Guide to: Partnership Agreements

The principal law governing partnerships is set out in the Partnership Act 1890 (the "Act") which defines a partnership as "the relation which exists between persons carrying on a business in common with a view to profit" (section 1 of the Act).

The question of whether a partnership exists or not is therefore a matter of fact (not necessarily agreement). It is therefore not something which the parties can simply determine for themselves. While the relationship can be governed by a written partnership agreement, the essence of a partnership is the continuing relationship between two or more individuals, personal as well as commercial, with the contractual partnership agreement being only an indication of the relationship.

The reason why it is important to have a written partnership agreement is that where there is no written agreement, the provisions set out in the Act (which is over a hundred years old) apply instead and the default position set out in the Act may not be attractive to the partners.

This article highlights some of the default provisions which apply in the absence of a written partnership agreement and which often come as a surprise to those unfamiliar with partnership law.

Management of the partnership

Where a partnership is set up with one partner who contributed more capital to start the business, or where one partner is considered a Managing Partner for whatever reason, it may be considered that that partner is in charge of the general management of the partnership.

However, without a written partnership agreement, the default position on day-to-day management of the partnership is that this is done by all the partners with decisions made on a majority basis. Therefore, without a written partnership agreement, all partners are considered equal in terms of making decisions.

Sharing of profits and losses

Imagine there is a partnership business, Perfect Printing, which was set up with £10,000 from Alan, Brian and Charlie. Alan contributed £5,000 and Brian and Charlie each contributed £2,500. Since everyone got along and they did not want to incur legal fees, they all agreed that a written partnership agreement was not necessary.

Perfect Printing has now made a profit of £100,000 which Alan, Brian and Charlie have agreed to divide between themselves. However, Alan says that £50,000 belongs to him because he contributed 50% while Brian and Charlie each contributed 25%. Brian and Charlie disagree and say that the £100,000 should be divided equally between them.

While what Alan says makes sense and seems fair, this is not the case without a written partnership agreement. The default position under the Act is that profits and losses are shared equally irrespective of different capital contributions. If the sharing of profits is not intended to be equal, this must be set out in a written partnership agreement.

Expulsion of a partner

In circumstances where one of the partners in a partnership has done something wrong, the other partners may wish to expel them from the partnership. Let's take Perfect Printing as an example again. Imagine if Alan has been working for a competitor and Brian and Charlie wish to expel him. Some people may consider that if someone has done something wrong, they must be able to expel them from a partnership.

Unfortunately, this is not correct. Under the Act, if there is no express right to expel a partner from a partnership (i.e. in a written partnership agreement), then a partner cannot be removed from the partnership. Brian and Charlie must therefore continue in partnership with Alan unless they end the partnership.

Retirement

If we look at the issue of retirement next, there comes a time when everyone is ready to stop work and enjoy a relaxing retirement. Where there are still partners who wish to continue the partnership business, they may assume that they can simply buy out the retiring partner and carry on as if nothing has changed.

However, that assumption would be incorrect. Without a written partnership agreement, there is no right to retire without dissolving the partnership. While the continuing partners could in theory re-form the partnership, they would have to reach agreement with the retiring partner for the purchase of their share of the partnership.

Why you need a partnership agreement

As can be seen from the above, there are a wide range of matters which should be dealt with in a written partnership agreement to avoid unwanted consequences. The management of the partnership, the ownership of partnership property, introducing and expelling partners, how to dissolve the partnership and the sharing of profits are just some of the things which should be included in a written partnership agreement.

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