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LAW ON PARTNERSHIP IN INDIA

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CHAPTER 1: INTRODUCTION ON PARTNERSHIP

What is a Partnership?

- Partnership is an association of two or more persons who agree to carry on a lawful business in common with the object of sharing in partnership. The partners provide the capital and share the responsibility for running the business on agreed basis.

- Some of the important definitions of partnership are given below:

  (1) **According to L.H.Haney**: "Partnership is an agreement between persons having contractual capacity to carry on a business in common with a view to private gain."

  (2) **According to Dr. John A. Shubin**: "Two or more individuals may form a partnership by making a written or oral agreement that they will jointly assume full responsibility for the conduct of a business."

  (3) **According to Dr. William R. Spriegal**: "Partnership has two or more persons, each for whom is responsible for the obligation of the

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partnership. Each of the partners may bind the others, and the assets of each of the partners may be taken for the debts of the Partnership."

- According to English Partnership Act, 1890, "The relation which subsists between persons carrying on a business in common with a view to earn profit."

- The persons who form a partnership are individually called 'partners' and collectively 'firm'. The name under which the business is conducted is called the 'firm name'.

Requirement of Partnership:

- The need of Partnership arose from the limitations of sole Proprietorship. In Sole Proprietorship, financial resources and managerial skills were limited. One person can provide only limited amount of capital and cannot start the business on large scale. It cannot provide even required managerial skills. Single owners cannot manage all activities effectively and efficiently and risk bearing capacity is also limited.

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- When business activities started expanding, the need for more funds arose. When the size of firm extends, the sole proprietor finds it difficult to manage the business and is forced to take the help of outsiders who will not only provide additional capital but also help him in managing the business activities efficiently and effectively.

- So more persons were associated to form groups to carry on business and consequently partnership form of organization came into existence. It is the ideal form of organisation for the enterprise requiring moderate amount of capital and diversified managerial talent.

- In a nutshell, it can be said that partnership form of organisation came into existence because of the limitation of Sole Proprietorship.

<u>Essential Characteristics of Partnership</u>:

1. **<u>Contractual Relationship</u>**: The partnership results only from a contract between certain numbers of persons called partners. According to Partnership Act, "The relation of partnership arises from

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contract and not from status." An oral contract is sufficient but it is always better to draft a deed of partnership specifying the terms and conditions and the rights, duties and obligations of partnership. Minors, insolvents, lunatics, and other persons are incompetent to enter into a valid contract and cannot enter into a partnership agreement.

2. **Two or more persons:** In partnership there must be at least two persons. According to Partnership Act there is no maximum limit of partners in the partnership, but according to Companies Act, 1956 the maximum number of partners is 10 in case of banking business and 20 in case of other business operations.

3. **Existence of Business:** The objective of the association of persons must be to do some kind of business. Where there is no business there is no partnership. By business, we mean all activities concerning production and distribution of goods and services for the purpose of earning profits.

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4. **Earning and sharing profits:** The agreement to carry on business must be with the objective of making profit and sharing it among all partners. If the partnership is formed to do some charitable work, it will not be called a partnership.

5. **Extent of liability:** The liability of each partner for the firm is unlimited. The creditors have the right to recover the firm's debts from the private property of any or all partners, where the assets are not adequate.

6. **Mutual Agency:** The business may be carried on by all partners or one or more acting on behalf of other partners. In result, such a partner is both an agent and a principal, agent for other partners and principal for himself.

7. **Implied Authority:** Each partner is an agent able to bind the other for the acts done by him on behalf of others, such as purchases and sales, the borrowing of money, the hiring of employees, etc. Such an act is said to be and treated as act of the firm and the authority so

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exercised by any of the partners is known as implied authority of the partners.

8. **Restriction on transfer of share:** No partner can sell or transfer his share to anybody else so as to make him partner in the business. This can, however, be done with the consent of all the partners.

9. **Utmost good faith:** All the partners must have utmost good faith in each other. Every partner should act honestly and in the best interest of the firm. They should prepare true accounts and must disclose every information to one another. Distrust and suspicion among partners lead to the failure of many partnership firms.

10. **No separate Entity:** Partnership is an association of persons who are individually called 'partners' and collectively a 'firm', legally a partnership firm is not a legal entity nor a person with any separate right distinct from the partners constituting it. It is only an association of persons. Further, a firm is only a convenient phrase to describe the partners and has no legal existence apart from them.

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11. **Dissolution:** The partnership may be dissolved on the death, lunacy or insolvency of any one of the partners.

When all the above characteristics are present in a certain relationship then that is known as 'Partnership'.

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CHAPTER 2: ADVANTAGES OF PARTNERSHIP OVER COMPANY

1. For the creation of a partnership just an agreement between various persons is all what you require.

   WHEREAS, In case of a company a lot of procedural formalities have to be gone through before a company is created.

2. The partners are their own masters for regulating their affair.

   WHEREAS, A company is subject to a lot of statutory control.

3. For dissolution of partnership, a mere agreement between the partners is enough.

   WHEREAS, A Company can be wound up by only after a certain set of procedure is followed.

4. Since all the profits are to be pocketed by the partners in a partnership firm, there is a great incentive for the partners to make business successful

   WHEREAS this is not the case in a Company.

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5. In a partnership the persons who have entered into are individually called partners and collectively a firm. A partnership firm does not have legal personality.

   WHEREAS, company is a legal entity different from its members.

6. A partnership firm means all the partners put together, if all the partners cease to be partners, e.g. all of them die or become insolvent, the partnership firm gets dissolved.

   WHEREAS, A Company being a person different from the members, the members may come and go but the company's life is not affected thereby.

7. A partner in a Partnership Firm cannot substitute another person in his place unless all the other partners agree to the same.

   WHEREAS, the shareholder of a company can transfer his share to anybody he likes.

8. On the death of a partner his legal representatives do not get substituted in his place of partnership.

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WHEREAS, on the death of a member of a company his legal representatives will step into his shoes for the purpose of rights in the company.

9. The minimum number of members in partnership are 2 and maximum in case of partnership carrying on banking business is 10 and in case of any other business is 10 and in case of any other business is 20.

   WHEREAS, in the case of private company the minimum no. is 2 and the maximum are 50 whereas in the case of public company the minimum number should be 7 but there is no limit to the maximum number and therefore any number of persons can hold shares in a public company.

10. The liability of a partner is unlimited.

    WHEREAS, the liability of the members of a company is limited.

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CHAPTER 3: THE SCOPE AND NATURE OF PARTNERSHIP ACT, 1932

To govern the Partnership Firms in India, the Indian partnership Act was enacted in 1932 and it came into force on 1st day of October, 1932. The present act supersedes the earlier law relating to partnership, which was contained in chapter IX of the Indian Contract Act, 1872. The act is not exhaustive. It purports to define and amend the law relating to partnership.

A partnership arises from a contract and therefore such a contract is governed not only by the provisions of the Partnership Act in that regard but also by the general law of contract in such matters, where the Partnership Act does not specifically make any provision. It has been expressively provided in the Partnership Act that un-repealed provisions of the Indian contract Act, 1872, save in so far as they are inconsistent with the express provisions of this act shall continue to apply. Thus, the rules relating to offer and acceptance, consideration, free consent, legality of object etc. as contained in the Indian Contract Act are applicable to contract of Partnership also.

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Definition of Partnership:

Section 4 of the Indian partnership Act, 1932 defines '**Partnership**' as:

'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.'

Elements of Partnership:

(1) There must be an agreement entered into by all the persons concerned.

(2) The agreement must be to share the profits of the business

(3) The business must be carried on by all or any of the persons concerned acting for all.

Scope:

The scope of Partnership is primarily a matter of partner's intentions. The application of the power it chooses to exercise at any time is not restricted except prohibition on illegal, immoral or fraudulent behaviour that applies equally to individuals.

1. If consent is given by the constituent company's partners, a partner may itself be a member of another company.

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2. If the contract appears to be authorised or ratified by all partners, then there is no further question as to its validity remains.

The case where the question of validity of partnership contract arises is where one partner has made the contract without specific authority from his co-partners. As to their implied scope partnership may be divided into the classes of non-trading and trading. Some powers can be exercised by partners in partnership of either type.

Nature:

Partnership is a form of business organization, where two or more person join together for jointly carrying on some business. It is an improvement over the 'sole trade business', where one single individual with his own resources, skills and effort carries on his own business. Due to the limitation of resources of only a single person being involved in the sole-trade business, a larger business requiring more investments and resources than available to a sole-trader cannot be thought of in such a form of business organisation. In partnership on the other hand can pool their resources and

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efforts and could start a much larger business compared to be afforded by any one of these partners individually. In case of loss also the burden gets divided amongst various partners in partnership.

Partnership not created by status:

- Section 5 of the Indian Partnership Act, 1932 says that the relation of partnership arises from contract and not from status, and in particular, the members of a Hindu Undivided Family carrying on a family business as such, or a Burmese Buddhist husband and wife carrying on business as such are not partners in such business.
- The explicit declaration of the law in this section is required, in the words of the select committee, by the vast extent of non-contractual quasi-partnership relations in India.
- The term Hindu joint undivided firm has a special meaning, it is a firm which has come down to the family ancestrally and does not need to have a partnership agreement.

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- A firm fiction of law represents the names of its numerous partners but a trade name of a joint family business would not stand for the coparceners who at the time of the institution of the suit may constitute the joint Hindu family.

- The rights and liabilities of the coparceners in a joint Hindu firm cannot be determined by exclusive reference to this Act.
- The managing member of the family can pledge the credit or the property of the family for the ordinary purpose of that business.

- If the manager of a joint Hindu family has entered into a contract of partnership does not make other members of the family, the members of the partnership.

- Two Hindu joint families cannot unite to constitute a partnership, but their managing members may become partners each having rights and duties with reference to their respective families.

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Difference between Partnership and Hindu Joint Family Firm:

Partnership	Hindu Joint Family Firm
1.) Arises as a result of an agreement	1.) Arises by operation of law
2.) Death of a partner dissolves the partnership (subject to a contract to the contrary)	2.) Death of a member does not dissolve the family firm.
3.) A new partner can be admitted only with the consent of the other partners	3.) There are constant additions in the family by birth.
4.) Partners have authority to borrow and bind the other partners by their acts	4.) Only the manager has authority to borrow and bind other members.
5.) All Partners are personally liable for the debts of the firm	5.) Only the manager is personally liable for the debts of the family member.
6.) The liability of partner is unlimited	6.) The liability of member of Joint Hindu family (except Karta) is limited.
7.) Partners can demand the accounts of the firm	7.) A member cannot ordinarily ask for an account of the past dealings
8.) A minor cannot be a partner (although he can be admitted to the benefits of a partnership)	8.) A minor can be a member of a Joint Hindu Family.

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Determining existence of partnership:

- Section 6 of the Indian Partnership Act, 1932 says that in determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in the firm, regard shall be had to the real relation between the parties as shown by all the relevant facts taken together.
- The sharing of profits or of gross returns arising from property by persons holding a joint or common interest in that property does not itself make such person a partner.
- The receipt by a person of a share of the profits of a business, or of payment contingent upon the earning of profits or varying with the profits earned by a business, does not itself make him a partner with the persons carrying on the business, and in particular the receipt of such share or payment.

  (a) by a lender of money to persons engaged or about to engage in any business.

  (b) by a servant or agent as a remuneration

  (c) by a widow or child of a deceased partner as annuity

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(d)by a previous owner or part-owner of the business, as consideration for the sale of goodwill or share thereof, does not itself make the receiver a partner with the persons carrying on the business.

- In **Ross v/s. Parkyns**, 'it is said that the mere participation in profit inter se affords cogent evidence of partnership. But it is now settled by the case of **Cox v/s.Hickman**, **Buller v/s. Sharp** that although a right to participate in profits is strong test of partnership, and there may be cases where upon a single presumption, not of law, but of fact, that there is a partnership, yet whether the relation of partnership does or does not exist must depend upon the whole contract between the parties and that circumstances is not conclusive'. The section also indicates the manner in which the general principle to be applied to particular circumstances. The question whether the relation of partnership does or does not exist, must depend upon the real intention and contract of the parties

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Kinds of Partnership:

A partnership between two people is when they run a business together with the intention of sharing the profits amongst themselves. However, there can be various types of partnerships according to their duration or the intent of their creation.

The distinction between partnerships can be done on the basis of 2 criteria. They are as follows:

1. With regard to the duration of the partnership – either ***partnership at will or partnership for fixed duration***.

2. With regards to the extent of the business carried by the partnership – either ***General partnership or Particular partnership***.

1.) **Partnership at Will:** When forming a partnership if there is no clause about the expiration of such partnership then it is partnership at will. According to section 7 of the Indian Partnership Act, 1932, there are two conditions to be fulfilled for a partnership to be a partnership at will. These are:

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(a) There is no agreement about a fixed period for the existence of a partnership.

(b) No provision with regards to the determination of a partnership.

So if there is an agreement between the partners about the duration or the determination of the firm, this will not be a partnership at will. But if a partnership was entered into a fixed term and continues to operate beyond this term it will become a partnership at will from the expiration of this term.

2.) **Partnership for a fixed term:** Now during the creation of partnership, the partners may agree on duration of this arrangement. This would mean the partnership was created for a fixed duration of time.

Hence, such a partnership will not be a partnership at will, it will be a partnership for a fixed term. After expiration of such duration, the partnership shall also end.

However, there may be cases when the partners continue their business even after the expiration of duration. They continue to share profits and there is an element of mutual agency. Then in such a case the partnership will now be a partnership at will.

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3.) **Particular partnership:** A Partnership can be formed for carrying on continuous business, or it can be formed for one particular venture or undertaking. If the partnership is formed only to carry out one business venture or to complete one undertaking such a partnership is known as particular partnership.

After the completion of said venture or activity, the partnership will be dissolved. However, the partners can come to an agreement to continue the said partnership. But in the absence of this, the partnership ends when the task is complete.

4.) **General Partnership:** When the purpose for the formation of the partnership is to carry out the business, in general, it is said to be a general partnership.

Unlike a particular partnership in a general partnership the scope of the business to be carried out is not defined. So all the partners will be liable for all the actions of the partnership.

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True Test of Partnership:

The Indian Partnership Act 1932 clearly defines a partnership. But how can we decide if a given association of persons is truly a partnership or not? So the Act has also given us a litmus test to determine if a firm is a partnership. This is known as the True Test of a Partnership.

The true test of a partnership is a way for us to determine whether a group or association of persons is a partnership firm or not. It also helps us recognize the partners of the firm and separate them from the third parties.

The idea behind such a true test is to examine the relevant facts and determine the real relations between parties and conclude about the presence of a partnership. Let us take a look at the three important aspects of a true test of a partnership, namely agreement, profit sharing and mutual agency.

1.) Agreement between the parties:

For there to be a partnership between two or more persons there has to be an agreement of partnership between them. The partnership cannot arise family

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status or any operation of law. There has to be a specific agreement between the partners.

So if family members of a HUF are running a business together this is not a partnership. Because there is no agreement of partnership between them. The members of HUF are born into the HUF, so they cannot be partners.

2.) <u>Profit Sharing</u>:

Sharing of profits is an aspect of the true test of a partnership. However, profit sharing is only a prima facie evidence of a partnership. The Act does not consider profit sharing as a conclusive evidence of a partnership. This is because there are cases of profit sharing that are still contradictory to a partnership. Let us see some such cases

(1) Sharing of profits/ gross receipts from a property that two or more persons own together or have joint interest in it is not a partnership.

(2) A share of profit given to an agent or servant does not make him a partner.

(3) If a share of the profit given to a widow or child of deceased partner does not make them partners.

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(4) Part of the profits shared with the previous owner as a part of goodwill or as a form of consideration will not make him partner.

Now ascertaining this motive becomes difficult if there is no express agreement between the concerned parties. In such a case we will consider the cumulative effect of all relevant facts. This will help us to determine the true relationship between the parties.

3.) **Mutual Agency**:

This is the truest test of a partnership, it is the cardinal principle of a partnership. So if a partner is both the principle as well as an agent of the firm we can say that mutual agency exists. This means that the actions of any partner/s will bind all the other partners as well.

So whenever there is confusion about the existence of a partnership between people we check for the presence of a mutual agency. If such an agency exists between the parties who run a business together and share profits it will be deemed that a partnership exists.

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Types of Partners:

A partnership is when two or more people work together and share the profits from the business or profession. However, one must not always assume that all the partners participate in the work or profits or even liabilities of the firm equally. In fact, there are various types of partners based on the extent of their liability, or their participation in the firm.

There are six types of partners that we come across on a regular basis. This list is not exhaustive; the Partnership Act does not restrict any unique kind of Partnership that the partners want to define for themselves.

1) **Active Partner/ Managing Partner**: An active partner is also known as Ostensible Partner. As the name suggests he takes active participation in the firm and running of the business. He carries on the daily business on behalf of all the partners. This means he acts as an agent of all the other partners on a day to day basis and with regards to all ordinary business of the firm.

Hence, when an active partner wishes to retire from the firm he must give a public notice about the same. This will absolve him of the acts done by other

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partners after his retirement. Unless he gives a public notice he will be liable for all acts even after his retirement.

2.) **Dormant/ Sleeping Partner**: This is a partner that does not participate in the daily functioning of the partnership firm, i.e. he does not take active part in the daily activities of the firm. He is however bound by the action of all the other partners.

He will continue to share the profits and losses of the firm and even bring in his share of capital like any other partner. If such a dormant partner retires he need not give a public notice of the same.

3.) **Nominal Partner**: This is a partner that does not have any real or significant interest in the partnership. So, in essence, he is only lending his name to the Partnership. He will not make any capital contributions to the firm, and so he will not have a share in the profits either. But the nominal partner will be liable to outsiders and third parties for acts done by any other partners.

4.) **Partner by Estoppel**: If a person holds out to another that he is a partner of the firm, either by his words, actions or conduct then such a partner cannot

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deny that he is not a partner. This basically means that even though such a person is not a partner he has represented himself as such, and so he becomes partner by estoppel or partner by holding out.

5.) **Partner in profits only**: This partner will only share the profits of the firm, he will not be liable for any liabilities. Even when dealing with third parties he will be liable for all acts of profit only, he will share none of the liabilities.

6.) **Minor Partner**: A minor cannot be a partner of a firm according to the contract act. However, a partner can be admitted to the benefits of a partnership if all the partners give their consent for the same. He will share profits of the firm but his liability for the losses will be limited to his share in the firm.

Such a minor partner on attaining majority has six months to decide if he wishes to become the partner of the firm. He must declare then his decision via a public notice. So whether he continues as a partner or decides to retire, in both cases he will have to issue a public notice.

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CHAPTER 4: CONSTRUCTION OF PARTNERSHIP AGREEMENT

The partnership is an agreement in which two or more persons have decided to carry out business and share the profit and losses equally. To create a legal relationship it is necessary to form a partnership agreement.

It is a settled canon of construction that a contract of partnership must be read as a whole and the intention of the parties must be gathered from the language used in the contract by adopting harmonious construction of all the clauses contained therein. The cardinal principle is to ascertain the intention of the parties to the contract through the words they have used which are key to open the mind of the makers. The guiding rule is to ascertain the ordinary sensible meaning to the language through which the parties have expressed themselves, unless the meaning leads to absurdity. A Partnership deed must be constructed reasonably.

The partnership agreement becomes the foundation or the basis on which it is based. It can be either written or oral. The written agreement is known as a partnership deed. Partnership deed mainly consists of the following details:

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- Name and address of its firm and business
- Name and address of its partner
- Capital contributed by each partner
- Profit and loss sharing ratio
- Rate of interest on capital, loan, drawings etc.
- Rights, duties and obligation of partners
- Settlement of accounts on the dissolution of the firm
- Salaries, commission payable to partners
- Rules to be followed in case of admission, retirement and death of a partner
- Mode of settlement on disputes among partner.
- Any other affecting the rights of the partners

The Supreme Court has, construing the provisions of section 4, observed that a partnership agreement is the source of a partnership and it also gives expression to the other ingredients defining the partnership, specifying the business agreed to be carried on, the persons who will actually carry on the business, the shares in which the profit will be divided and several other

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considerations which constitute such an organic relationship. A partnership agreement therefore identifies the firm and each partnership agreement may constitute a distinct and separate partnership. That is not to say that a firm is a corporate entity or enjoys a juristic personality in that sense. However, each partnership is a distinct relationship. The partners may be different and yet the nature of the business may be the same, the business may be different and yet the partners may be same. The intention may be to constitute two separate partnerships and therefore two distinct firms, or to extent merely a partnership, originally constituted to carry on one business, to the carrying on of another business. The intention of the partners will have to be decided with reference to the terms of the agreement and all the surrounding circumstances, including evidence as to the interlacing or interlocking of management, finance and other incidents of respective business.

Agreement of partnership need not be express, but can be inferred from the course of conduct of the parties to the agreement. The firm rule is that once the parties entering into the partnership are clearly described in the instrument, there is no scope of further inquiry to find out by some process or casuistry, if any of the parties has got obligation to others for the purpose

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of inducting those others to whom any of the parties may be accountable in law, into the arena of partnership and for treating them as partners under the law. If the parties to an agreement have not agreed on the date of commencement of the partnership, it cannot be said that they have become partners.

The Supreme Court, in **Tarsem Singh v/s. Sukhminder Singh**, has held that it is not necessary under the law that contract must be in writing. There can be an equally binding contract between the parties on the basis of the oral agreement, unless there is a law which requires the agreement to be in writing.

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CHAPTER 5: RELATION OF PARTNERS WITH ONE ANOTHER

All partners are free to form their own terms and conditions with respect to functioning in their partnership deed. The Indian Partnership Act, 1932 has also prescribed provisions to govern their relationship *inter se* (amongst them), and these provisions are applicable if no such deed exists.

Right to Determine Relationship by Contract

As per section 11 of the Partnership Act, Partners can determine their mutual rights and duties by a contract called partnership deed, which determines aspects of general administration, such as which partner will do what work, what will be their share in profits, etc. It may be varied by express or implied consent of all the partners.

Such deed can be expressly made or implied by a course of dealing. For example, if one partner checks accounts of the firm daily and others do not object, his conduct will be presumed to be a right of all partners in the absence of a written partnership deed between them. So they can themselves determine the rights of partners.

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Agreement in Restraint of Trade is valid:

Section 27 of the Indian Contracts Act, 1872 declares contracts in restraint of trade as void. All agreements restraining exercise of a lawful profession, trade or business are invalid.

Section 11 of Partnership Act, however, states that partners can validly levy such a restraint on each other, but such restraint must be provided for under the partnership deed. Partners can use this agreement to prohibit each other from carrying on any business other than that of the firm.

Rights of partners:

Partners can exercise the following rights under the Act unless the partnership deed states otherwise:

(1) **Right to participate in business:** Each partner as per section 12(a) of the Partnership Act has an equal right to take part in the conduct of their business. Partners can curtail this right to allow only some of them to contribute to the functioning of the business if the partnership deed states so.

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(2) **Right to express opinions:** Another one of the rights of partners as per section 12(c) of the Partnership Act is their right to freely express their opinion. Partners, by a majority, can determine differences with respect to ordinary matters connected with the business. Each partner can express his opinion to decide such matters.

(3) **Right to access books and accounts:** Each partner as per section 12(d) of the Partnership Act can inspect and copy books of accounts of the business. This right is applicable equally to active and dormant partners. In case of death of a partner, his legal heir can inspect the copies of accounts.

(4) **Right to share profits:** Partners generally describe in their deed the proportion in which they will share profits of the firm. However, they have to share all the profits of the firm equally if they have not agreed on a fixed profit sharing ratio.

(5) **Right to be indemnified:** Partners can make some payments and incur liabilities through their decisions in the course of their business. They can claim indemnity from each other for these decisions. Such decisions must be

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taken in situations of emergency and should be of such nature that an ordinarily prudent person would resort to under similar conditions.

(6) **Right to interest on capital and advances:** Partners generally do not get an interest on the capital they contribute. In case they decide to take an interest, such payment must be made only out of profits. They can, however, receive interest of 6% p.a. for other advances made subsequently towards the business.

Duties of Partners:

(1) **General duties:** Every partner as per section 9 of the Partnership Act has the following general duties like carrying on the business to the greatest common good, duty to be just and faithful towards each other, rendering true accounts, and providing full information of all things affecting the firm. etc.

(2) **Duty to indemnify for fraud:** Every partner as per section 10 of the Partnership Act has to indemnify the firm for losses caused to it by his fraud in the conduct of business. The Act has adopted this principle because the

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firm is liable for wrongful acts of partners. Any partner who commits fraud must indemnify other partners for his actions.

(3) **Duty to act diligently:** Every partner as per section 12(b) of the Partnership Act must attend to his duties towards the firm as diligently as possible because his not functioning diligently affects other partners as well. He is liable to indemnify others if his willful neglect causes losses to the firm.

(4) **Duty to use the firm's property properly:** As per section 15 of the Partnership Act, Partners can use the firm's property exclusively for its business, and not for any personal purpose, because they all own it collectively. Hence, they must be careful while using these properties.

(5) **Duty to not earn personal profits or to compete:** Each partner as per section 16 of the Partnership Act must function according to commonly shared goals. They should not make any personal profit and must not engage in any competing business venture. They should hand over personal profits made to their firm

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Mutual Rights and Liabilities:

Section 13 of the Partnership Act states that subject to contract between the partners;

(1) A partner is not entitled to receive remuneration for taking part in the conduct of the business.

(2) The partners are entitled to share equally in the profits earned and shall contribute equally to losses sustained by the firm.

(3) Where a partner is entitled to interest on the capital subscribed by him such interest shall be payable only out of profits.

(4) A partner making, for the purpose of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six percent per annum.

(5) The firm shall indemnify a partner in respect of payments made and liabilities incurred by him-

(i) in the ordinary and proper conduct of business

(ii) 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

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(6) a partner shall indemnify the firm for any loss caused to it by his wilful neglect in the conduct of business of the firm.

In **Mansha Ram v/s Tej Bhan**, the Punjab-Haryana High Court has made it very clear that all the partners are entitled and liable for equal share in loss and profit in absence of any agreement.

When do Rights and Duties of a Partner change?

As per section 17 of the Partnership Act, the existing relationship between the partners comes to an end when there is a change in the constitution of the firms. Such change in the constitution of the firm may occur due to the following reasons:

(1) Expiration of term of the firm.

(2) Carrying out the additional business other than agreed upon.

(3) Changes in the composition of members due to admission, retirement or the death of a partner.

The duties and rights of partners remain the same until there is any change in agreement but such right and duties may vary or modified by creating a fresh agreement.

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Property of the Firm and its Application:

Section 14 and 15 of the Partnership Act lay down a few simple rules relating to the application of the property of a firm. First of all, the property of the firm includes all property and rights and interests in the property originally brought into the stock of the firm, or acquired by purchase or otherwise, by or for the firm or for the purposes and in the course of the business of the firm and includes the goodwill of the business. Unless the contrary intention appears, properties acquired with money belonging to the firm are deemed to have been acquired for the firm.

It may be noted that just because property belonging to one partner is used for the purpose of the firm's business, it does not become the property of the firm. But if there is anything to show the intention of the partners to make it so, then it will become the firm's property. In **Robinson v/s. Ashton** it is stated that where the owner of a mill agreed to carry on the manufacture in partnership with others, and the owner partner was credited in the firm's account with the value of the mill as his capital, it was held that the mill had become the firm's property and any additions to the mill would also be partnership property.

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Likewise, in **Nerot v/s. Burnard** if land is bought in the name of one partner and paid for by the firm out of the profits of the partnership business, the land will be considered to be partnership property. Similarly, if one partner buys shares of a railway company in his own name, without the authority of the other partners but with the firm's money and on account of the firm, such shares would be partnership property.

As stated above, the property of the firm includes its goodwill. The term goodwill is not defined by the Act and may be said to be "the whole advantage, whatever it may be of the reputation and connection of the firm". It is something more than the mere chance or probability of old customers maintaining their connection with the firm. Section 15 declares the rule that, subject to a contract between the partners, the property of the firm is to be held and used by the partners exclusively for the business of the firm.

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CHAPTER 6: RELATIONS OF PARTNERS TO THIRD PARTIES

Authority of Partners:

The principle as to authority of a partner is declared in section 18 of Indian Partnership Act which lays down that a partner is the agent of the firm for the purpose of the business of the firm. This is one of the most important test of partnership. Agency is the essence of the relationship of partnership. A partner is both a principal and agent. While the relation between partners inter se is that of principals, they are agents of the firm and also of one another in relation to third parties for the purposes of the business of the firm.

Thus, each partner is regarded as an agent of the other partners and as such a partner acting in the course of the business of the firm can bind his co-partners. But in order to bind his co-partners, it is necessary for the partner acting on the behalf of the firm to contract in the firm name or in any other manner expressing or implying an intention to bind his co-partners. A partner contracting in his own name incurs only a personal liability and not the collective liability of the firm.

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<u>Implied authority of Partners</u>:

Section 19 of the Indian Partnership Act lays down that, subject to the provisions of section 22 which deals with the mode of doing an act to bind the firm, the act of the partner which is done to carry on, in the usual way, a business of the kind carried on by the firm, binds the firm. The authority of a partner to bind the firm is called his "implied authority". This implied authority is often referred to as his ordinary or apparent or ostensible authority.

In order to bind the firm, for an act of a partner done within the scope of his implied authority, three conditions must exist:

(1) The act must be done in the conduct of the business of the kind carried on by the firm.

(2) The act must be done in the way which is usual in such business.

(3) Finally, the act must be done in the firm name or in any other manner expressing or implying an intention to bind the firm.

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The question whether the given act can or cannot be said to be done in carrying on a business in the way in which it is usually carried on must evidently be determined by the nature of the business and by the practice of the persons engaged in it.

An interesting question that arises is that in this connection whether a firm would be liable for the act of its partner, which though within his authority, has in fact been done in fraud upon his other partners. Now it is a well-established rule of law that a principal is answerable for the acts of his agent, including the agent's fraudulent acts, provided that they fall within the scope of his authority. The same principal applies to partners and for the same reason, a firm cannot escape liability showing that a partner's act was actually a fraud on the firm. However, this rule does not apply to a case where there is collusion between such a partner and the third party. The rule presumes that the third party is acting bona fide and has no knowledge of the fraud.

Acts that fall outside the implied authority of a partner:

Section 19(2) enumerates 8 acts of a partner which will not bind the firm. These are the acts which don't bind the firm.

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Thus, in the absence of any usage or custom of the trade to the contrary, the implied authority of a partner does not empower him to –

1. Submit a dispute relating to the business of the firm to arbitration.
2. Open a bank account on behalf of firm in his name.
3. Compromise or relinquish any claim or portion of a claim by the firm.
4. Withdraw a suit or proceeding filed on behalf of the firm.
5. Admit any liability in a suit or proceeding against the firm
6. Acquire immoveable property on behalf of the firm.
7. Transfer immoveable property belonging to the firm.
8. Enter into a partnership on behalf of the firm.

It has been held that though, in the absence of specific agreement, usage or custom, a partner has no authority to refer a dispute to arbitration, nevertheless an award in such arbitration will be binding on such partner, though it may not bind the other partners of the firm.

It was held that in order to avail credit facilities, a partner opened a bank account in the name of the firm, forging the signatures of the other two

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partners and so there was a restriction on the implied authority of a partner as regards opening a bank account in the name of the concerned partners. In the **Bank of Baroda v/s. Himalaya Brush Industries** case, as the account was opened in the name of the firm, all the partners were liable.

It may also be noted that the above enumerated acts which fall outside the scope of a partner's implied authority is not exhaustive, but merely illustrative. To these may be added the following four, to be found in the case law on this point:

(a) A partner has no implied authority to bind the firm by giving a guarantee in respect of debts of third parties.

(b) A Partner has no implied authority to set off his own personal debts against debts due to the firm.

(c) A partner has no implied authority to set off a decree obtained by the firm for less than the decretal amount.

(d) A partner has no implied authority to accept fully paid-up shares in a company in satisfaction of a debt due to the firm.

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Extension and restriction of a partner's implied authority:

Section 20 of the Indian Partnership Act states that the partner in a firm, by contract between the parties, may extend or restrict the implied authority of any partner. However, in spite of any such restriction, any act done by a partner on behalf of the firm which falls within his implied authority, binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.

Partner's authority in an emergency:

Under section 21 of Indian Partnership Act, a partner has authority, in an emergency to do all such acts for purpose of protecting the firm from loss as would be done by a person of ordinary prudence in his own case, acting under similar circumstances and such act binds the firm.

A similar authority to act in an emergency is given to an agent under sect. 189 of the Indian Contract Act. It is submitted that even in the absence of Section 21, a partner would be able to claim the protection of said section 189, in view of the fact that the Act expressly declares a partner to be an agent of the firm.

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A question sometimes arises as to whether a power to do what is usual includes a power to do what is unusual, however, urgent it may be. It has been held in an old English case, **Hawtayne v/s. Bourne** that an agent who has no authority to borrow money, cannot do so even in an emergency to enable the business to be carried on.

Mode of doing an act to bind the firm:

Section 22 of the Indian Partnership Act lays down the mode of doing an act by which a firm can be bound. It provides that in order to bind a firm, an act or instrument done or executed by a partner (or other person on behalf of the firm) should be done or executed in the firm name or any other manner expressing or implying an intention to bind the firm.

In **Punjab Bank v/s. Muhammad,** where one of the two partners in the Punjab Alliance Auction Rooms, executed a pronate in favour of the plaintiff. The note was signed by one of the partners describing himself as the proprietor of Punjab Alliance Auction Rooms. It was held that mere description as a

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proprietor of the firm was not sufficient to justify the firm being held liable on the note.

Effect of admission by partner:

An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in ordinary course of business. The rule contained in section 23 of the Indian Partnership Act is based on corresponding provision of section 15 of the English Partnership Act.

If a partner makes an admission regarding the partnership affairs, and such an admission is made in the ordinary course of business, it will be evidence against the firm. But the rule will not apply where such a representation refers to the extent of the Partner's authority to bind the firm. It may also be noted that such an admission, though relevant is not conclusive against the firm unless it operates by way of an estoppel.

Effect of notice to acting partner:

Under section 24 of the Indian Partnership Act, notice to a partner who habitually acts in the business of the firm of any matter relating to the affairs of

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the firm operates as notice to the firm, except in the case of fraud on the firm committed by or with consent of that partner. This rule is based on the Principle of agency that notice to an agent is equivalent to a notice to the principal. Since partnership is a form of agency, this rule applies to partnership firm also.

As observed by the Supreme Court in **Ashutosh v/s. State Of Rajasthan** with reference to a partnership, notice to a principal is notice to all his agents and notice to an agent in matters connected with his agency is notice to his principal.

A question arose in English case **Williamson v/s. Barbour**, as to whether a notice given to a partner before he became a partner would operate as a notice to the firm. The court held that such knowledge of a partner would not operate as a notice to the firm.

An exception is made by section 24 in case of fraud. When a partner is committing a fraud on his other partners, notice to him will not be notice to the firm. In **Bignold v/s. Waterhouse**, a partner of a firm of a carrier, acting in fraud of his co-partners agreed to transport valuable parcels free of charge. The

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other partners were held not liable for the loss of the parcels. The fact that some clerk in the firm was aware of fraud was held not to affect the innocent partners. Likewise, if a partner who is also trustee of a trust employs trust funds in the partnership business, his guilty knowledge cannot be imputed to the firm.

Liability of the firm for Partner's act:

Section 26 and 27 of the Indian Partnership Act deals with the liability of a firm for its partner's acts, including his torts, misappropriation etc. where by the wrongful act or omission of a partner acting in the ordinary course of business of a firm, or with the authority of his partners, loss or injury is caused to any third party or any penalty is incurred, the firm is liable therefore for the same extent as that of partner.

The word 'injury' in section 26 of the Indian Partnership Act implies a tort. The liability of a firm for the torts of a partner rests on precisely the same principles as the liability of a master for the torts of his servant in as much as both are merely branches of the law as principal and agent. Both under English and Indian law of Torts, partners are liable jointly and severally for wrongful

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acts committed by a partner acting in the ordinary course of the Partnership business. The principle underlying this is that the other members hold him out to the world as a person for whom they are responsible.

Thus, in **Hamlyn v/s. Houston & Co**. , one of the two partners, without the knowledge of the co-partner, bribed the clerk of the Plaintiff, a competitor in trade and induced him in breach of his duty to his employer to divulge confidential information in regard to the plaintiff's business. It was in the ordinary course of the business of the firm to obtain such information by legitimate methods, and the partner acted in the interest of the firm. Both partners were held liable to the firm. But a wrongful act or default of a partner, when not acting in the ordinary course of the business of the firm, does not render other partners responsible for the same.

Section 27 of the Indian Partnership Act proceeds to deal with the liability of the firm for misapplication by a partner of money or property of a third person received for or lying in the custody of the firm.

This section lays down that where,

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(a) a partner, acting within his apparent authority, receives money or property from a third party and misapplies it

(b) a firm, in the course of its business, receives money or property from third party and the money or property is misapplied by any of the partners while it is in the custody of the firm then the firm is liable to make good the loss.

Liability by Holding Out:

Section 28 of the Indian Partnership Act deals with what is known as liability by "holding out". If one turns to section 235 of the contract Act, which deals with the liability of a 'pretended agent', it will be seen that it is very much similar to the present section 28. The principle underlying both is exactly the same.

Anyone who by words or by conduct, represents himself or knowingly permits himself to be represented as a partner in a firm, is liable as a partner in that firm, to anyone who has, on the faith of any such representation, given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.

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However, when after a partner's death, the business is continued in the old firm name, the continued use of that name does not of itself, make his legal representative or his estate liable for any act of the firm done after his death.

Where a person represents himself or knowingly permits himself to be represented as a partner in a firm, he becomes liable as a partner in that firm, to anyone who on the faith of any such representation has given credit to the firm. The person so representing himself, or permitting himself to be so represented is known as partner by holding out or partner by estoppel. Even want of knowledge on his part of the effects of his acts and conduct would not absolve him from liability.

In other words, where a man holds himself out as a partner, or allows other to do it, he is then estopped from denying the character he has assumed, upon the faith of which creditors may be presumed to have acted. A man so acting may be rightly held liable as a partner by estoppel. In other words the doctrine of "holding out" is a part of the principle of estoppel, which lays down that where one person, by words or conduct induces another to believe him and act upon the existence of a particular state of facts, he cannot afterwards as regards that person deny the existence of such facts.

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Of course this does not mean that such a person actually becomes a partner of that firm or that he has any rights against the other partners for a share of the profits or any other thing. The legal effect of section 28 is that such a person becomes liable to third party as if he was partner in that firm.

In order to stop a person from denying that he is a partner on the doctrine of "holding out", the following 2 important element must co-exist:

1. A person must represent himself to be a partner in a firm or knowing permit himself to be represented

2. Another person must have given credit to the firm on the faith of such representation.

The following seven additional points may also be noted in connection with the doctrine of holding out:

i) the representation may be expressed or implied. It need not necessarily by words, spoken or written. It need not be made by the person himself but may be made by others.

ii) there will be no representation by conduct if the acts relied upon are ambiguous

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iii) A general representation to the world at large is not sufficient, unless the person who gives credit can satisfy the court that he was aware of and acted upon it to his prejudice.

iv) To establish liability, it is not essential to show that the party making the representation has acted fraudulently or negligently. Even want of knowledge on his part, of the effects of his acts and conducts would not absolve him from liability, if his acts and conducts were such as would induce a reasonable man to believe that he was a partner and to act upon such belief.

v) A former owner does not become a partner by estoppel merely because the firm has continued to use its old name of which his own name forms a component part. The rule of estoppel is binding on a former partner who has retired without giving proper notice of his retirement.

vi) There is no liability in tort on the ground of holding out because the injured person cannot claim that he was led to suffer the injury be his belief in any representation.

vii) There can be no holding out to a person who is aware of the actual facts.

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Effects of "Holding Out": If a person holds himself out to be a partner of a firm, he becomes personally liable. He does not thereby become a partner in the firm and he is also not entitled to any rights as against those who are in fact partners in the firm. By holding out to be partner, he does not become an agent of the firm. He merely makes himself personally liable for the credit given to the firm on the faith of his representation.

Rights of a Transferee of a Partner's Interest:

Can a partner transfer his interest in the partnership to a stranger? The wording of section 29 of the Indian Partnership Act clearly suggests that he can. A transfer by a partner of his interest in the firm may be either absolute or by mortgage or by creation by him of charge on such interest. However, the fundamental principle underlying the law of partnership is that a stranger cannot be foisted upon the remaining partners against their will. Consequently even when a partner transfers his interest in firm, the transferor does not cease to be a partner nor the transferee become one. Section 29 of the Act deals with such transferee's rights, both during continuance of partnership and after its dissolution.

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Transferee's rights during continuance of Partnership:

A transfer by a partner of his interest in the firm does not entitle the transferee, during the continuance of the firm, to interfere

in the conduct of the business, or to require accounts, or to inspect the books of firm but entitle the transferee only to receive the share of profits of the transferring partner, and the transferee has to accept the accounts of profits agreed to by the partners.

Transferee's rights after discontinuance of Partnership:

If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled as against the remaining partners, to receive the share of the assets of the firm to which the transferring partner is entitled and for the purpose of ascertaining that share, to an account as from the date of the dissolution.

In other words, if the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled to receive the transferring partner's share of

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the assets of the firm and for this purpose is also entitled to an account as from the date of dissolution.

Laws relating to Minor admitted to the benefits of partnership:

In the Contract Act, minors cannot be a party to a contract. A contract involving a minor is void-ab-initio. However, the Partnership Act has its own sets of legal rules regarding minors.

Section 30 of the Indian Partnership Act 1932 contains legal provisions about a minor in a partnership. Now we know the Indian Contract Act 1857 clearly states that no person less than the age of 18, i.e. a minor can be a party to a contract. And a partnership is a contract between the partners. Hence a minor cannot be a partner in a partnership firm. However, according to the Partnership Act, a minor may be admitted to the benefits of a partnership. So while the minor will not be a partner he will enjoy all the benefits of a partnership. To admit all the minor to the benefits of the partnership all of the partners of the firm must be in agreement.

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In India, a minor is not competent to contract at all and therefore cannot be a partner of the firm which is stated in **Sanyasi Charan Mandal v/s. Krishnadhan Banerji**. Needless to say, there cannot be a partnership wholly of minors which was ruled in **Shivaram v/s. Gaurishankar**. The Punjab High Court has laid down that if minor is made a full-fledged partner, the entire partnership deed is invalid and not only vis-à-vis the minor but also with respect to the other partners who are not minors.

The Allahabad High Court has held that if a partnership consists of two partners and one of them dies, and the other admits a minor to the benefit of the business, the minor cannot enforce his rights under section 30. That section does not apply in such a case, because there was no subsisting partnership to the benefit of which minor could be said to be admitted.

The act does not lay down as to which are the acts which would amount to admitting a minor to the benefits of a partnership. No doubt, there must be some definite act on the part of the partners, such as the allotment of a share or a distribution of a part of the profits or any other similar act. Such a minor has no right to a share of the property and of the profits of the firm as may be

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agreed upon, and he may have access to and inspect and copy any of the accounts of the firm.

Section 30 also lays down that where any person has been admitted as a minor to the benefits of partnership in a firm, the burden of providing the fact that such person had no knowledge of such admission until a particular date after the expiry of six months of his attaining majority lies on the person asserting that fact.

<u>Rights of a Minor</u>:

Once the minor is given benefits in a partnership there are certain rights that he enjoys.

1.) A minor partner will obviously have the right to his share of the profits of the firm. But the minor partner is not liable for any losses beyond his interests in the firm. So a minor partner's personal assets cannot be liquidated to pay the firms liabilities.

2.) He can also like any other partner inspect the books of accounts of the firm. He can demand a copy of the books as well.

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3.) If necessary he can sue any or all of the other partners for his share of the profits or benefits.

4.) A minor partner on attaining majority has the right to become a partner of the firm. He has six months from attaining majority to decide if he will execute this right. Whether he decides to become a partner or not he must give public notice about the same.

5.) On attaining majority, he also has the option of severing his connection with the firm, in which case his share is not liable for any act of the firm done after the date of public notice that he has elected not to become a partner. He is also entitled to sue the partners for his share of the property and profits.

6.) Lastly, he is not personally liable for any acts of the firm during his minority, he cannot be adjudged insolvent if the debts of the firm cannot be satisfied out of the property of the firm.

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Liabilities of a Minor:

1.) A minor cannot be held personally liable for the losses of the firm. And if the firm declares insolvency the minor's share is kept with the Official Receiver

2.) After turning 18 the minor partner can choose to become a partner of the firm. But he may choose to not become a partner. In this case, the minor partner has to give a public notice about this decision. And the notice has to be given within 6 months of gaining a majority. If such a notice is not given even after 6 months then the minor partner will become liable for all acts done by the other partners till the date of such notice.

3.) Should the minor partner choose to become a partner he will be liable to all the third parties for the acts done by any and all partners since he was admitted to the benefits of the partnership.

4.) If he becomes a full-time partner he will be treated as a normal partner and have all the liabilities of one. His share in the profits and property of the firm will remain the same as it was when he was a minor partner.

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Minor's disabilities:

Such a minor cannot sue the partner for an account or payment of his share of the property or profits of the firm, except when severing his connection with the firm, and in such case the amount of his share is to be determined by a valuation made as far as possible in accordance with the rules contained in section 48. All the partners acting together, or any partner entitled to dissolve the firm upon notice to the other partners, may elect in such a suit to dissolve the firm and there upon the court will proceed with the suit as one of dissolution and of settling accounts between the partners, and the amount of the share of the minor is determined along with the shares of the partners.

Effect of election by minor:

So long as the minor remains a minor, he is governed by the aforesaid rule. But what is his position as and when he attains majority.

Section 30 provides that at any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of Partnership, such a person may give public notice that he has

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elected to become or that he has elected not to become, a partner in the firm and such notice determines his position as regards the firm. If he fails to give such notice, he becomes a partner in the firm on the expiry of the said period of six months:

(a) his rights and liabilities continue to be those of minor under this section up to the date on which he gives public notice.

(b) his share is not liable for any acts of the firm done after the date of the notice.

(c) he is entitled to sue the partner for his share of the property and profits.

The rules of English law regarding a minor's position in a partnership differ from those of Indian law in the following two respects:

1.) Under the English law, a minor's contract is not void, but voidable, so that there is nothing to preclude him from entering into a contract of partnership. Though while he is a minor, he incurs no liability and is not responsible for the debts of the firm, when he comes of age, or even before, he may disaffirm past transactions.

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2.) If such a minor, on coming of age, neither affirms nor disaffirms the partnership, in an English law, he is held liable only for debts incurred by the firm since his majority and is not conclusively held to ratify obligations contracted during his minority.

As already observed in India, the minor would be liable for all the obligations incurred by the firm since he was admitted to the benefits of partnership, whereas in England, he would be liable only for debts by the firm since his majority.

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CHAPTER 7: INCOMING AND OUTGOING PARTNERS

Introduction of a new partner:

Section 31 of the Indian Partnership Act provides that no person can be introduced as a partner into a firm without the consent of all the existing partners. Moreover a person who is introduced as a partner into the firm does not thereby become liable for any act of the firm done before he became a partner.

It may be noted that there is nothing to prevent an incoming partner agreeing with his co-partners to make himself liable for the debts incurred by the firm prior to his admission therein. But even when he has so agreed, the agreement does not confer any right on creditors of the old firm to impose the old debts on new partner. They can acquire such right only by entering into an agreement between themselves and the new partner either expressly or by implication.

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Rights and Liabilities of a new partner:

Subject to a contract between the partners and to the right of a minor under section 33 of the Act, the consent of all existing partners is necessary for the introduction of a new partner.

Further, a new partner cannot be held responsible for the acts of the old partners, for at the time when the acts were done, they were not authorised to act as his agent. Nor can he be held liable on the ground that he has ratified those acts, for ratification is impossible, since the acts were not done on his behalf. He is liable however for new liabilities arising out of a continuing contract made by the firm before he joined it.

The only way in which a new partner can be made liable to the creditors of the firm in respect of past debts is by proving-

(1) that the re-constituted firm has assumed the liability to pay the debt

(2) that the creditor concerned has agreed to accept the reconstituted firm as his debtor and discharge the old firm from his liability.

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Where a minor admitted to the benefits of partnership elects, on attaining majority, to become a partner, he becomes personally liable for all the acts done since the date of his admission.

Retirement of a Partner:

Section 32 lays down three ways in which a partner can retire. It says that a partner may retire:-

(1) with the consent of all the other partners

(2) in accordance with an express agreement between the partners

(3) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by an agreement made by him with such third party and the partners of the re-constituted firm and such agreement may be implied by a course of dealing between such third party and the re-constituted firm after he had knowledge of the retirement.

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Moreover, notwithstanding the retirement of a partner from a firm, such a person and the remaining partners continue to be liable as partners to third parties for any act done by any of them which would have been act of the firm if done before the retirement until public notice is given of the retirement. Such notice may be given by the retiring partner or by any partner of the reconstituted firm.

However a retired partner is not liable to any third party who deals with the firm without knowing that he was a partner.

Under English Law, the right of a partner to retire is quite restricted. In the words of Lindley, "there is only one method by which a partner can retire without the consent of the co-partners and that is by dissolving the firm".

Modes of giving Public Notice:

Section 72 of the Indian Partnership Act lays down the rules relating to giving of public notice as follows:

(a) If such notice relates to-

(i) the retirement of partner of registered firm

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(ii) the expulsion of a partner of registered firm

(iii) the election by a person who was admitted to the benefits of a registered firm and who has now attained majority.

Then the notice must given to the Registrar of Firms and must be published in the local official gazette and in at least one vernacular newspaper circulating in that district.

(b) If such notice is to be given in any other case, then the notice must be published in the local official gazette and in at least one vernacular newspaper circulating in that district.

It may be noted that publication in a vernacular newspaper should be in the district where the firm has its place of business and in case there is more than one, the principal place of business.

In common parlance, a dormant or sleeping partner is one who has only contributed to the capital of the firm but who does not take an active part in the conduct of the business and who may be and often is prohibited from taking such active part. By remaining a partner, he is always liable for the debts of the partnership whether third parties know of his being a partner or not.

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Even if a dormant partner retires without public notice, he is not liable to any third party who subsequently deals with the firm without knowing that he was a partner. Similarly a party dealing with the firm after dissolution of the old partnership had no knowledge whatever of the dormant partner's previous connection with the partnership, he cannot get any relief against the dormant partner.

Rights and Liabilities of an Outgoing Partner:

A partner who leaves the partnership firm in which the remaining partners continue the business is an outgoing partner. Such a partner has certain liabilities and rights as prescribed by the Partnership Law. In this article, we will focus on the rights of an outgoing partner.

Rights of an outgoing partner to carry on a competing business:

Section 36 (1) of the Indian Partnership Act, 1932 (Partnership law), imposes certain restrictions but allows an outgoing partner to carry on a business and advertise it, which competes with the partnership firm. However, it restricts him from:

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- Using the name of the partnership firm
- Representing himself as a partner of the firm
- Soliciting the custom of persons who were dealing with the firm before he ceased to be a partner.

Section 36 (2) talks about an agreement in restraint of trade. According to this subsection, an outgoing partner may make an agreement with his partners that when he ceases to be a partner of the firm, he will not carry on any business similar to that of the firm within a specified period or local limits. This is notwithstanding anything contained in Section 27 of the Indian Contract Act, 1872.

Right of an Outgoing Partner to share subsequent profits:

According to Section 37, of the Partnership Law, if a member of the firm dies or otherwise ceases to be a partner of the firm, and the remaining partners carry on the business without any final settlement of accounts between them and the outgoing partner, then the outgoing partner or his estate is entitled to share of the profits made by the firm since he ceased to be a partner.

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The share may be attributable to the use of his share of the property of the firm or the interest at six per cent per annum on the amount of his share in the property.

The surviving partners also have an option of purchasing the interest of the deceased or outgoing partner. If the surviving partners choose to purchase the interest, then the outgoing partner is not entitled to any further share in profits of the firm.

As seen earlier, a partner make an agreement with his partners, that on ceasing to be partner, he will not carry on any business similar to that of the firm within a specified period or within specified local limits and not withstanding anything contained in section 27 of the Indian Contract Act 1872 such an agreement is valid if the restrictions imposed are reasonable.

When the continuing partners carry on the business of the firm with the property of the firm without any final settlements of accounts as between them and the outgoing partners, then in absence of the contract to the contrary the outgoing partner is entitled to claim his share in the profits of the firm or at his

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option, interest at 6% per annum on the amount of his share in the property of the firm.

Liabilities:

A retired partner continues to be liable to the third party for acts of the firm till such time that he or other members of the firm give a public notice of his retirement. However, if the third party deals with the firm without knowing that he was a partner in the firm, then he will not be liable to the third party.

The retired partner, however, continues to be liable for acts of the firm done before such retirement of a partner. This liability holds good unless there is an agreement between him, the concerned third party, and partners of the reconstituted firm. Such an agreement can also be implied by the course of dealings between the third party and the reconstituted firm post announcement of the retirement of a partner.

If the partnership is at will, then it can relieve a partner without giving a public notice. To do so, the partnership needs to give a written notice to all the partners of his intention to retire.

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Expulsion of a Partner:

Section 33 deals with expulsion of a partner. It lays down that a partner cannot be expelled from a firm by any majority of the partners, save in exercise, in good faith of powers conferred by contract between the partners.

All the provisions which apply to a retired partner also apply to an expelled partner. A power to expel a partner can only be conferred by an express agreement between the partners. Even where such a power is conferred by the terms of the partnership agreement, it can only be exercised by a majority of the partners, and it must be exercised in utmost good faith. Reasonable warning and opportunity of explanation must be given to the partner sought to be expelled.

It is stated in **Wood v/s. Wood** that an irregular expulsion, being wholly inoperative, the person against whom it is directed does not cease to be a partner. He may claim reinstatement in his rights as a partner, but he cannot recover damages for wrongful expulsion.

In **Const v/s. Harris**, where a partnership deed conferred a power of expulsion clause, it will not be deemed to have been exercised in good faith, unless it is

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exercised honestly in the best interest of the firm and after giving that partner an opportunity to be heard.

In **Green V/s. Howell,** a partnership deed conferred a power of expulsion on the ground of misconduct. One of the partners issued letters to the Bank to stop payment of all cheques of the firm, unless such cheques were signed by him, thereby dislocating the entire business of the firm. The court held that his expulsion would be justified on the ground of this misconduct and could not be said to be warning in good faith.

As stated above section 33 provides that all the rules which govern the liability of a retired partner to third parties will apply in the case of an expelled partner. It places an expelled partner on precisely the same footing as a retired partner, as regards his liabilities for existing and future debts of the firm. Section 33 regards expulsion in the same way as section 32 regards retirement, that is, it makes the assumption that the firm continues after expulsion without dissolution of partnership as between the remaining partners.

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Insolvency of a Partner:

Section 34 of the Indian Partnership Act lays down law as to the effect of insolvency of a partner. It provides that where a partner in a firm is adjudicated an insolvent, he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is thereby dissolved.

When under a contract between the partners, the firm is not dissolved by the adjudication of a partner as an insolvent, the estate of a partner so adjudicated is not liable for any act of the firm, and the firm is not liable for any act of the firm, and the firm is not liable for any act of the insolvent done after the date on which the order of adjudication is made.

The insolvency of a partner does not invariably result in dissolution of the firm for it is open to the partners to agree that the adjudication of a partner as insolvent will not dissolve the firm as regards the continuing partners. Section 34, 41(a), 42(d) and 47 may conveniently be read together when dealing with the effect of insolvency of one or more partners in a firm.

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Effects of insolvency of a partner:

The effects of the insolvency of a partner may be summed up as follows:

(i) the partner adjudicated an insolvent ceases to be a partner on the date on which the order of adjudication is made.

(ii) the firm is dissolved on the date of the order of adjudication, unless there is a contract to the contrary.

(iii) if all the partners, or all the partners but one, are adjudicated insolvent, the firm is automatically dissolved.

(iv) the estate of the insolvent is not liable for any act of the firm after the date of the order of adjudication. Adjudication as an insolvent is a notorious event, and no further notice thereof is required to old or new customers of the firm.

(v) after the dissolution of the firm, the firm is not bound by the acts of a partner who has been adjudicated insolvent. However this would not affect the liability of any person who has, after such adjudication, represented himself or knowingly permitted himself to be represented as a partner of the insolvent.

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Deceased Partners:

Subject to a contract between the partners, a firm is dissolved by the death of a partner. Where a firm is thus dissolved, though the surviving partners continue to be liable for acts done on behalf of the firm until public notice of dissolution is given, the estate of the deceased partner is not subject to any such liability.

Section 35 deals with the liability of the estate of a deceased partner. It provides that where under a contract between the partners, the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death.

An exception is a partnership consisting of only two partners. In such cases the death of a partner results in the dissolution of the Partnership.

Revocation of continuing guarantee by change in firm:

A continuing guarantee given to a firm, or to a third party in respect of the transaction of a firm, is in the absence of agreement to the contrary, revoked as to further transactions, from the date of any change in the constitution of the firm is given under section 38 of the Indian Partnership Act.

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CHAPTER 8: DISSOLUTION OF FIRMS

The dissolution of a firm means discontinuance of its activities. When the working of a firm is stopped and the assets are realised to pay various liabilities it amounts to dissolution of the firm. The dissolution of a firm should not be confused with the dissolution of partnership. When a partner agrees to continue the firm under the same name, even after the retirement or death of a partner, it amounts to dissolution of partnership and not of firm.

The remaining partners may purchase the share of the outgoing or deceased partner and continue the business under the same name; it involves only the dissolution of partnership. The dissolution of firm includes the dissolution of partnership too. The partners have a contractual relationship among themselves. When this relationship is terminated it is an end of the firm.

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Difference between Dissolution of a firm and Dissolution of Partnership:

Parameters	**Dissolution of a Firm**	**Dissolution of a Partnership**
Continuation of Business	The Business discontinues	The Business continues. However, the Partnership is reconstituted.
Winding Up	The firm is wound up. Assets are realized and liabilities are settled	Assets and Liabilities of the firm are only revalued.
Court Order	A court order can dissolve a firm	A court order cannot dissolve a partnership
Scope	It involves the dissolution of partnership between all the partners	It does not involve the dissolution of the firm
Final Closure of books	Yes	No

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The rules regulating the dissolution of a firm are contained in section 39 to 55 of the Indian Partnership Act. Section 39 lays down that the dissolution of partnership between all the partners of a firm is called the 'dissolution of the firm'.

The dissolution of a firm may take place in one of the following five ways:

1.) Dissolution by Agreement:

According to Section 40 of the Indian Partnership Act, 1932, partners can dissolve the partnership by agreement and with the consent of all partners. Partners can also dissolve the partnership based on a contract that has already been made. This type of dissolution is known as Voluntary dissolution.

2.) Compulsory dissolution:

According to section 41 of the Indian partnership Act, 1932, a firm may dissolve when all the partners of a firm are declared insolvent or all but one partner are insolvent then the firm is compulsorily dissolved. An event can make it unlawful for the firm to carry on its business. In such cases, it is compulsory for the firm to dissolve. However, if a firm carries on more than

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one undertakings and one of them becomes illegal, then it is not compulsory for the firm to dissolve. It can continue carrying out the legal undertakings.

3.) Dissolution on the happening of certain contingencies:

In case there is no agreement among partners regarding certain contingencies, partnership firm will be dissolved on the happening of any of the situations. According to Section 42 of the Indian Partnership Act, 1932, the happening of any of the following contingencies can lead to the dissolution of the firm:

- Some firms are constituted for a fixed term. Such firms will dissolve on the expiry of that term.
- Some firms are constituted to carry out one or more undertaking. Such firms automatically get dissolved when the undertaking is completed.
- Death of a partner.
- If a partner does not want to continue in the firm, his resignation from the concern will dissolve the partnership.

4.) Dissolution by notice of Partnership at will:

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According to Section 43 of the Indian Partnership Act, 1932, if the partnership is at will, then any partner can give notice in writing to all other partners informing them about his intention to dissolve the firm.

In such cases, the firm is dissolved on the date mentioned in the notice. If no date is mentioned, then the date of dissolution of the firm is the date of communication of the notice. A notice once given cannot be withdrawn without the consent of all the partners.

5.) Dissolution by the court:

According to Section 44 of the Indian Partnership Act, 1932, the Court may dissolve a firm on the suit of a partner on any of the following grounds:

1] Insanity/Unsound mind:

If an active partner becomes insane or of an unsound mind, and other partners or the next friend files a suit in the court, then the court may dissolve the firm. Hence the firm is not automatically dissolved on the insanity of a partner. The

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court will act only on the petition of a partner who himself is not insane. Two things to remember here:

- The partner is not a sleeping partner
- The sickness is not temporary

2] Permanent Incapacity:

If a partner becomes permanently incapable of performing his duties as a partner, and other partners file a suit in the court, then the court may dissolve the firm. Also, the incapacity may arise from a physical disability, illness, etc. However such illness should be of permanent nature.

Thus, in **Whitewell v/s. Arthur**, it was held that the paralysis of a partner was not a ground for dissolution of the firm as the medical evidence showed that the attack of paralysis was only temporary.

3] Misconduct:

When a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business and the other partners file a suit in the court, then

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the court may dissolve the firm. The misconduct of a partner brings bad name to the firm and it adversely affects the reputation of the concern.

Under this clause, moral turpitude of a partner would be sufficient ground. Professional misconduct would also suffice. Thus a misapplication by a solicitor and adultery by a doctor have been held to be sufficient grounds.

Further, it is not important that the misconduct is related to the conduct of the business of the firm, it should be of such a nature that it would damage the business prospects of the firm. The court looks at the effect of the misconduct on the business along with the nature of the business.

4] Persistent Breach of the Agreement:

A partner may willfully or persistently commit a breach of the agreement relating to

- the management of the affairs of the firm, or
- a reasonable conduct of its business, or

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- Conduct him in matters relating to business that is not reasonably practicable for other partners to carry on the business in partnership with him.

In such cases, the other partners may file a suit against him in the court and the court may order to dissolve the firm. The following acts fall in the category of breach of agreement:

1. Embezzlement
2. Keeping erroneous accounts
3. Holding more cash than allowed
4. Refusal to show accounts despite repeated requests, etc.

5] Transfer of Interest:

A partner may transfer all his interest in the firm to a third party or allow the court to charge or sell his share in the recovery of arrears of land revenue. Now, if the other partners file a suit against him in the court, then the court may dissolve the firm.

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6] Continuous/Perpetual losses:

When the firm cannot be carried on profitably, then the firm can be dissolved. If a firm is running under losses and the court believes that the business of the firm cannot be carried on without a loss in the future too, then it may dissolve the firm.

7] Just and equitable grounds:

The court may find other just and equitable grounds for the dissolution of the firm. Some such rounds are:

- Deadlock in management
- Partners not being in talking terms with each other
- Loss of substratum (the foundation of the business)
- Gambling by a partner on the stock exchange.
- When a partner committed adultery with co-partner's wife which was held in **Hasham v/s. Nariman**

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- When there was a total want of cooperation and mutual confidence between the partners leading to chronic disputes which were held in **Babu Lal v/s. Kanhaiya Lal**.
- Tense feelings between the partners which was held in **Hasham v/s. Nariman**

The power of the court to dissolve a partnership on this ground is analogous to its power to wind up a company on the just and equitable ground under section 433 of the Companies Act, 1956.

As regards to the just and equitable clauses, Lord Lindley has rightly remarked that the court ought not to fetter itself by any rigid rules in this regard. This clause cannot be construed to be ejusdem generis with the other six which precede it. In fact, an application of the ejusdem generis rule of construction would not leave any room for this clause to operate. However the words "just and equitable" connote something more than mere convenience. A mere option of judge that dissolution of a firm would on the whole be the best course for that firm, would not be enough.

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The exercise of the power by the court under this clause is discretionary. However this discretion is judicial discretion and must be exercised with due regard to the circumstances and exigencies of the case. On the other hand, the discretion ought not to be crystalized by decisions laying down define the rules on point. Rather, the court should have untrammelled discretion and decide each case on its merits.

Rights and Liabilities of Partners after Dissolution:

Upon dissolution, a partner has the following rights and liabilities as under:

Rights of Partner:

1.) **Right to lien**:

On the dissolution of the firm, every partner is entitled to have the property of the firm applied in payment of the debts and liabilities of the firm and to have the surplus distributed among the partners according to their rights.

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Partners Equitable Lien: in order to discharge himself from the responsibility to which a partner is subject, every partner has a right to have the property of the firm applied first in payment of the debts and liabilities of the firm and in order to secure his proper share of the assets of the firm, every partner has the right to have the surplus distributed among the partners or their representatives according to their rights. This right is known in English law as the equitable lien of a partner. Although this right exists during the partnership, it is not so much in evidence during the continuance of a firm and comes into full play in the event of its dissolution.

Pollock defines equitable lien as a partner's "right to have a specific portion of property dealt with in particular way for the satisfaction of a specific claims". It is thus distinct from a 'possessory lien', which is a mere right to hold the goods of another man until he makes a certain payment, and which does not carry with it the right of dealing with the goods.

2.) **Right to return of premium**:

Where a partner has paid premium on entering into partnership for a fixed term and the firm is dissolved before the expiry of that term otherwise than by death

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of the partner, he is entitled to repayment of the premium regarding being had to the terms upon which he became a partner and to the length of time during which he was a partner, unless:

(a) the dissolution is mainly due to his own misconduct

(b) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

The conditions necessary to attract the applicability of section 51 are:

(i) the partnership must be for a fixed term

(ii) the first must have been dissolved prematurely, i.e. before the expiry of that term.

(iii) it must have been dissolved otherwise than by the death of a partner.

The section will not operate where;

(i) the firm is dissolved, through prematurely on account of the death of a partner.

(ii) the dissolution is mainly due to the misconduct of the partner who had paid the premium.

(iii) the dissolution is in pursuance of an agreement which contains no provision for the return of the premium or any part thereof.

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3.) **<u>Right where Partnership contract is rescinded for fraud or misrepresentation</u>**:

Where a contract creating a partnership is rescinded on the ground of fraud or misrepresentation of any of the parties thereto, the party entitled to rescind is, without prejudice to any other right entitled-

(a) to a lien on, or a right of retention , the surplus or the assets of the firm remaining after the debts of the firm have been paid for any sum paid by him for the purchase of a share in the firm and for any capital contributed by him.

(b) to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm

(c) to be indemnified by the partner or partners guilty of the fraud or misrepresentation against all the debts of the firm.

A contract of Partnership, like any other contract, may be rescinded on the ground of fraud or misrepresentation. The rights of the party entitled to rescind are expressly provided for in the present section

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4.) **Right to restrain use of firm name or property**:

After a firm is dissolved, every partner or his representation may, in the absence of a contract between the partners to the contrary, restrain any other partner or his representative from carrying on a similar business in the firm name, or from using the property of the firm for his own benefit until the affairs of the firm have been completely wound up.

Where, however any partner or his representative has bought the goodwill of the firm, nothing in this section affects his right to use firm name. As seen earlier partners may upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on business similar to that of the firm within a specified period or within specified local limits and not withstanding anything contained in section 27 of the Indian Contract Act, such an agreement is valid, if the restriction imposed are reasonable.

Liabilities of Partner:

Upon dissolution, a partnership is subject to two main liabilities:

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1.) Notwithstanding the dissolution of a firm, the partners continue to be liable as such to third parties for any act done by any of them which would have been an act of the firm if done before the dissolution until public notice is given of the dissolution.

The principle on which this provision is based is that, after the dissolution of a firm, persons dealing with its partners are entitled to assume that they continue to be each other's agents until public notice is given of the dissolution. It is only fair and equitable that a secret dissolution should not be allowed to prejudice the rights of third parties, who have continued to deal with the firm in ignorance of the dissolution and upon the assumption that the relationship of partnership has continued.

But the estate of a partner who dies, or who is adjudicated an insolvent, or of a partner who not having been known to the person dealing with the firm to be a partner, retires from the firm, is not liable under this section for acts done after the date on which he ceases to be a partner.

Thus there are three cases wherein no notice of dissolution need not be given:

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(i) where a partner dies

(ii) where a partner is adjudicated insolvent

(iii) where a dormant partner retires.

2.) After the dissolution of a firm, the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners, continue notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm, and to complete transaction begun but unfinished at the time of the dissolution, but not otherwise.

A partner is the agent of the firm for the purpose of the business of the firm. The general rule is that the agency of a partner is terminated by dissolution of the firm. But even after dissolution of the firm, it is necessary that someone should have authority to wind up the affairs of the firm. Hence section 47 of the Act makes the necessary provisions in this connection

After the dissolution of the firm, partner has however no authority to acknowledge a debt or to make part-payment because it is not necessary for the winding up. It is to be noted however that the firm is in no case bound by

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the acts of a partner who has been adjudicated insolvent. But a person who represents himself or knowingly allows himself to be represented as the partner of an insolvent will be liable for the latter's act.

In Woodbridge v/s. Swann it was held that A and B are partners. A becomes bankrupt. B continues to carry on the trade of the firm and pays partnership money into a bank to meet the current bills of the firm. A's trustees in bankruptcy claims these moneys from the bank. Here the bank is entitled to this money as against A's trustee in bankruptcy.

<u>Rules for settling accounts after dissolution</u>:

Section 48, 49 and 55 of the Indian Partnership Act prescribes the mode in which accounts are to be settled between the parties after dissolution of partnership.

<u>Mode of settling accounts and division of profits and losses</u>:

In settling the accounts of a firm after dissolution, the following rules are to be observed, subject to any agreement by the partners

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(a) Losses including deficiencies of capital are to be paid first out of profits then out of the capital and lastly if necessary by the partners individually in the proportions in which they were entitled to share profits.

(b) The assets of the firm including any sums contributed by the partners to make up deficiency of capital are to be applied in the following manner and order:

i. In paying the debts of the firm to third parties

ii. In paying to each partner rateably what is due to him from the firm for advances as distinguished from capital.

iii. In paying to each partner rateably what is due to him on account of capital

iv. The residue, if any, is to be divided among the partners in the proportion in which they were entitled to share the profit.

Difficulty however arises when the assets are insufficient to pay the partners, because the partners have become insolvent and nothing is recoverable from him. This is in accordance with the rule laid down in **Garner v/s. Murray**, a

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leading case on the subject. The effect of the rule no doubt is that in such a case, a partner who has contributed a greater part of the capital may lose more than his other partners otherwise sharing equally with him in the profits and losses of the firm. But as pointed out by Joyce J. in the abovementioned case, there is nothing in the section to make a solvent partner liable to contribute for an insolvent partner who fails to pay his share.

Payment of Partnership debts and Separate debts:

Where there are joint debts due from the partnership and also separate debts due from any partner, the partnership property must be first applied in payment of the debts of the firm and if there is any surplus then the share of each partner must be applied in payment of his separate debts, or paid to him if he has no debts. So also the separate property of any property of any partner must first be applied in payment of separate debts and the surplus if any in the payment of the debts of the firm.

Thus when the partnership assets are not sufficient to pay off the joint debts of the firm, the creditors of the firm can have recourse to the partner's separate property only after his separate creditors have been paid. A partner is not

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entitled to insist that a creditor of the firm should proceed against the assets of the firm before proceeding against the partners individually. In order to discharge the joint debts after its dissolution, each partner has a lien over the partnership property.

Sale of goodwill after dissolution:

Section 55 lays down certain rules for settling accounts so far as the goodwill of the firm is concerned. It provides that in settling the accounts of a firm after dissolution, subject to any contract between the partners, the goodwill is to be included in the assets, and it may be sold separately or along with the other property of the firm.

Where the goodwill of a firm is sold after dissolution, a partner may carry on a business, competing with that of the buyer and he may advertise such a business, but subject to agreement between him and the buyer, he cannot-

(1) use the firm name

(2) represent himself as carrying on the business of the firm

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(3) solicit the custom of persons who were dealing with the firm before its dissolution.

Any partner may, upon the sale of the goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits and not withstanding anything contained in section 27 of the Indian Contract Act.

GOODWILL: "Goodwill" is the benefit arising from a firm's business connection. It is defined by Lord Eldon in **Cruttwell v/s. Lye** as the probability that customers will resort to the old place. But this definition is not complete. What goodwill means must depend on the character and nature of business to which it is attached.

It has rightly been said that "goodwill" is a thing very easy to describe, but very difficult to define. The term goodwill is not defined in the Act. It may be described as the advantage which is acquired by a business, beyond the mere value of the capital, stock, fund or property employed therein, in consequence

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of the general public patronage and encouragement which it receives from constant or habitual customers.

According to the Bombay High Court, the goodwill of a business is an intangible asset, being the whole advantage of reputation and connections formed with the customers, together with the circumstances which make the connection durable. It is that component of the total value of that undertaking which is attributable to the ability of the concern to earn profit over the course of years because of its reputation in the location and other features.

What goodwill means must depend on the character and nature of the business to which it is attached, it is composed of a variety of elements and is bound to differ in its composition in different trades and in different businesses in the same trade. One element may preponderate in one business and another in another business.

Goodwill may be personal or local. "Personal Goodwill" is the advantage of the recommendation of the owner of a business and of the use of his name,

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"Local Goodwill" is merely advantage which is attached to the premises and must be taken into account in calculating the value of such premises.

In **C.I.T v/s. B.C. Srinivasa Setty**, the Supreme Court held that no business commenced for the first time possesses any goodwill from the start. Goodwill is generated as the business is carried on and may be augmented by the passage of time. Explaining the term "Goodwill", the court observed as follows:

"Goodwill" denotes the benefit arising from connection and reputation. A variety of elements goes into its making and its composition varies in different trades and in different businesses in the same trade, and while one element may preponderate in one business, another may dominate in another business. Its value may fluctuate from one moment to another, depending on changes in the reputation of the business. It is affected by everything relating to the business like the personality and business rectitude of the owners, the nature and character of the business, its name and reputation, its location, its impact on the contemporary market, the prevailing socio-economic ecology, introduction to old customers and agreed absence of competion

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CHAPTER 9: REGISTRATION OF FIRMS

Section 57 of the Act provides that the Government may appoint Registrars of Firms for the purpose of this Act and may define the area in which they must exercise their powers and perform their duties. Every Registrar is deemed to be a public servant within the meaning of section 21 of the Indian Penal Code.

Section 58 explains the procedure of the registration of a Partnership Firm.

The registration of a firm may be effected at any time by sending by post, or delivering to the registrar of the area in which any place of business of the firm is situated or proposed to be situated by any of its partner along with the prescribed fee and copy of the Partnership Deed within one year from the date of constitution of the firm. Such a statement shall be signed by all of its partners. Such a statement should contain:

- Name of the firm
- Principal place of business
- Any other place where the business is carried on
- Duration of partnership firm

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- Name and address of all partners of a firm
- The date on which each partner joined the firm

- **Verification**: Each partner who has signed the statements needs to be verified.
- The **name of the firm** shall not contain any name resembling the name of Crown, Emperor, king, Royal, Emperors', or any other words implying or expressing the sanction of the government.

Section 59 of the Act states that when the Registrar is satisfied that the conditions of **section 58** are complied with then he shall record an entry of the statement in a register called the Register of Firms, and shall file the statement.

When an alteration is made in the firm name or in the location of the principal place of business of a registered firm, a statement is to be sent to the Registrar specifying the alteration, signed and verified in the manner required under section 58. When the Registrar is satisfied that the provision of law have been duly complied with, he amends the entry relating to the firm in the Registrar of Firms in accordance with the statement and file it

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along with the statement relating to the firm filed under section 59 of the Act.

When a registered firm discontinues a business at any place or begins to carry on business at any place, such place not being its principal place of business, any partner or agent of the firm may send an intimation thereof to the registrar who must make a note of such intimation in the entry relating to the firm in the Registrar of firms and file the intimation along with the statement relating to the firm as per section 61 of the Act.

When any partner in a registered firm alters his name or permanent address, an intimidation of the alteration may be sent by any partner or agent of the firm to the Registrar who deals with it in the manner provided in the Act.

When a change occurs in the constitution of a registered firm, any incoming, continuing or outgoing partner and when a registered firm is dissolved any person who was a partner immediately before the dissolution may give notice to the Registrar of such change or dissolution specifying the date thereof. The Registrar then has to make a record of the notice in the entry

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relating to the firm in the Register of firms and file the notice along with the statement relating to the firm.

When a minor who has been admitted to the benefits of partnership in a firm attains majority and elects to become or not to become a partner and the firm is a registered firm, he or his agent specially authorised in this behalf may give notice to the Registrar that he has or has not become a partner and the registrar then deals with the notice in prescribed manner.

The Registrar has the power at all times to rectify any mistake in order to bring the entry in the Register of Firms relating to any firm in conformity with the documents relating to that firm filed under this chapter as per section 64 of the Act

A court deciding any matter relating to a registered firm, may direct the Registrar to make any amendment in the entry in the Register of Firms relating to such firm which is consequential upon its decision and the Registrar must amend the entry accordingly as per section 65 of the Act.

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The Register of Firms is open to inspection by any person on payment of such fees as may be prescribed. All statements, notices and intimations filed upon this chapter are also open to inspection subject to such conditions and on payment of such fee as may be prescribed. On application, the Registrar must furnish to any person on payment of such fee as may be prescribed a copy certified under his hand of any entry or portion thereof in the Register of firms.

Penalty for furnishing false particulars:

Section 73 provides that if any person who signs any statement, notice or intimation-

(a) containing any particulars, which he knows to be false or does not believe to be true.

(b) containing particulars which he knows to be incomplete or does not believe to be complete.

then he becomes punishable with imprisonment which may extend to three months or with fine or with both.

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Effects of Registration:

At the outset, it is to be noted that the Act does not make it obligatory to register the firm. It is not compulsory that a partnership firm must be registered. The Act does not say so. But it is highly advisable that it should be registered. Section 68 of the Act creates and declares a rule of evidence, namely that of conclusive proof. Section 68 provides that any statement, intimation or notice recorded or noted in the Registrar of firms is as against any person by whom or on whose behalf such statement, intimation or notice was signed, conclusive proof of any fact therein stated.

It is further provided that a certified copy of an entry relating to a firm in the Registrar of Firms may be produced in proof of the fact of the registration of such firm and of the contents of any statement, intimation or notice recorded or noted therein.

As seen above, registration of a firm is not made compulsory under the Act but section 68 lays down a rule of conclusive proof and enables a certified copy of an entry in the Registrar of the Firms to be tendered in evidence. The result is that although the law does not make registration of a firm

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compulsory from the practical angle but it is highly advisable to do so. This is all the more so if one considers the effects of non-registration which are provided in section 69 of the Act.

Section 70 of the Act imposes a penalty for furnishing false or incomplete particulars in any statement or document sent to the Registrar. Thus, when once a firm is registered, the Registrar of Firms will continue to contain a complete, correct and up to date list of all the partners who will be liable for the debts of the firm and the statement recorded in the Register would afford a strong protection against false denials of partnership and the evasion of liability towards persons who deal with the firm.

Effect of Non- Registration:

Section 69 of the Indian Partnership Act is one of the most important section in the Act. It is because of this section that it would be in the interest of the partners to get the firm registered although under the Act such registration is not compulsory.

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Section 69 lays down four rules which may be set out as under:

Rule I

Firstly it is provided that no suit to enforce a right (i) arising from a contract or (ii) conferred by this Act can be instituted in any court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be a partner in the firm unless,

(a) the firm is registered

(b) the person suing is or has been shown in the Register of Firms as a partner in the firm.

The difficulty caused by this rule may be got over by getting registration of the firm affected at any time before the suit is filed. Registration of the firm however can be affected only if the statement required to be furnished to the Registrar of Firms is signed by all the partners or their specially authorised agents and duly verified and when disputes have arisen between partners, it is not at all likely that they would all join in doing so. The only remedy of the partner or partners desiring to bring a suit in such a case will be to ask

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for dissolution of the firm and accounts or for accounts if the firm is already dissolved.

An interesting point has been raised in some cases under this section. Is registration of a firm a condition precedent to the filing of the suit? In other words, must such registration necessarily take place before the suit is filed? Or can the firm be registered after the suit is filed on the ground that such registration would operate retrospectively? Some decisions mainly from the Nagpur and Calcutta High Courts have held that a suit by an unregistered can be validated by subsequent registration. However several other High Courts of Bombay, Madras, Patna and Lahore have held that such subsequent registration cannot cure a defect which existed when suit was instituted. These decisions have taken the view that such a suit is non-existent in the eyes of law and should therefore be dismissed at the threshold. It is of course open to the firm to withdraw the suit, get itself registered and then file a fresh suit.

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It is submitted that the latter view is more sound and now also finds support in the decision of Supreme Court in **C.I.T v/s. Jayalakshmi Rice and Oil Mills.**

Another interesting question is whether the defence of non-registration of the firm can be raised for the first time at the appellate stage. Here also, there are conflicting decisions of various courts. According to the Madras High Court, this point can be raised for the first time in appeal. The Rajasthan High Court has however ruled that this point cannot be raised for the first time at the appellate stage which was held in **Kalyan Sahai v/s. Lachhminarain**.

Rule II

Secondly, it is provided that no suit to enforce a right arising from a contract can be instituted in any court by or on behalf of a firm against any third party unless,

(a) the firm is registered
(b) the person suing is or have been shown in the Register of Firms as partners in the firm.

One important point is to be noted in connection with this rule. This section does not affect the right of the third party to proceed against the firm or its

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partners even though unregistered nor does it affect the right of the Official Assignee to realise the property of an insolvent partner.

It is also important to note that Act does not lay down that any transaction of an unregistered firm will be invalid; it merely says that a firm will not be allowed to take the assistance of a Civil Court, except upon the condition precedent that is registered. Registration may be affected by a firm at any time before filing a suit or taking other civil proceedings in a court against the third parties

Rule III

Rule III lays down that the provisions of Rule I and II apply also to a claim of set-off or other proceeding to enforce a right arising from a contract.

Two important exceptions are, however made to the rules contained in those subsections. The first exception seems to have been made on equitable grounds and the second on the ground of convenience. The first exception allows partners even in case of an unregistered firm, to enforce their right to sue for dissolution and accounts or to ask for accounts where the firm has been already dissolved. This sub clause also makes it clear that it will not be

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necessary to have registration of a firm affected where a suit or any legal proceedings are instituted to realise the property of a dissolved firm as for instance, a suit to recover a debt due to the firm.

The second exception saves the power of an Official Assignee, Receiver or court to realise the property of an insolvent partner under the Insolvency Act.

Rule IV

This rule provides that rule I, II and III do not apply to,

(a) it exempts from the operation of section 69 of the Act, firms whose places of business are all outside India or in areas exempted from the operation of this chapter under section 55. Such firms can institute suits or other legal proceedings or plead set-offs, without being registered, in any court in India otherwise having jurisdiction to entertain the suit or legal proceedings.

(b) it states a rule which is half hearted attempt on the part of the legislature to look at the matter of registration from the point of view of persons engaged in business on a very small scale. It exempts from the operation of this section suits and claims of set-off not exceeding an unrealistically meagre amount of

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one hundred rupees, in respect of matters otherwise triable by the various small causes courts.

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CHAPTER 10: CONCLUSION

A Partnership agreement is a voluntary contract between two or more persons to enter into a business relationship between or among one another with the intention of carrying out the said business and sharing its profits/ losses among themselves as agreed in the document.

Hence, partnership is very important because in day to day activities, We enter in to partnership agreements and by making partners big goals are achieved with the help of joint and more number of people. The joint efforts of all the members result in successful accomplishment of tasks. Division of work lead to increase in efficiency at work among different partners.

Partnership is one of the oldest forms of business relationships. Though limited liability companies have replaced partnership firms in complex businesses, partnerships are still preferred by professionals and small trading and business enterprises in India and abroad.

General partners are also jointly and severally liable for tortuous acts of co-partners. Each partner has the exposure of their personal assets being appropriated and liquidated to meet partnership dues. These are statutory

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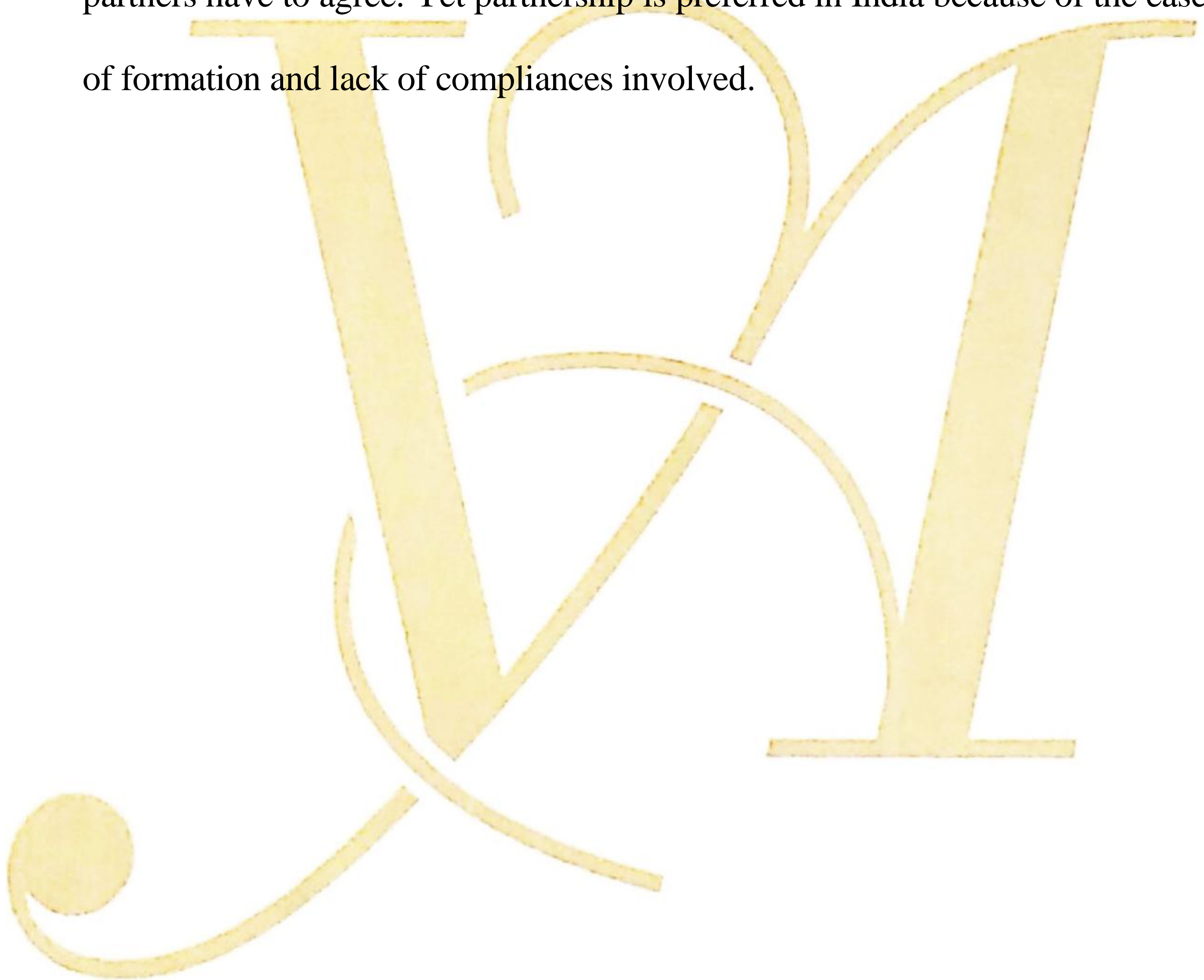
positions which cannot be altered by contract inter-se though at times subterfuges are resorted to be unscrupulous partners to avoid personal liability. General partnership holdings are not easy to transfer because typically all the partners have to agree. Yet partnership is preferred in India because of the ease of formation and lack of compliances involved.



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Disclaimer:

This information is obtained from following sources:

(1) Notes from Jhabvala

(2) https://blog.ipleaders.in/the-indian-partnership-act-1932/

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