

The Pictons Directors guide to: Partnership Agreements

Partnerships are one of the easiest ways to start in business. There is no need to register your business at Companies House in the way that a limited company is. A partnership starts as soon as the **partners begin trading** – whether they have agreed a written **partnership agreement** or not!

But, when contemplating trading as a partnership the lesson is **always, always, always** enter into a properly drawn partnership agreement. It is the rules for the business. It will provide for the admission of new partners and retirements including all the financial consequences. In a partnership arrangement there is no “articles of association” or “shareholder agreement” such as you would have to **regulate the internal workings** of a limited company. A partnership agreement fills in these gaps.

Trading without a partnership agreement is a high risk strategy! Partnerships are governed by the Partnership Act 1890, which is one of the **oldest acts of parliament** still in regular day to day use. If no partnership agreement exists then you may be left at the mercy of the Parliament Act which will dictate how the partnership will dissolve and what will happen to the clients and profits.

Generally partners will not want the retirement, death or bankruptcy of one partner to cause **dissolution of the partnership** and so they agree at the outset, in the partnership agreement, how to adapt to a particular event. If any **event is not included** in the partnership agreement then the partners may have to fall back on the Partnership Act 1890.

A partnership agreement should give the right to **retirement** and should include a mechanism for calculating the retiring partner’s share of the business while allowing the remaining partners to continue the partnership. The partners will simply follow the mechanism set down and the business will continue largely as before with a different membership of the partnership.

Expulsion of a partner is analogous to retirement save that the partner is leaving at the instigation of the other partners. It is an important sanction for breach of the agreement or for other stipulated forms of misconduct. The agreement should state on what grounds a partner can be expelled. Will it be with immediate effect? Will it require unanimous consent? And how much will the expelled partner get for his partnership share.

Death or **bankruptcy** of a partner are difficult to plan for, but the former can sometimes be insured against. The partnership agreement can provide that the remaining partners continue the partnership by buying out the share of the deceased or bankrupt partner. This will only work if the agreement also provides a procedure for dealing with the purchase of the outgoing partner’s share.

A good partnership agreement should state whether there is a **binding obligation** on the partners to purchase the outgoing partner’s share, or whether there is merely an **option to purchase**. It will also set out the mechanism or formula for valuing the outgoing partner’s share or provide for a **professional valuation** if the partners can’t agree.

Alternatively, the partnership may be **sold as a going concern**. There are a myriad of questions that a partnership agreement can answer about how the important decision is made to **prevent deadlock** between partners who cannot agree. How much should the business be sold for? Is unanimous consent of the partners required?

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A partnership agreement may also set out the **limitations** on what each partner is allowed to do without first obtaining the consent of his fellow partners (e.g. not to incur expenditure over £10,000, not to hire employees with a salary over £20,000 pa). This is especially relevant to partnerships because each partner has **unlimited liability** for the debts and losses of the partnership (no matter which partner incurred them). Compare this to a limited company where the owners (shareholders) have limited liability, which extends only to the money that they agreed to put into the company in return for their shares.

If you don't already have a suitable partnership agreement it may be time to do something about it.