

Chapter 3: Formation of Partnerships

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Aims of this Chapter

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

- 1 Understand the key practical, financial and fiscal implications in choice of business medium
- 2 Understand the practices and procedures relating to the formation and management of a partnership

3.1 Introduction

A partnership is formed when all the elements within the definition of partnership set out in **s1 PA 1890** exist. This cannot occur unless business has commenced. Partnership is a contractual relationship, and the general rules on the formation of contracts apply. Accordingly, a partnership may come into existence through a course of dealings provided it is possible to identify agreement between the parties on the essential elements of the contract (*Dungate v Lee [1967]*). It may be possible to discern agreement on essential terms from the conduct of the parties. Thus, a partnership may arise in two ways.

(1) **By express agreement:** while the law does not require formality to establish a partnership, in practice it is usual to have a written agreement drawn up and executed by the partners, setting out the terms upon which the relationship subsists (see **Document 1** of the **Appendix**). It remains possible to have an express partnership agreement without committing the terms to writing, in which case the agreement may be proved by oral evidence.

(2) **By implied agreement:** in the eyes of the law, a partnership exists when two or more persons carry on business in common with a view of profit. Persons in such a position are partners even if they are not aware of that fact. As with any other type of contract, it is possible to infer the contractual relationship from the conduct of the parties. Their conduct in the circumstances may go further and be evidence of an implied agreement of the terms of their relationship – for example, their right to a specified proportion of profits. Insofar as it is impossible to discern agreement on terms from the partners' conduct, it will be necessary to refer to the provisions of the **Partnership Act 1890 (PA 1890)**, which provides, in the absence of agreement to the contrary, terms between the partners.

3.2 Commencement of partnership

Partnership commences when all elements of the definition of partnership are satisfied. It follows that the relationship does not necessarily exist from the moment of execution of a written partnership agreement; prudent partners will agree the terms of their relationship before the relationship commences. In ***Dickenson v Gross [1927]*** the execution of a partnership agreement did not operate to create a partnership from the date of the agreement because extrinsic evidence clearly showed there was no partnership. It follows that one cannot create or form a partnership simply by saying or agreeing that there is one. Any statement in an agreement to the effect that a partnership exists, commenced, or shall commence on a specified date is not conclusive and may be rebutted if evidence suggests otherwise (***IRC v Williamson [1928]***).

In ***Ilott v Williams and Others [2013]*** the Court of Appeal noted that a mere agreement to form a partnership was insufficient. The parties had to commence carrying on the business.

3.3 Variation of terms of partnership

Relationships between partners are governed by freedom of contract, and terms may be varied in exactly the same way as the terms of any other type of contract, by consent of all parties (**s19 PA 1890**). Although a somewhat unusual provision, partners might agree that particular terms may be varied on the basis of consent from a majority of partners rather than all of them. Any partner who agrees to such a term should secure the right to withdraw from the partnership if he strongly disagrees with an alteration to the terms secured by the consent of a qualified majority. Moreover, a partner should seriously consider whether he should sign the contract in the first place if it provides for an issue important to him to be decided by a qualified majority.

3.4 Capacity

Partnerships can be formed only between persons who have the necessary capacity, which is governed by the ordinary law of contract. Generally speaking, anyone over the age of 18 years who is of sound mind may become a partner. Since partnership is a relationship which can subsist between "persons", a limited company or a limited liability partnership can be a partner provided it has the necessary power to enter into such a relationship. A minor may enter into a partnership agreement but retains the ability to repudiate the contract throughout his minority and also within a reasonable time of attaining his majority. A minor who repudiates the agreement is not liable for any of the partnership debts contracted during their minority but equally cannot recover money which they have paid in respect of the agreement unless there has been a total failure of consideration (***Steinberg v Scala (Leeds) Ltd [1923]***). A person of unsound mind who does not know what they are doing when they enter into the agreement is not bound by it provided the other partners knew the minor was incapable of understanding their actions (***Imperial Loan Co v Stone [1892]***).

3.5 Illegal purpose

As with any contract, a partnership is illegal if it is formed for a purpose forbidden by law or for immoral purposes or for a purpose which is against public policy. **s20 Solicitors Act 1974** forbids an unqualified person from practising as a solicitor, so a partnership between a solicitor and an unqualified person established to provide services normally provided by solicitors is illegal. A partnership formed for a legal purpose which subsequently becomes illegal – for example, because of a change in the law – automatically dissolves on the occurrence of the event which makes the business of the firm unlawful or for the members of the firm to carry it on in partnership (**s34 PA 1890**).

3.6 Number of partners

There is no limit on the number of members in a partnership.

3.7 Discrimination

All previous discrimination legislation was repealed and replaced by the **Equality Act 2010 (EA 2010)**. Whilst equity partners (including members of LLPs) do not qualify for many employment protection rights, they do have similar rights to employees not to suffer unlawful discrimination on grounds of the nine protected characteristics under **EA 2010**:

- age (**s5**);
- disability (**s6**);
- gender reassignment (**s7**);
- marriage and civil partnership (**s8**);
- pregnancy or maternity (**s18**);
- race (**s9**);
- religion or belief (**s10**);
- sex (**s11**);
- sexual orientation (**s12**).

In addition, it is unlawful for a firm or a proposed firm to discriminate against a person on the grounds of the protected characteristic:

- in the arrangements made for the purpose of determining who should be offered a position as partner;
- in the terms in which a position as partner is offered;
- by not offering an individual a position as partner;
- against an existing partner:
 - in the terms on which he is a partner;
 - in the way he has access to opportunities for promotion, transfer or training, or for receiving any other benefit, facility or service;

- by expelling him;
- by subjecting him to any other detriment.

However, such treatment may be lawful if an “occupational requirement” exists, the positive action provisions in **EA 2010** apply, or if the discrimination in question is capable of objective justification.

It is also unlawful to discriminate against a partner by subjecting him to any form of harassment or victimisation (**s44(6) EA 2010**).

3.8 Legal status

A partnership is an unincorporated association. Unlike a company it does not have separate legal personality. Collectively, the partners are known as “the firm” (**s4 PA 1890**). The relationship between each member of the firm is that of partnership. Because the firm does not have separate legal personality, all the partners are liable to the full extent of their private estates for the debts of the firm.

3.9 Partnership name

Partnerships trading under a name which does not consist solely of the surnames of all individual partners and the corporate name of any corporate partners must comply with the provisions of the **Companies Act 2006 (CA 2006)**. The firm name which does not comprise any such names is a business name.

If a business name is to be used that is likely to give the impression that the business is connected with the government or which includes a word or expression listed in regulations promulgated by the Secretary of State, his written consent must be obtained to carry on business under that name (**ss1193–1195 CA 2006**).

A partnership which uses a business name must state on all business letters, written orders for goods or services and written demands for payment of business debts the name of each partner and the address within the United Kingdom at which service of any documents relating to its business will be effective (**ss1200–1206 CA 2006**). Partnerships comprising more than 20 partners do not have to disclose this information on their documents provided the address of the principal place of business of the partnership, along with a statement that the names and addresses of the partners can be inspected there, is set out on the documents.

3.10 Duration and dissolution of partnership

Linked to the issue of formation and commencement of partnership is the question of duration and dissolution. Partners may expressly agree the circumstances in which a partnership may be brought to an end. The contractual and legal principles involved are analysed in **Chapter 6**.

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