

Chapter 2: Formation of a Partnership

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Aims of this Chapter

This chapter will enable you to achieve the following learning outcome from the CILEx syllabus:

- 2 Understand the principles of partnership law

2.1 Introduction

This chapter reviews some of those issues which it is advisable to address when a partnership is being created, including who may be in partnership and the limitations on forming a partnership. Again, remember that in **Chapter 1–Chapter 5** we are looking at the ordinary partnership. Refer back to Samantha, our cabinet maker from **Chapter 1**. If she did decide to enter into a partnership with Grace, the following table highlights some of the typical items that Samantha and Grace might have to consider when forming a partnership.

Items which are typically included in a partnership agreement

- The names of the partners and the business name under which their partnership might trade.
- The nature of the business or profession and the business address.
- Capital: the amount contributed by Samantha and Grace and the arrangements governing any necessary increases of capital – for example, how much extra might Samantha and Grace be expected to contribute in the future?
- Preparation and auditing of annual accounts.
- The method of apportioning profits and drawing on accounts – for example, will profits be split equally between Samantha and Grace?
- The duration of the partnership (e.g. for a fixed number of years, or until retirement, or on the death of a partner) and the arrangements for continuation by survivors.
- Arrangements for dissolution of the partnership, whether voluntary, on retirement, or by death.

Items which are typically included in a partnership agreement
<ul style="list-style-type: none"> • The method of valuation and division of assets for contributions to net losses on dissolution. • Collection of debts, banking and bookkeeping arrangements. • Employment and dismissal of staff. • Whether unanimity, or a majority view, is required in questions of management – are Samantha and Grace to be equal partners or should, for example, Samantha, as the founder of the business, have a greater say in its management? • Agreements by partners not to set up in competition within a certain area. • Provision for arbitration in the event of dispute. • The sharing of profits and losses. • Exclusion, if relevant, of sleeping partners from participating in partnership management. • Division of responsibility.

2.2 The form of the agreement

A partnership is governed by the **Partnership Act 1890 (PA 1890)** and any agreement between the partners. Therefore, a partnership may arise in two ways.

(1) **By express agreement**

No formal agreement is required by law but, in practice, it is usual to prepare a written agreement which may often take the form of a partnership deed. In the absence of any formal documents, the terms of the agreement may be proved by parol evidence and may also be inferred from the conduct of the parties to the agreement.

Where a new partner is admitted to an existing partnership, then, unless agreed otherwise, it is implied that she joins on the same terms as were expressly agreed between the existing partners, subject to any express agreement to the contrary (***Cheema v Jones [2017]***).

The general law of contract will apply to an express partnership agreement and its informality should be contrasted with the company membership contract whereby the Memorandum and Articles of Association must be in written form and registered (**s18 Companies Act 2006 (CA 2006)**). Companies limited by shares can, of course, rely on the Model Articles (see **Chapter 7**).

(2) **By implied agreement**

As we saw in **Chapter 1**, in the eyes of the law, a partnership exists where two or more persons carry on business in common with a view to making a profit. Quite often, persons in business together will be partners so far as the law is concerned even though they are unaware of it themselves.

PA 1890 itself will fill in any gaps in this agreement and enable a full agreement to be construed where necessary.



Grevill v Venables [2007]

It was held that the existence of a partnership could not be based on an implied agreement where the parties, on discussing the matter expressly, had not reached agreement. To infer an implied agreement where one party declined the other party's proposal to form a partnership would have the effect of overriding the express dealings of the parties. The defendant started an equine business and had formed a personal relationship with the claimant. The claimant lent money to the defendant for use in her business and became actively involved in the business through continued financial support. During a period of substantially increased stud activity, the claimant dealt with the bookkeeping, management and advertising aspects of the business. Later, the personal relationship between the two parties came to an end and the claimant claimed that, as there was a partnership between the parties, he was entitled to an equal share of the assets of the business. The Court of Appeal agreed with the judge's decision that, although the claimant had wanted to be a partner in the business, the defendant had never agreed to the claimant becoming a partner. There was neither an oral agreement nor one that could be inferred from the circumstances, because to do so would have contradicted the express dealings of the parties. The Court of Appeal did express the view that the claimant might be entitled to take action in respect of the money lent in support of the equine business, but such an action could not be based on the existence of a partnership.

2.3 Capacity

Only persons who have the necessary capacity can form a partnership or become members of existing partnerships. Capacity in this context is governed by the ordinary law of contract. Therefore, generally speaking, anyone over the age of 18 who is of sound mind and not an enemy alien may become a partner.

A limited company may also be a partner provided that there is no express restriction in the company's constitution on the company's powers which would prevent it acting as a partner (see **10.5**).

(1) **Minors**

Although a minor may enter into a partnership agreement, they can repudiate it either during their minority or within a reasonable time of attaining their majority. If they repudiate the agreement, they are not liable for any of the partnership debts contracted during their minority, but the repudiating minor cannot then recover money paid in respect of the agreement unless they can show that there has been a total failure of consideration (***Steinberg v Scala (Leeds) Ltd [1923]***). If such a partner does not repudiate the agreement, they become liable equally with the other partners, but only for those debts contracted by the partnership after they attained their majority (***Goode v Harrison [1821]***).

Since a minor who is a partner cannot incur contractual liability for partnership debts, any judgment against the firm in respect of such debts cannot be enforced against the firm as a whole but only against the adult partners (***Lovell and Christmas v Beauchamp [1894]***). A minor can be made bankrupt only in respect of legally enforceable debts.

The adult partners can insist that the partnership assets are applied in payment of the liability of the firm before any portion of them is allocated to the minor partner. To this extent, third parties may obtain payment of their debts out of the minor's property. It is, however, clearly unwise for adult partners to enter into a partnership with a minor.

(2) **Persons of unsound mind**

A person may avoid the partnership agreement provided that they can prove that at the relevant time they were of unsound mind and did not know what they were doing. They must also prove that the other partner or partners knew that they were incapable of understanding what they were doing (***Imperial Loan Co v Stone [1892]***). Although the mental disorder of a partner does not automatically terminate the partnership, it is a ground for dissolution. The court may grant an interim injunction restraining a partner who is mentally disordered from interfering in the partnership business pending the dissolution.

2.4 **Illegal partnerships and discrimination**

A partnership must not be formed for an illegal purpose and must comply with legislation covering discrimination.

(1) **Illegal purpose**

As in contract, a partnership may be illegal if it is formed for a purpose forbidden by law, for immoral purposes, or for a purpose which is against public policy.

Therefore, since **s20 Solicitors Act 1974** provides that an unqualified person is forbidden to carry on practice as a solicitor, a partnership between a solicitor and an unqualified person is illegal.

A partnership formed to operate a brothel would also be illegal.

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