

Chapter 9

Partnership Act

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Definitions

The law governing partnership in Pakistan is the Partnership Act, 1932.

Partnership

“Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all”.

Firm and partners

“Persons who have entered into partnership with one another are called individually “partners” and collectively “a firm” and the name under which their business is carried on is called the “firm name”.

Act of firm

“An act of firm means any act or omission by all the partners, or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm.”

Third party

“Third party used in relation to firm or to a partner therein means any person who is not a partner in the firm.”

Please See The Example 01

Essential elements of a partnership

The definition of partnership indicates the following essential elements in a partnership:

- 1. Association of two or more persons**
- 2. Agreement**
- 3. Carrying on Business**
- 4. Sharing of profits**
- 5. Mutual Agency**

1 Association of two or more persons

The partnership is an association between two or more persons and all persons must be competent to contract. Thus, there can be no partnership consisting of a single individual. If the number gets reduced to one, for any reason, it ceases to be a partnership.

The partnership Act does not say anything about the maximum number of partners. However, through other pronouncement the following maximum numbers are fixed:

- (a) In case of a partnership firm carrying on banking business maximum number is 10.
- (b) In case of a partnership firm carrying on any other business maximum number is 20.
- (c) In case of a partnership firm of professional persons maximum number may exceed 20.

If the number of partners exceeds the maximum number allowed then such partnership firm becomes an illegal association.

2 Agreement

A partnership is a contractual agreement between the partners. This agreement may be express (whether written or oral) or implied. The written agreement is known as 'partnership deed'. In Pakistan partnership arises from contract and not from status such as, Joint Family Business operation of law inheritance, or succession.

A partnership deed usually sets out the following:

- Firm name
- Place or principal place of business of the firm
- Names of any other places where the firm carries on business
- The date when each partner joined the firm
- Number of partners
- Names in full and permanent addresses of partners
- Duration of partnership (if any)
- Purpose of the partnership
- Rights and duties of the partners
- Amount of capital that each partner should put into the business, and keep in the business until the partner retires or the partnership is dissolved.

2 Agreement - continued

In Pakistan, if the partnership agreement does not specify what the rights or duties of the partners should be in particular circumstances, the rules set out in the Partnership Act 1932 are assumed to apply. These are the 'default rules' in the absence of anything else.

This means that if a partnership exists but does not have a written agreement, it will be assumed (unless there is evidence to suggest otherwise) that the rules of the partnership agreement are those contained in the Partnership Act.

3 Carrying on business

To constitute a partnership, the parties must have agreed to carry on a business.

Where there is no business to be done, there can be no question of partnership.

Business here includes any lawful trade, occupation and profession.

An agreement to carry on business at a future time does not result in partnership unless that time arrives and the business is commenced. If the purpose is to carry on some charitable work it will not be a partnership.

4 Sharing of profits

The next essential element of partnership is that there must be an objective to make profit. The partners may agree to share profits in any manner they like.

The sharing of profits is a prima facie evidence and not a conclusive evidence of partnership. Partners may share it equally or in any other proportion. Further, it is not necessary that the partners should agree to share losses. It must be noted that even though a partner may not share in the losses of the business, yet his liability towards outsiders shall be unlimited.

A person receiving profits is not necessarily a partner, such as:

- Lender of money to persons engaged or about to engage in any business
- Servant or agent as remuneration
- Widow or child of a deceased partner as annuity
- A transferee of a partner's interest
- A minor who is admitted to the benefits of an existing partnership
- Previous owner or part owner as consideration for the sale of goodwill or share of it.

5 Mutual agency

There must exist a mutual agency relationship among partners. Mutual Agency relationship means that each partner is both an agent and a principal. Each partner is an agent in the sense that he has the capacity to bind other partners by his acts done. Each partner is principal in the sense that he is bound by the acts of other partners.

Following two important features of the partnership need to be understood.

- A partnership does not have a legal personality. Unlike a company, it is not a legal person. A third party entering into business transaction with a partnership does not have a contractual agreement with the partnership; the contractual agreement is between the third party and all the partners as individuals.
- Partners in a partnership do not have limited liability, and are personally liable for any liabilities of the partnership business that the partnership cannot pay.

Please See The Example 02 to 09

Test of partnership

In determining

- whether a group of persons is or is not a firm or
- whether a person is or is not a partner in a firm regard shall be given to the real relationship between the parties as shown by ***all relevant facts taken together i.e.***

(a) Association of two or more persons

(b) Agreement

(c) Carrying on business

(d) Sharing of profits

(e) Mutual agency

Please See The Example 10 to 14

Types of partnership

Partnership-at-will

Where no provision is made between the partners for the duration of their partnership, or for the determination of their partnership, the partnership is called partnership at will. In such partnership there is no provision as to when the partnership will come to an end.

Any partner is free to dissolve the partnership by giving a notice in writing to all other partners of his intention to dissolve the firm.

The firm is dissolved as from the date mentioned in the notice as the date of dissolution or if no date is mentioned as from the date of the communication of the notice.

If freedom to dissolve the firm at will is curtailed by agreement, like if the agreement provides that the partnership can be dissolved by mutual consent of all the partners, only then will it not constitute a partnership at will.

Particular partnership

Where a partnership is created for any particular adventure or undertaking or for a specific time period it is called a particular partnership. Such partnership comes to an end on the completion of venture or on the expiry of the period.

If the partners decide to continue such a partnership even after the expiry of the specific period or completion of specific venture then it becomes partnership at will.

Please See The Example 15 to 18

Types of partners

Actual or ostensible partner

A partner who is actively engaged in the conduct of a business is called actual or ostensible partner.

Such a partner is an agent of all other partners for the purposes of the business of the firm. He can bind himself and other partners for the acts done in the ordinary course of the business.

Sleeping or dormant partner

A sleeping partner is not known as such as a partner to third parties dealing with the firm. He may or may not take active part in the conduct of the business of the firm. He, like other partners, invests capital and shares in the profits of the business. He is equally liable along with other partners for all the debts of the firm, even though his existence is kept a secret from the outsiders dealing with the firm.

Note

A sleeping partner is not required to give public notice of his retirement and he is not liable for any act done by the firm after his retirement.

Nominal partner

A partner who does not contribute any capital or share in profits, but lends his name to the firm is called a nominal partner. He along with other partners is liable to the outsiders for all the debts of the firm.

Partner in profits only

A partner may agree that a partner shall get a share of the profits only and that he shall not be liable to contribute towards the losses. But for third parties he is liable for all the debts of the firm.

Sub-partner

When a partner agrees to share his profits derived from the firm with a stranger, that stranger is known as a sub-partner. A sub-partner is in no way connected with the firm and cannot represent himself as a partner of the firm. He has no rights against the firm nor is he liable for the acts of the firm.

Silent partner

Those who by agreement with other partners have no voice in the management of the partnership business. They share profit and losses, are fully liable for the debts of the firm.

Partner by estoppel or holding out

Where a person

- Holds himself out as a partner or
- Allows others to do it

they are then stopped from denying the character he has assumed and upon the faith of which creditors may be presumed to have acted.

Please See The Example 19 to 25

What exactly Estoppel means?

Estoppel is a **legal** principle that prevents someone from arguing something that contradicts what they previously said.

What exactly Holding out means?

Conduct by one person that leads another to believe that he has an authority that does not in fact exist.

For example, a person who wrongly represents himself as being a partner in a firm will be as liable as if he were in fact a partner to anyone who gives credit to the firm on the faith of the representation.

Please check section 1.6 & 1.7 of Study Text

For difference between partnership and company.

**For difference between partnership and
coownership**

Please See The Example 26 to 32

General duties of partner

These are mandatory duties of a partner that cannot be changed by an agreement amongst the partners. These are:

Duty to be just and faithful

An ideal partnership is one where there is mutual trust and confidence, and spirit of helpfulness among partners. As such every partner must be just and faithful to his co-partners. He must observe utmost good faith and fairness towards other partners of the firm.

Duty to carry on business to the greatest common advantage

Every partner is bound to carry on the business of the firm to the greatest common advantage. It implies that every partner must use his knowledge and skill for the benefit of the firm and not for his personal gain. He must conduct the business with the best of his ability and secure maximum benefits of the firm.

Duty to render true accounts

Every partner must render true and proper accounts to his co-partners. It implies that each partner must be ready to explain the accounts of the firm and produce vouchers in support of the entries.

No partner should think of making a secret profit at the expense of the firm.

Duty to provide full information

A partner must give full information to the other partners, in relation to everything affecting the partnership.

Duty to indemnify for loss caused by fraud

Every partner shall indemnify (compensate) the firm for any loss caused to it by his fraud in the conduct of the business of the firm.

Duty to be liable jointly and severally – unlimited liability

Every partner is liable jointly with all the other partners and also severally means separately, to third parties for all acts of the firm done while he is a partner. The third party may take legal action for non-payment of a debt or losses incurred as a result of a breach of contract against:

- all the partners jointly, or
- any individual partner.

The liability of all the partners is not only joint and several but is also unlimited.

Duty to act within authority

Every partner is bound to act within the scope of his actual or apparent authority. Where he exceeds the authority conferred on him and the firm suffers a loss he shall have to compensate the firm for any such loss, unless the other partners ratify i.e. accept such acts.

Duty in case of emergency

It is the duty of the partner to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary care, in his own case acting under similar circumstances.

He can even exceed his authority in order to save the firm from any loss.

Please See The Example 33 to 41

Qualified duties of partner

The qualified duties of a partner can be changed by an agreement amongst the partners. Unless, otherwise agreed by the partners, every partner has the following duties:

Duty to attend diligently to his duties

Every partner is bound to attend diligently to his duties in the conduct of the business.

Duty not to claim remuneration

A partner is not entitled to receive remuneration for taking part in the conduct of the business. It is, however, usual to allow some remuneration to the working partners provided there is a specific agreement to that effect.

Duty to contribute to the losses

The partners are bound to contribute to the losses sustained by the firm. An agreement to share profits may imply an agreement to share losses also.

Duty to indemnify for wilful neglect

Every partner is under a duty to indemnify the firm for any loss caused to it by his wilful neglect (i.e. failure to perform a duty or to do something which the partner should have done) in the conduct of the business of the firm.

Duty to use firm's property exclusively for the firm

It is the duty of every partner to use the property of the firm exclusively for the purposes of the business. No partner should use partnership property for his personal benefit.

Duty to account for personal profits derived

A partner must 'account to the firm' for any benefit obtained, without the consent of the other partners, from any transaction involving the partnership, the partnership property, the partnership name or the partnership's business connection.

In other words, if a partner uses the partnership property, name or business connections to make a secret profit (a personal profit that the other partners do not know about), the other partners can claim those profits for the partnership.

Duty not to compete with the business of the firm

Similarly, if a partner competes in business (as in the case of personal profit) with the partnership, without the consent of the other partners, he is liable to account to the partnership for all the profits that he earns from the competing business.

Duty not to assign his interest

No partner can assign or transfer his partnership interest to any other person so as to make him a partner in the business without the consent of all other partners. He can, however, assign his share of the profit and his share in the assets of the firm but the transferee shall not have any right to interfere in the conduct of the business during the continuance of the firm.

Please See The Example 42 to 49

Rights of partner

Right to take part in the conduct of the business

Every partner irrespective of the amount of capital contribution has an inherent right to take part in the conduct of the business of the firm. Although one may agree not to participate but right of participation should be available to each partner.

Right to be consulted

Every partner has the right to be consulted before any matter is decided. Any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners in good faith but no change may be made in the nature of the business without the consent of all the partners.

Right to have access to the books

Every partner has a right to have access to and to inspect and copy any of the books of the firm.

Right to share the profits

In the absence of a contract to the contrary every partner has a right to share profits equally earned by the firm.

Right to interest on capital

No partner is allowed to receive any interest on capital as a general rule because a partner is not a creditor of the firm. Interest on capital is allowed only when agreed among the partners.

Where a partner is entitled to interest on the capital subscribed investment by him such interest will be payable out of the profits, earned by the firm.

Right to interest on advances

Where a partner makes for the purpose of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, he is entitled to interest on it at the rate of 6% per annum or as agreed upon.

Right to indemnity

Every partner has a right to claim indemnity from the firm in respect of payments made or liabilities incurred by him:

- In the ordinary and proper conduct of the business and
- In doing such act, in an emergency, for the purpose of protecting the firm from loss, as would

be done by a person of ordinary prudence, in his own case, under similar circumstances.

Right to retire

A partner has a right to retire.

- With the consent of all the partners or
- In accordance with an express agreement between the parties or
- Where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

Right of outgoing partner to share in the subsequent profits

Where a partner has died or has ceased to be a partner by retirement, expulsion, insolvency or any other cause, the surviving or continuing partners may carry on the business with the property of the firm without any final settlement of accounts as between them and the outgoing partner. In such a case in the absence of a contract to the contrary, legal representative of the deceased partner or the outgoing partner, is entitled at his option to:

- Such share of the profits as in proportionate to his share in the property of the firm or
- Interest at the rate of 6% on the amount of his share in the property of the firm.

Rights after reconstitution of firm

Where a change occurs in the constitution of a firm or a firm constituted for a fixed term continues to carry on business after the expiry of that term, the mutual rights and duties of the partners in the reconstituted firm remain the same as far as may be possible, as they were immediately before the change

Please See The Example 50 to 60

Mutual Rights and Liabilities

Partners have the following mutual rights and liabilities which are subject to contract between them:

1. Duty to work without remuneration
2. Rights to share profits and losses equally
3. Right to interest on capital
4. Rights to interest on subsequent advance
5. Right to indemnity
6. Duty to indemnify for wilful neglect

These have been discussed earlier.

Please See The Example 61

Partnership property

Subject to contract between the partners, the property of the firm includes:

- All property originally brought into the common stock of the firm
- All rights or interest in the property originally so brought
- All property acquired, by purchase or otherwise, by or for the firm and all rights and interest in any property so acquired and
- Goodwill of the business of the firm

Note

- Unless, any contrary intention appears any property purchased with partnership money without other partners consent will be deemed to be partnership property.

Goodwill

Goodwill is an accounting concept meaning the value of an intangible asset which has a quantifiable value in a business. An example would be the reputation the firm enjoys with its customers. This reputation enables the firm to earn more than the normal profits earned by the business as a whole.

Goodwill can be thought of as the value of the business as a whole less aggregate value of identifiable net assets.

Please See The Example 61

RELATIONS OF PARTNERS TO THIRD PARTIES

Agent of the firm

A partner is the agent of the firm for the purpose of the business of the firm.

Authority of partners

The authority of a partner means the capacity of a partner to bind the firm by his act. Since the partnership is not a legal person, a partner acts as an agent for the other partners. The authority of a partner may be **actual** or **implied**.

Actual authority

The authority of each partner to take decisions for the business, and enter into transactions with other parties, may be specified in the partnership agreement. Since the partnership agreement is a contract, its terms are the terms of a contractual agreement between the partners.

Implied authority

The act of a partner done by him:

- as an agent of the firm
- in the course of business of the firm
- in the name of the firm, or in any other manner expressing an intention to bind the firm.

An authority to bind the firm is known as implied authority of a partner.

In a trading partnership, all the partners have the **implied authority to borrow money on the credit of the** partnership, and a lender is under no particular obligation to investigate the purpose of the loan. This means that unless a lender has knowledge that a partner does not have the actual authority to borrow on behalf of the partnership, he can rely on the partner's implied authority.

- Every partner within the scope of his implied authority may bind the firm by the following acts:
 - Buying and selling good, on behalf of the firm and giving valid receipts for them
 - Receiving payments of the debts due to the firm and giving valid receipts or discharge for them
 - Contracting debts and paying debts on behalf of the firm
 - Settling accounts with persons dealing with the firm
 - Employing servants for the partnership of the firm
 - Drawing cheques, accepting or endorsing bills of exchange and promissory notes in the name of the firm
 - Pledging movable property of the firm
 - Suing on behalf of the firm and defending suits in the name of the firm

Statutory restrictions on the implied authority of a partner

The restrictions imposed by law are statutory restrictions and is applicable against the whole world whether a particular person dealing with the firm has knowledge of it or not e.g. about the name of the firm, etc.

- Following acts are not included in the implied authority of a partner unless there is any usage or custom of trade:
 - Arbitration:** Submit a dispute relating to the business of the firm to arbitration
 - Bank account:** Open a banking account on behalf of the firm in his own name
 - Compromise:** Compromise or relinquish any claim or portion of a claim by the firm
 - Withdrawal of suit:** Withdraw a suit or proceeding filed on behalf of the firm
 - Acceptance of liability:** Admit any liability in a suit or proceeding against the firm
 - Acquisition:** Acquire immovable property on behalf of the firm
 - Transfer:** Transfer immovable property belonging to the firm
 - Partnership:** Enter into partnership on behalf of the firm.

Restrictions by partnership deed

A restriction which is specifically written in partnership deed is effective only against the person dealing with the firm having knowledge of it.

Ratification of actions taken by a partner outside his actual authority

When a partner exceeds his authority, that is act outside his actual authority, the other partners may approve such unauthorized act with retrospective effect. This is known as ratification.

By giving their retrospective approval to the contract made by another partner, even though it was outside the partner's actual authority at the time, the partners can remove any questions about whether implied authority existed or whether the other party knew that the partner did not have the actual authority to make the contract.

Liabilities of partner and firm

Liability of a partner for acts of a firm

In order to make a partner liable for any act of the firm, the same must have been done while he was a partner. The liability of the partner is both joint and several, so that the creditor may compel any one or more of the partners to discharge the whole of the debts of the firm.

Liability of the firm for wrongful acts of a partner

Where by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, loss or injury is caused to any third party or any penalty is incurred the firm is liable to the same extent as the partner.

In case of fraud, although the firm is liable to the third party for loss caused to the third party by fraud committed by a partner but as between partners same must be borne by the partner committing the fraud and cannot be shared among all the partners.

Liability for misapplication by partners

- A partner acting within his apparent authority receives money or property from a third party and misapplies it or
- A firm in the course of its business receives money or property from a third party, and the same is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.

Liability to indemnify for wilful neglect

Every partner is under a liability to indemnify the firm for any loss caused to it by his wilful neglect (i.e. failure to perform a duty or to do something which the partner should have done) in the conduct of the business of the firm.

Liability to share losses

The partners are bound to contribute to the losses sustained by the firm. An agreement to share profits may imply an agreement to share losses also.

Liability to account for personal profits

A partner must 'account to the firm' for any benefit obtained, without the consent of the other partners, from any transaction involving the partnership, the partnership property, the partnership name or the partnership's business connection.

In other words, if a partner uses the partnership property, name or business connections to make a secret profit (a personal profit that the other partners do not know about), the other partners can claim those profits for the partnership.

Liability to account for profit of competing business

If a partner competes in business (as in the case of personal profit) with the partnership, without the consent of the other partners, he is liable to account to the partnership for all the profits that he earns from the competing business.

Effect of admissions by a partner

Any admission or representation made by a partner is evidence against the firm if the following two conditions are fulfilled:

- Such admission or representation must relate to the affairs of the firm and
- Such admission or representation must be made in the ordinary course of business.

Effect of notice to an active partner

Any notice to a partner operates as a notice to the firm if the following conditions are fulfilled:

- Such notice must relate to the affairs of the firm
- Such notice must be given to a working partner and not to a sleeping partner
- There must not be any fraud committed by the partner receiving the notice.

Holding out

Where a person

- Represents himself or
- Allows partners to do it, he is then estopped from denying the character he has assumed and
- Upon the faith of which creditors may have acted.

Requirement

In order to render a person liable as a partner on the ground of estoppel or holding out:

Direct Representation

He must have by words spoken or written or by his conduct represented himself to be a partner.

Indirect Representation

He must have knowingly permitted himself to be represented as a partner to the other person.

Knowledge of the third party

The other person must have acted on the faith of such representation and gives credit to the firm. It does not matter whether the person representing himself or represented to be a partner does or does not know that the representation has reached the other person giving credit.

Applications of holding out partner

Retiring partner

Where a retiring partner does not give a public notice of his retirement and the continuing partners still use his name as a partner he will be personally liable on the ground of holding out to third parties.

A Minor on attaining majority

If a minor (who was admitted to the benefits of an existing partnership) after attaining majority act as a partner without giving public notice, he will be liable as a partner by estoppel.

Exceptions of holding out

Deceased partner

After a partner's death if the business of the firm is continued in the old firm's name the continued use of that name or of the deceased partner's will not itself makes his legal representatives liable for any act of the firm done after his death.

Insolvent partner

Where a partner is adjudicated as insolvent he ceases to be partner on the date on which the order of adjudication is made whether or not the firm is dissolved. The estate of the insolvent partner is not liable for any act of the firm and the firm is not liable for any act of the insolvent.

Rights of transferee of a partner's interest

A partner may transfer his interest in the firm by sale, mortgage or charge fully or partially.

Rights of Transferee

- He is entitled to receive the share of the profits of the transferring partner.
- On the dissolution of the firm or on retirement of the transferring partner he is entitled to receive:
 - the share of the assets of the firm to which the transferring partner is entitled.
 - an account from the date of the dissolution for the purpose of ascertaining the share.

Disabilities of Transferee

- No status of a partner.
- Disability to interfere in the conduct of the business during the continuance of the firm
- Disability to require accounts.
- Disability to inspect the books of the firm.
- Disability to challenge the accounts of profits agreed to by the partners.
- Disability to sue for dissolution of the firm.

Minor's admission to the benefits of partnership

Since a minor is not capable of entering into a contract, a contract by or with a minor is void abinitio i.e. from the beginning. Since partnership is formed by a contract, a minor cannot enter into a partnership agreement but with the consent of all the partners for the time being a minor may be admitted to the benefits of partnership.

An analysis of the above provision highlights the following three conditions:

- Before admission of a minor there must be an existence of partnership
- There must be mutual consent of all the partners
- A minor can be admitted only to the benefits of partnership

Benefits of partnership include benefits, which the minor would enjoy if he was a major.

Position of a minor before attaining majority

Rights

- Right to share property and profits of the firm as agreed by the partners
- Right to have access to accounts of the firm ONLY and not to the secret books
- Right not to be adjudged insolvent

Liabilities:

- Personally not liable i.e. limited liability.
- His share is liable for the acts of the firm.

Disabilities:

- No status of a partner.
- No suit against partners for profit and property except after disconnecting his relation with the firm.
- Not entitled to have access to books other than accounts.

Position of a minor on attaining majority

On attaining majority the minor partner has to decide within six months whether he shall continue in the firm or leave it.

These six months run from the date:

- of his attaining majority or
- when he first comes to know that he had been admitted to the benefits of partnership, whichever is later.

Within this period he should give a public notice of his choice:

- to become or
- not to become a partner in the firm.

If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the six months after obtaining majority.

Where such person elects to become a partner

The following holds:

- Personal liability since the date of admission to the benefits of the firm
- Same share in the profits and property of the firm to which he was entitled as a minor.

Where such person elects not to become a partner

The following holds:

- The status of a minor up to the date of public notice
- His share not liable for any act of the firm after the date of public notice
- Right to sue partners for share of the property and profits

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