cumbersome, slow and costly. We propose that differences between the partners should normally be decided by a majority, but that the court should be able where necessary to appoint a partnership liquidator with powers and duties similar to those of a liquidator of a solvent company. On some particularly important matters the liquidator would require either the agreement of all the partners or the approval of the court. We believe that our proposals should result in a system of solvent winding up which is simple, fair, quick and cost effective. Insolvent partnerships will be wound up under the regime of the Insolvency Act 1986 and the Insolvent Partnerships Order 1994 (or its successor) in England and Wales or the Bankruptcy (Scotland) Act 1985 in Scotland. (The Insolvent Partnerships Order is under separate review).

Special types of partnership

There are two special forms of partnerships: limited partnerships (introduced under the Limited Partnerships Act 1907) and limited liability partnerships (introduced under the Limited Liability Partnerships Act 2000). Although the names sound similar, they are very different.

Limited partnerships

A limited partnership differs from a general partnership in that it includes at least one partner who does not wish to take part in the general management of the firm, but merely to invest in it and whose capital at risk is limited to the amount of his investment. Limited partnerships have become popular in recent years as venture capital funds. The 1907 Act has been criticised for lack of clarity in a number of areas. The proposed Bill takes account of those matters and would replace the 1907 Act.

Special limited partnerships

We propose that limited partnerships should (like general partnerships) become legal entities, but subject to an exception. Serious concerns have been expressed that giving legal personality to limited partnerships may affect their tax treatment overseas and we therefore propose that in English law those who wish should be able to enter into special limited partnerships which would not have separate legal personality.

Limited liability partnerships

Limited liability partnerships (LLPs) were introduced by the Limited Liability Partnerships Act 2000 in response to worries of professional partnerships about being exposed to unlimited liability for very large professional negligence claims. Despite their name, they are in many ways closer to being limited companies than partnerships and many of the provisions of the Companies Act

1985 apply to them. The limited liability of LLPs comes at the price of regulatory control to which general partnerships are not subject. Because LLPs are a recent statutory creation, they are not part of our Report and proposed Bill.

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