A Review of Developments in Partnership Law 2017

Introduction

What follows is our regular review of new developments in Partnership Law. There is the usual flow of traffic in the courts in relation to commonly contested issues in addition to the arrival on the scene of a new member of the partnership family.

The problem of the identification of a partnership

This conundrum of characterisation of a partnership relationship only arises in the case of a general partnership governed by the Partnership Act 1890, as both limited partnerships and limited liability partnerships require registration. The fact of registration should be decisive of the matter. Informality, which is one of the strengths of the general partnership, thus can create complications. This identification problem in partnership can arise in a number of contexts where there is commercial interplay between individuals or firms. A review of recent case law will once again illustrate the ubiquity of the problem.

So, for instance, in *Khan v Khan* [2015] EWHC 2625 (Ch) Master Bowles found that the claimant was in fact an employee and not a partner. The case is interesting in that the court accepted in principle at para [65] of the judgment that cultural norms are relevant when determining whether a partnership had been created in the context of an Indian family firm. Thus, an implied partnership might readily arise where a son or daughter is brought into the family firm and works for little or no remuneration, possibly also sacrificing educational opportunities at the same time. But, on the facts of the case before the court, this was not the true position. The son had been a senior employee and had been well rewarded for his services.

At the other end of the spectrum in *Younes v Chrysanthou* [2016] EWHC 3269 (QB) the High Court was required to examine the relationship between two international businessmen, who had cooperated on a number of projects over the years on an ad hoc basis. One of these individuals then argued that a partnership had come into being with the result that he was entitled to a share of a fee. After considering the evidence, HHJ Waksman QC ruled that there was not sufficient proof of a partnership nexus [see para 136]. There was no documentary evidence pertinent to the matter and the oral evidence put before the court by witnesses was unclear. Merely because individuals might have been loosely described to third parties as “partners” was not conclusive of the matter.

In *Worbey and Farrell v Campbell et alia* [2016] CSOH 148 again the question was whether there was a partnership in existence. Once again this question was answered in the negative by the Court of Session (Outer House). Lord Tyre, after considering the Scottish authorities on what was required to trigger a finding of partnership, applied these to the evidence. The facts suggested that the parties were preparing to set up a partnership, but had not reached the point of so doing. Therefore there was no carrying on business in common and no partnership in the eyes of the law. This conclusion was unsuccessfully challenged on appeal – see [2017] CSIH 49 where the Inner House added that before a partnership could be found to exist it had to be established that the parties had entered into a contractual relationship, but a consensus had never been reached as to the terms upon which proceeds would be shared.

A slightly different variation on the theme tested the court In *Campbell v Campbell* [2017] EWHC 182 (Ch). Here the issue was whether an existing admitted partnership extended to an overseas business operation. The conclusion of the High Court in this case was in the affirmative. The court indicated that the weight of the evidence supported the view that the partnership did extend to the overseas business activities. It can be seen that to extend the parameters of a partnership is potentially contentious and that the preferred solution in such cases is precautionary and requires explicit provision.

The sharing of returns from a business might indicate partnership. Partnership Act 1890 s. 2(2) indicates this possibility. In *Lewis v Narayanasamy* [2017] EWCA Civ 229 at para [85] it was reaffirmed that the sharing of gross returns does not necessarily mean that a partnership has been created. The Court of Appeal concluded on the facts of that case that the claimant was in fact an employee and not a partner. Sir Colin Rimer explained that the critical issue in characterisation is one of determining the intention of the parties. That observation should however be placed into context. Should it really be a matter of objectivity in which subjective intention is but part of the calculation?

On the other side of the coin is *Cheema v Jones* [2017] EWHC 1156 (QB). Here the court was satisfied that a partnership existed between a number of doctors because it would have been difficult to operate their medical practice without such a partnership. This conclusion was arrived at by David Greenaway QC (sitting in the High Court) in spite of the lack of a written partnership agreement. This partnership was seen as a partnership at will.

A crude statistical analysis of the above cases will reveal the true judicial perspective in such matters. A partnership relationship will usually not be inferred by the court. The onus is very much on the party asserting it to prove it. Oral evidence will be treated with some caution, particularly if it seeks to verify matters years after the event. That approach is justifiable in view of the serious consequences that flow from a conclusion that a partnership exists. It should also serve as a warning to those who wish to litigate the point. If a partnership relationship is truly desired then it should be provided for expressly.

Internal disputes within different types of partnership

The closeness of the partnership relationship can ironically magnify disputes which in another context might be open to amicable resolution. Within general partnership law the governing principles are well settled. A fiduciary nexus applies between partners. The Partnership Act 1890 plays a useful default role in defining the features of this relationship. So in *Campbell v Campbell* (supra) the court gave strong support to the duty of good faith and the rendering of accurate accounts.

Although partnership principles have, in the absence of express agreement to the contrary, been exported to the LLP context by virtue of reg 7 of the LLP Regulations 2001 (SI 2001/1090) there has been a need for clarification of domestic relationships in the LLP context. This is because the LLP is more like a corporate body and this can affect its internal workings. The interposition of the LLP firm between the LLP members can produce significant legal consequences.

Internal relationships within an LLP may be more complex because it seems possible in principle that an LLP member may be an employee. This has been the subject of considerable controversy; witness the litigation resulting in the conclusion of the Supreme Court in *Clyde & Co LLP v Bates van*

Winkelhof [2014] UKSC 32. The latest contribution to the debate is *Roberts v Wilson Solicitors LLP* [2016] ICR 659, [2017] 1 BCLC 138, where the Employment Appeal Tribunal confirmed that an LLP member can be a "worker" within the meaning of s. 47B of the Employment Rights Act 1996 for the purposes of the whistleblower provisions in the Act.

Again there are no directly enforceable fiduciary duties between LLP members. Any fiduciary duty is owed to the LLP firm, which, unlike a general partnership, enjoys legal personality. If there is a breach of such duty a range of remedies may be available to the LLP firm. This was underlined by Newey J in *Hosking v Marathon Asset Management LLP* [2016] EWHC 2418 (Ch) which confirmed the possible use of a forfeiture remedy where partner/LLP member may be in breach of fiduciary duty. Forfeiture could thus be exercised in respect of a share of profits. This is a useful adjunct to the other equitable remedies that might come into play where a breach of fiduciary duty has been established.

An LLP member, rather like a shareholder in a company, may wish to litigate on behalf of the firm. The position here was clarified by *Harris v Microfusion 2003-2 LLP* [2016] EWCA Civ 1212 where the court indicated that derivative claims under a modified version of Part 11 of CA 2006 were not available. It is therefore necessary to revert to common law principles, as developed from the starting point of *Foss v Harbottle* (1843) 2 Hare 461. In this case none of the exceptions to that principle were found to be applicable. This need to revert to the discredited common law is an unfortunate position for the law to be in – it would make much more sense if Part 11 of the Companies Act 2006 were to be applied to LLPs. The fear of a massive increase in derivative claims arising in Company Law from the introduction of statutory derivative claims has proved to be unfounded.

The other main statutory remedy for minorities is found in the unfair prejudice jurisdiction embodied in s. 994 of the Companies Act 2006. This is capable of applying to LLPs provided it has not been excluded by unanimous written agreement – see reg 48 of the LLPs (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804) introducing a modified s. 994(3) into the Companies Act 2006 for LLP purposes). Surprisingly, not all LLPs take advantage of the possibility of excluding recourse to the court for the remedying of alleged unfair prejudice. No such exclusion was present in *Liontrust v Flanagan* [2017] EWCA Civ 985. This case was concerned with botched attempt to compulsorily retire a member from the firm. Here Henderson J at first instance ([2015] EWHC 2171 (Ch)) had found that there had been no appropriate remedy available for any resulting unfair prejudice, but had found for the claimant on the grounds that there had been a breach of agreed procedures in seeking to expel a member. As a result the member might have a Part 7 claim in damages. The Court of Appeal dismissed the appeal from Henderson J. The trial judge had correctly determined whether compulsory retirement notices had complied with the required procedures under the LLP agreement.

Partnership property

For general partnerships there are two related questions to consider. Firstly, what is to be regarded as a partnership asset? The Partnership Act 1890 offers some basic guidance in this regard. Under s. 20 of the Act partnership property is described as property that which was originally brought into the firm or subsequently acquired by it. This is not the most helpful of tests, though it is clear that property purchased with partnership funds will be presumed to be partnership property (Partnership Act 1890 s. 21).

Once this first question of identification has been resolved, we must ask what are the consequences of an asset being treated as partnership property? One consequence is that partnership property must be used exclusively for the benefit of the firm and not to enrich individual partners. That is consistent with fiduciary principles. Partnership capital is to be shared equally in the absence of provision to the contrary (Partnership Act 1890 s. 24).

The question of determining partnership property came before the court in *Goldup v Cobb* [2017] EWHC 526 (Ch). Here the court found that a pension entitlement held by a partner was not a partnership asset. The pension related to the holding of public office as a coroner and whilst that office was held the net income from the office went to the partnership firm. Nevertheless, the court found that there was no agreement to treat the pension derived from the office as a partnership asset. The case once again underlines the need for express provisions dealing with such matters.

External relationships

These are doubly important with the general partnership because of the dangers of personal liability.

Section 5 of the 1890 Act is a central provision here. This section confers wide authority on partners to bind the firm with regard to transactions which are within the ordinary course of business. It reflects the risk element inherent in any partnership and provides security of transaction for those counterparties dealing with firm members. There was some discussion of this provision by Master Bowles in *Kotak v Kotak* [2017] EWHC 1821 (Ch). The case was concerned with preliminary rulings and possible amendment of pleadings in respect of a banking mandate. The court indicated (at para [65]) that s. 5 is designed to protect outsiders. When determining whether a transaction I in the ordinary course of business the focus should be on what is normal for firms of that type and not upon the particular firm (see para [127]). Master Bowles expressed doubts at para [132] about the established view that borrowing did not fall within the ordinary course of business of a partnership: that view was outdated. The judgment is valuable because it shows how judges are alert to changes in business practice, particularly with regard to the way firms are financed. It also shows the dangers of reliance on old authorities without regard to modern commercial practice. A salutary and commendable judgment.

Incoming partners do not automatically take over existing debts of the firm according to s. 17(1) of the Partnership Act 1890. It may be that there is a presumption in Scots Law that this will happen where the incoming partners are in effect taking over the existing firm – but there needs to be clear evidence on this point. The courts will lean against any assumption of liability: on this see the comments of Lord Woolman in *Heather Capital Ltd v Levy and McRae* [2015] CSOH 115. There was no evidence in that particular case that the incoming partners had either expressly ot tacitly agreed to assume existing liabilities of the firm. Once again, the need for explicit provision in partnership matters is reinforced. A novation is required.

Dissolution and winding up

The lack of legal personality for the partnership firm under the 1890 Act makes the question of dissolution doubly important. Dissolution will terminate contractual relationships between the firm and third parties. This is commercially inconvenient to put it mildly.

Dissolution will be determined by the 1890 Act in the light of any pertinent provisions in the partnership agreement. The case of *Moore v Moore* [2016] EWHC 2202 (Ch) is worthy of scrutiny as it deals with dissolution and the potential role of s. 35 of the Partnership Act 1890. Here S Monty QC (sitting as a Deputy Judge of the High Court) notes the reluctance of the court to dissolve a partnership that had been successful in the past. There was an even greater reluctance to point the finger of blame under the various clauses of s. 35. That said, the ill health of a partner might in an appropriate case justify dissolution.

In *Eason v Miller* [2016] CSOH 59 the question of retirement came before the court. Lord Doherty was asked to determine whether the rights of the outgoing partner were to be determined by the partnership agreement or the general law. The conclusion reached was that the partnership agreement did not cover the particular matter (valuation of a partnership share in the case of a "technical dissolution") and that the issue fell to be determined by the general law.

Returning to *Campbell v Campbell* (supra) the High Court stressed that, where a partnership has been dissolved and is being wound up, the court retains supervisory jurisdiction over the process to ensure that an equitable split of assets is achieved. This might involve ordering the share out of assets in specie. In *Taylor v Taylor* [2017] EWHC 1080 (Ch) HHJ Matthews made the point that equitable principles of accounting can come into play on dissolution which might affect interests in property used in connection with the partnership but not technically constituting partnership property.

A partnership at will can be determined by one partner giving notice to the other partners (Partnership Act 1890 s. 26). The question of dissolution in the context of a partnership at will was considered further in *Cheema v Jones* [2017] EWHC 1156 (QB). David Pittaway QC had held that the disputed partnership between doctors was a partnership at will and therefore could be dissolved by notice. He did, however, add (at para [41]) that, even if it was not a partnership at will, in view of the inability of the partners to work together he would have been quite prepared to order its dissolution on the just and equitable ground pursuant to s. 35(f) of the Partnership Act 1890.

<u>Limited partnerships</u>

Limited partnerships, which were introduced by the Limited Partnerships Act 1907, have proved attractive to certain firms. But for others the attractions are then mitigated by the restrictions imposed upon limited partners having any significant participation in management (a restriction imposed by s. 6 of the 1907 Act). This has prompted government action in the form of limited partnership reform to aid hedge funds. This has been implemented by the Partnerships (Private Fund Limited Partnerships) Order 2017 (SI 2017/514). The background to this change was outlined in our editorial [2016] 387 Co L N 1 at 2. As a result of this change limited partners in a private fund limited partnership ("PFLP") can engage in a range of what may be described as management activities. An indicative (but not exhaustive) list of permitted activities is mapped out in Art 2, which introduces a new s. 6A of the 1907 Act. Procedures for securing designation as a PFLP are described in a new s. 8D for the 1907 Act.

Transparency with regard to companies and LLPs has been a major theme in the past 12 months. This is tied up with concerns about money laundering and the need to implement EU measures. Scottish limited partnerships and certain Scottish qualifying partnerships became subject to PSC regime in 2017 as a result of The Scottish Partnerships (Register of People with Significant Control) Regulations 2017 (SI 2017/694) but this major legislation has attracted some criticism for the way it

has been drafted, particularly with regard to the question of what amounts to significant control. It was criticised in Parliament by the Secondary Legislation Scrutiny Committee (2nd Report, 13 July 2017). Amendments may therefore be required at some future date.

Discrete aspects of LLP regulation

There have been a number of cases that are relevant to a proper understanding of the juristic nature of the LLP. In reality LLPs are a hybrid form of entity sitting midway between traditional partnership and limited company, a point made by Cranston J in *Sword Services Ltd v HMRC* [2016] EWHC 1473 (Admin) at para [60].

Another important point was made by Lord Tyre in the Scottish court in *Kidd v Paull & Williamson LLP* [2017] CSOH 16 at para [16], namely that there is no general importation of partnership principles into LLP law. That reflects the official policy that an LLP is a corporation – Limited Liability Partnerships Act 2000 s. 1(5). Any importation is more likely to reflect corporate law principles rather than the partnership variety. An example of such importation concerns the disclosure of late debt payment by LLPs under the Limited Liability Partnerships (Reporting on Payment Practices and Performance) Regulations 2017 (SI 2017/425).

A technical point relating to litigation finance and procedure featured in *Halborg v EMW Law LLP* [2017] EWCA Civ 793. The point at issue was whether an LLP firm of solicitors involved in litigation could be a litigant in person within the meaning of CPR 46.5(6) if it were acting for itself – if so, the consequence would be that the level of costs awarded would be affected. At first instance ([2015] EWHC 2005 (Ch)) HHJ Purle QC held that the LLP could not be a litigant in person (see our editorial [2015] 375 Co L N 1 at 3). On appeal, the Court of Appeal confirmed that an LLP cannot be a litigant in person. The main reason for this was the fact that the concept of litigant in person applied to individuals and not corporations (such as an LLP). As it happened, that conclusion nicely aligned LLP Law with Partnership Law.

Insolvency: some partnership issues

Partnerships of any variety can take advantage of the administration regime under modified Sched B1 of the Insolvency Act 1986. This was confirmed by Jeremy Cousins QC (sitting as a Deputy Judge of the High Court) in *Patley Wood Farm LLP v Brake et alia* [2016] EWHC 1688 (Ch). The case was concerned with an application by a creditor for an administration under the Insolvent Partnerships Order 1994 (SI 1994/2421) (as amended). Questions had arisen as to whether this application was authorised and whether the partners should be joined to the application. The court held that the partners should be joined. Having decided that point the court ruled that it was appropriate to make an administration order in this case because the partnership was insolvent and administration would produce a better result than liquidation. The case is significant because of the detailed procedural analysis of administration applications in respect of insolvent partnerships.

An odd case to note *is Re Newtons Coaches Ltd* (*Newton et alia v Secretary of State for Business, Energy and Industrial Strategy*) [2016] EWHC 3068 (Ch), [2017] BCC 34 – this makes the somewhat technical point a partnership is not a "company" for the purposes of s. 216 of the Insolvency Act 1986. Thus two individuals who were involved in a partnership that had been wound up could not be prevented from becoming involved in the management of a company in the same line of business using a similar name. See E. Berry [2017] 30 Insolvency Intelligence 42 for a fuller analysis.

McLean v Berry [2016] EWHC 2650 (Ch) is an unusual authority. It deals with a range of issues, including the question of whether partners can exercise subrogation rights in a partnership administration. Here the partnership firm had entered administration and the partners had been made the subject of bankruptcy orders. Norris J. was left to make sense of this complex scenario. He decided that section 39 of the Partnership Act 1890 does not apply to an insolvent partnership – that situation is instead governed by the Insolvent Partnership Order 1994. The fundamental rule that partners cannot compete with creditors of the firm was confirmed in para [35] of the judgment.

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