

Exiting a partnership (the A-Z of what happens when things start to go wrong)

End of the Road?

A partnership may break up for many reasons. Perhaps because all partners agree that it should, because **one partner wants 'out'** (contrary to the wishes of the remaining partners) or there may be sudden or unforeseen circumstances (e.g. new job, move abroad, death, bankruptcy).

When a partnership is dissolved the contractual relationship between partners is brought to an end. It may be that some of the partners take over the business (with or without a new partner) in which case technically one **partnership dissolves** and another is formed.

Separation Agreement?

In any circumstances where one partner is leaving or the partnership is breaking up entirely, the best outcome is for the partners to agree the terms of the break up in a formal **'separation agreement'**. This will deal with the division of the partnership assets, such as **who keeps the clients?** Who can use the **partnership name?** It will also specify who bears any **ongoing risk or liability**, such as outstanding lease commitments or **bank overdraft**.

It is sensible to get a solicitor to draw up the separation agreement. The agreement can deal with the time scale over which payment of the outgoing partner's share will be paid. It can contain clauses forbidding the partners from **directly competing** with each other. It will allow the sharing of **access to partnership data**. It might agree a process to release the exiting partner from any **personal guarantees** or leases given by the partners to a bank or a landlord for which he remains liable.

But agreement between partners – especially when things start to break up – is not always possible.

There is no partnership agreement?!

If there is **no partnership agreement** and no separation deal can be reached, then you may be left at the mercy of one of the **oldest acts parliament** still in regular day to day use.

Partnerships are governed by the Partnership Act 1890. If no partnership agreement exists the Partnership Acts dictates that the partnership will dissolve in any of the following circumstances:

- immediately on notice by any partner to the other(s);
- on expiry of a fixed term or the end of the venture for which the partnership was established;
- on the death or bankruptcy of a partner;
- illegality (if the business can't continue to trade legally because, for example, its business is to sell alcohol and it loses its licence);
- by court order when partner becomes permanently incapable of performing their part of the partnership contract.

The Partnership Act does not specify how to divide the partnership clients or material assets or (if any remaining partners will carry on the business) what **non-competition restrictions** will be imposed on an exiting partner.

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Any **surplus left over** after the partnership has been dissolved and wound up will be split between the partners in the proportions in which they were entitled to receive the trading profits of the partnership.

There is a partnership agreement?!

Generally partners will not want the retirement, death or bankruptcy of one partner to cause **dissolution of the partnership** and so they agree in advance how to adapt to a particular event.

They will have drawn up a **partnership agreement** at the outset to detail the circumstances under which partners can or must leave and how the outgoing partner's share in the capital and profits will be dealt with. If any **event is not included** in the partnership agreement then the partners may have to fall back on the Partnership Act 1890.

If a partnership agreement gives the right to **retirement** there should be 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 simply be sold as a going concern.