Do I Need a Partnership Agreement for My Partnership?

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If you enter into a partnership, it is very important to consider a written partnership agreement. Where there is no express partnership agreement, the terms of the Partnership Act 1890 will apply. Given the age of this statute, the provisions within it will not adequately reflect modern practices and are unlikely to be what the parties intend. The Act takes a neutral approach treating all partners as equals and this may not be appropriate for modern-day business arrangements, particularly where the contribution by the partners is not equal.

Profit Share:

The default position under the Act is that the profits and losses are shared equally irrespective of different capital contributions by partners. Care should therefore be taken here. Equal entitlement to the assets and capital of the partnership may not be appropriate where one partner gives a greater contribution to the partnership in terms of, for example, the amount of work they put in, the expertise they have or the amount of capital or assets they provide. Having a carefully drafted partnership agreement enables the partners to determine the nature and amount of each partner's contribution to the partnership and the return each partner will receive. Having a written partnership agreement should therefore result in a fairer outcome and entitlement for the partners, which reflects the contribution each individual makes to the business.

Decision Making Powers:

Under the terms of the Partnership Act 1890, the day-to-day management responsibilities lie equally between all the partners and all partners have equal decision making powers. Where one partner has made a greater investment into the partnership, they may wish to have increased decision-making powers as they potentially have more to lose through a careless or risky venture. Again the partnership agreement can make provisions for this.

Liability:

Following on from this, a partnership is not a separate legal entity under law, and therefore the partners as individuals (including their personal assets) are liable where a claim is made against the partnership. Where there is no partnership agreement in place, under the Partnership Act 1890, all of the partners are equally liable,

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therefore where one partner incurs a substantial liability on behalf of the partnership, this may seriously affect the other partners financially. This could be unfair where some partners had no involvement in, or knowledge of, the decision that has given rise to the liability. A partnership agreement can be drafted to avoid such scenarios and afford greater control and protection for the partners.

Retirement and Incoming Partners:

Where only the Partnership Act 1890 applies, the partnership dissolves where one partner leaves, for whatever reason, including death. Dissolution is likely to be a time consuming and costly process and should be avoided if at all possible. A well-drafted partnership agreement will provide for partners to leave and for new partners to join and will define the parties rights and obligations when these events occur. An incoming partner does not, simply by becoming a partner, acquire liability for anything done before they join the partnership, however, it is common practice for incoming partners to agree to take on a share of the existing liabilities of the partnership and this can be done under the terms of a partnership agreement.

Expulsion:

Under the Partnership Act 1890, a partner cannot be removed from the partnership by the other partners. This means the only option for the other partners is to end the partnership by dissolution and then form a new partnership (without the partner they want to remove) . This scenario can be avoided by an express provision in a partnership agreement which sets out the circumstances and procedure in which a partner may be expelled from the partnership by the other partners.

Summary:

Agreeing on all of these provisions in advance and setting them out in a carefully drafted partnership agreement, tailored to your business and circumstances can help to avoid costly and disruptive disputes in future. It is also advisable to keep your partnership agreement under periodic review to ensure it keeps pace with changed circumstances.

Should you wish to discuss a partnership agreement, please do not hesitate to contact our expert Corporate & Commercial team by emailing online.enquiries@la-law.com or calling 01202 786188.

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