



# EXCLUSIONS FROM PARTNERSHIPS & QUASI PARTNERSHIPS PRACTICAL POINTERS & PITFALLS

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## EXCLUSIONS FROM PARTNERSHIPS

1. Unlike the quasi partnership, the terms of the partnership are governed at first instance by the specific terms of the partnership agreement as agreed or by the default provisions of the Partnership Act 1890 (“the 1890 Act”) as may apply. To that extent, the power to expel another partner arises only where such express power is provided in the partnership agreement itself; there is no statutory or default power to expel.
2. In this context, expulsion means the mandatory exclusion of a partner from the partnership on the grounds that the remaining partners consider it is inappropriate for him to remain.
3. Prior to the formal introduction of the 1890 Act, Lord Lindley wrote:

*“In the absence of an express agreement to that effect, there is no right on the part of the members of a partnership to expel any other member. Nor, in the absence of express agreement, can any of the members of an ordinary partnership forfeit the share of the other member, or compel him to quit the firm on taking what is due to him. As there is no method, except a dissolution, by which a partner can retire against the will of his co-partners, so there is no method except a dissolution by which one partner can be got rid of against his own will.”<sup>1</sup>*

4. This concept was included in the 1890 Act at section 252 which provides that:

*“No majority of partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.”*

Thus any well drafted partnership agreement will include within it a provision for the expulsion of a partner; absent this, the other partners may be faced with the possibility of a dissolution of the partnership as the only alternative to resolving matters. If the partners are forced down this latter route, there is the option of asking the court to exercise its power, upon ordering dissolution, to direct that the share in the partnership of the problem partner be compulsorily sold to the others, thus allowing them to continue the business<sup>3</sup>.

### *Common Grounds for Expulsion*

5. A well drafted expulsion clause will set out a detailed list of grounds upon which the majority can seek to expel a member. These factors echo in part the list of grounds upon which the Court is able to make an order for dissolution: see the grounds set out in section 35 of the 1890 Act. The grounds for expulsion should be tailored to suit the specific needs of the business in question although care ought to be taken that the grounds are not so wide as to be without meaning or open to abuse.
6. These grounds might include:
  - a. Insolvency: where the member becomes subject to an insolvency process. It is important to have this as a specific provision of the partnership agreement because absent such a clause, bankruptcy of one of the partners will trigger a dissolution of the partnership pursuant to section 33 of 1890 Act which provides that:

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<sup>1</sup> *Re Clarke v Hart* (1858) 6 HLC 633.

<sup>2</sup> This has its counterpart at Regulation 8 of the Limited Liability Partnership Regulations 2001.

<sup>3</sup> *Syers v Syers* (1876) 1 App Cas 174, HL.



*“Subject to any agreement between the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.”*

For some smaller partnerships, this will be of more minor consequence, however, for bigger more formal partnerships for example those found amongst professionals such as doctors or dentists, a dissolution could have severe and profound consequences for the business.

Entry into an individual voluntary arrangement under the Insolvency Act 1986 is not sufficient to trigger the section; that is, entry by one partner into such an arrangement does not lead to dissolution. It is also unclear as to what the effect is of the dissolution of a corporate partner, and there appears to be no decided case on the point.

- b. **Misconduct:** This might include persistent breaches of the partnership agreement. The terms of the partnership agreement will often include the requirement that the partner be found guilty of ‘wilful’ or ‘persistent’ breaches, which import a further requirement of reckless conduct.

In addition, depending upon the type of partnership in issue, the partnership agreement might also include the concept of a breach of ethical or professional misconduct.

- c. **Material breach:** akin to the concept of misconduct, where the partner’s actions go to the root of the agreement including the duties owed by partners to each other<sup>4</sup>. This could also be framed as conduct by a partner, in matters relating to the partnership, which means that it is not reasonably practical for the business to be carried on in partnership with him. This would cover conduct which is so severe that the other partners are entitled to conclude that they can no longer have the confidence in the offending partner which is necessary for the continuation of a partnership.
- d. **Dishonesty:** the partner is charged with and / or convicted of a criminal offence involving issues of dishonesty.
- e. **Permanent incapacity:** permanent mental or physical incapacity. As noted above, this is also a ground for dissolution. Those cases covering dissolution arising out of permanent incapacity provide useful guidance as to how to apply this provision. Therefore it is suggested that any such incapacity needs to be permanent in nature and operate so as to prevent the partner in question “performing his part of the partnership contract”<sup>5</sup>.

Using further case law examples applicable to section 35, it might also be the case that:

- (1) Incapacity that is temporary will not be sufficient to satisfy this provision.
- (2) Any such incapacity must go to the heart of the partner’s ability to perform his role within the partnership; there may well be argument as to whether his ability is diminished or entirely removed<sup>6</sup>. It will clearly be a question of fact to apply in each case.

### *Procedure for Exercising Expulsion*

- 7. It is normal and desirable for the expulsion clause to specify the manner and form of exercising the power. In most cases, this is stipulated to be in the form of an expulsion notice which is approved by all the other partners, or in the case of larger firms, the specified majority of

<sup>4</sup> As noted by Dillon LJ his dissenting judgment in *DB Rare Books Ltd v Antiqubooks* [1995] 2 BCLC 306: “It is enough if a breach goes to the root of the confidence and good faith which should exist between partners.”

<sup>5</sup> Section 35(b) of the 1890 Act.

<sup>6</sup> *Sadler v Lee* (1843) 6 Beav 324.



partners. As is common in the employment context, it is desirable and sensible to include a provision for suspension within the power to expel; during this period of suspension the partner will continue to be entitled to receive his share of the partnership profits as may fall due.

8. In larger firms such as a solicitors' or accountants' firm, the partnership agreement will include the power to place the partner on garden leave, which can run for the whole of or part of the notice period. In theory, the partnership agreement can incorporate a wide range of powers, but it is unusual to see any power to reduce the profit share received during suspension or garden leave. Unlike the employment context where express covenants in restraint of trade are required, a partner is prohibited from benefitting from carrying on business in competition with the firm without the express consent of his partners. Section 30 of the 1890 Act provides that:

*“If a partner, without the consent of the other partners, carries on any business of the same nature as and competing with that of the firm, he must account for and pay over to the firm all profits made by him in that business.”*

#### *Strict Construction*

9. Notwithstanding the well trodden principles of construction, it is said that the construction of such expulsion clauses is always strict. In the Supplement to the Partnership Act 1890, Lord Lindley wrote:

*“Powers of expulsion are ‘strictissimi juris’ and parties who seek to enforce them must exactly pursue all that is necessary in order to enable them to exercise this strong power.”*

This is reflected in the case law: in *Re A Solicitors' Arbitration*<sup>7</sup>, the clause provided that:

*“[i]f any partner shall commit or be guilty of any act of professional misconduct the other partners may by notice in writing expel him from the partnership.”*

One partner served a notice on both the other remaining partners on the grounds of alleged misconduct on the grounds that the reference to ‘partner’ could be construed as a reference to two partners (based upon s 61 of the Law of Property Act 1925’s treatment of singular and plural). The judge instead found that the meaning of the clause was otherwise and noted:

*“I think very plain and express language would be required for such an extension of a power to take confiscatory measures.”*

10. In the same vein, the Australian court in *Russell v Clarke*<sup>8</sup> held that a clause providing power to the ‘other partners’ to expel one partner did not have application where eight partners of a ten partner firm signed notices expelling the other two. The court held that on its proper construction, each of the notices against individual partners had to be signed by the remaining nine.
11. Further, it has been held that if the notice specifies that the decision to expel must be taken at a meeting, that route cannot be avoided, even in a partnership of two<sup>9</sup>. However, the courts will also look to avoid applying a strained meaning to such clauses: in a case where it was stated that an expulsion notice required the signature of a particular partner of the firm as identified, the court held that it was still effective notwithstanding the absence of that signature. In that particular case, it would have been absurd indeed to require the partner to sign his own expulsion notice!<sup>10</sup>.

#### *Procedure after Service of the Notice to Expel*

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<sup>7</sup> [1962] 1 All ER 772, [1962] 1 WLR 353.

<sup>8</sup> [1995] 2 QdR 310.

<sup>9</sup> *Thakrar v Vadera* (31/03/00)(unrep).

<sup>10</sup> *Hitchman v Crouch Butler Savage Associates* (1983) 127 Sol Jo 441, 80 LS Gaz R 554, CA.



12. It is unclear whether the partner due to be expelled should be given prior warning of the fact of the notice and grounds for expulsion and given the opportunity to explain and challenge the grounds given and the case law on this point is undecided. It is quite clear that Lord Lindley took the view that the partner who was due to be expelled should be afforded the right to explain himself<sup>11</sup>. However, it has been decided by the Court of Appeal that there is no general right to allow a fair hearing before service of the notice to expel<sup>12</sup>. This view point has been endorsed generally by the Australian judiciary, but the New Zealand Courts appear to have moved towards the view that there is a right to a fair hearing<sup>13</sup>.
13. The question was most recently considered and left open by the English courts in *Kerr v Morris*<sup>14</sup> in which it was stated:

*“... the other partners ... must specify a reason for giving [notice of expulsion] which must prima facie be a reasonable reason ... so that it may well be that, apart from the question whether they were bound to afford him a hearing, and a hearing that went further than the meeting [held].. the question ... will come down to whether they were justified in their honest belief that the trust necessary between partners had been breached by the defendant.”*

The judge appeared to suggest that in exercising such power in good faith, there is also the need to give reasons which were reasonable and to afford the partner a hearing although ultimately in this case the court held back from giving a decided view on the position.

#### *Effect of an Invalid Notice*

14. It is recognised that the service of an invalid notice of expulsion does not in any way effect the status of that person as a partner in the firm. Whilst that partner is not able to claim damages against the other members of the firm, an action for damages for loss of reputation might lie depending on the circumstances in which the invalid notice was served and its subsequent effects: *Mullins v Laughton* (supra).
15. However, even though it is likely that the partner being served with an invalid notice to expel would not be able to bring an action for damages, the circumstances in which the other partners have sought to expel him may give rise to a right either to present his own notice or more likely (depending on the size and nature of the firm) to seek a dissolution<sup>15</sup>. It can never be treated as a repudiatory act, however<sup>16</sup>.

#### *Exercise of the Power to Expel*

16. Any such power to expel must be exercised with the utmost good faith and the court will be alive to the possibility of abuse, particularly where there is an ulterior motive for the expulsion. *Blisset v Daniel*<sup>17</sup> is an example of the court exercising this control, when it restrained an expulsion designed to take advantage of the fact that the partner purportedly expelled had been induced by the other partners to sign accounts which would falsely have valued his share in the firm to their benefit.
17. Notwithstanding that caveat, the Court will not necessarily strike out an expulsion notice simply because it is alleged that it sits with the majority's desire to be rid of the expelled partner but their bona fides motives cannot be challenged and the power is otherwise exercised in accordance with the terms of the clause<sup>18</sup>. Thus where a partner was expelled ostensibly for engaging in tax fraud, but in fact the other partners had wanted to expel him for some time, the fact of their desire

<sup>11</sup> In the Supplement to the Partnership Act 1890.

<sup>12</sup> *Green v Howell* [1910] 1 Ch 495 (CA), approved in *Mullins v Laughton* [2003] Ch 250.

<sup>13</sup> *Jackson v Moss* [1978] N.Z. Recent Law 20; *Re Northwestern Autoservice Ltd* [1980] 2 N.Z.L.R. 302; *Marlborough Harbour Board v Goulden* [1985] 2 N.Z.L.R. 378.

<sup>14</sup> [1987] Ch 90, [1986] 3 All ER 217, CA.

<sup>15</sup> S 35(d) of the 1890 Act. If cross expulsion notices are presented but none are upheld, a dissolution will almost certainly follow: *DB Rare Books Ltd v Antiqubooks* (supra).

<sup>16</sup> *Hurst v Bryk* [1999] Ch 1 (CA).

<sup>17</sup> (1853) 10 Hare 493.

<sup>18</sup> *Mullins v Laughton* (supra).



to have him removed from the partnership did not operate to undermine the otherwise legitimate expulsion<sup>19</sup>.

### *Compulsory Retirement*

18. An alternative method whereby the majority of partners are empowered to remove one of their number is that of compulsory retirement. One perceived advantage to this method of removal, as distinct from the power of expulsion, is that compulsory retirement can be exercised by the majority without the need to give substantive reasons for the decision. Clearly, the advantage of this being that the procedure is less open to challenge by the partner being removed.
19. The case law makes it clear that if no reason is given to the partner in question for the compulsory retirement, there are no powers to force the majority subsequently to disclose their reasons for so doing. However, any such provisions will be subject to restrictions on discrimination as contained in the Equality Act 2010 ("the 2010 Act") under which for example age is a protected characteristic<sup>20</sup>. It is clear that this would cover the situation whereby a partner must retire at a prescribed age. On the other hand, in such a case, the majority partners will not be treated as discriminating against the partner if they can show that their treatment of the partner to be compulsorily retired is a proportionate means of achieving a legitimate aim.
20. As is the case for exercising the power for expulsion, the power of compulsory retirement must also be exercised in the utmost good faith for the benefit of the partnership as a whole. Similarly, where the power is exercised invalidly, this will not affect the partner's rights as a member of the firm, but may provide grounds for that partner to seek a dissolution of the firm.

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<sup>19</sup> *Kelly v Denman* (1996) LTL, 17 Sept 1996.

<sup>20</sup> Ss 4 & 5 of the 2010 Act.

