

# PARTNERSHIPS: DO YOU NEED A PARTNERSHIP AGREEMENT?

**Almost without exception, the answer is yes.**

Many businesses trade as partnerships. Although not recommended, business people may trade as a partnership of individuals. More commonly, people carry on business or hold assets in a partnership of discretionary trusts. The advantages of this structure, including **asset protection** and **income flexibility**, are relatively well known (for more information, see our separate information leaflet entitled *Partnerships of Discretionary Trusts*).

Beyond achieving asset protection and income flexibility goals, it is critical that the business structure can be managed effectively by the principals. Above all, clients require **certainty**. Certainty is particularly important as regards, for example, the term of the partnership, profit share and capital entitlements, management decisions and veto, the right to terminate the partnership, the right to admit or expel partners and assign partnership interests and what happens in the case of a deadlock or dispute.

Without an effective written partnership agreement between the partners, there is no such certainty. In that case, the partners leave themselves open to the **uncertainties** and **peculiarities** of the *Partnership Act*.

For example:

- **Non-Competition:** The *Partnership Act* provides that partners must account to the firm for profits made in a business of a partner carried on in competition to the partnership without the consent of the other partners. However, this restriction does not carry over to the partner's activities after it has left the partnership.

Accordingly, absent a contractually binding non-competition clause, a partner is free to leave a partnership and immediately commence a new business in direct competition to its former partnership without contractual recourse. Obviously this can irreparably damage the partnership.

- **Joint and Several Liability:** Partners are jointly liable for debts and obligations of the partnership. Partners are also jointly and severally liable for torts (e.g. negligence) of the firm. Under the *Partnership Act*, all acts of a partner bind the partnership. Accordingly, in order to manage the joint and several risk of partners, it is critical that the authority of partners to bind the partnership is clear and, if required, limited.
- **Profit and Capital Share:** Under the *Partnership Act*, all the partners are entitled to share equally in the capital and profits of the business and must contribute equally to its losses. This rarely reflects the agreed position between partners (e.g. discretionary entitlements, disproportionate entitlements). Unless this is documented, there is scope for dispute between the partners which may undermine their relationship and the business.
- **Termination of the Partnership:** Under the *Partnership Act*, any partner can terminate a partnership without a fixed term simply by notice to the other partners.  
  
This is obviously not desirable. Partners usually commence an enterprise based on mutual commitment. It is usually inappropriate for a partner to be able simply to withdraw from the enterprise without any basis or agreement by the other partner(s).
- **Death and Insolvency:** Under the *Partnership Act*, these events automatically dissolve the partnership. However, this is seldom what partners desire. Typically, partners wish the partnership to continue but for the continuing partners to be able to purchase the relevant partnership interest on the occurrence of such an event. This right should be enshrined in a written agreement between the parties.
- **Dispute resolution.** There is no dispute resolution mechanism under the *Partnership Act*. An agreement by the partners to follow a mediation process in the event of a dispute between them will preserve their relationship and reassure the partners of a speedy and relatively certain resolution to future disputes.

**Baggiolegal** regularly prepares partnership agreements and commercial documentation for businesses. If you require a partnership agreement, or would like to discuss the merits of using one, please contact us.

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Before acting on any views expressed in this publication, careful consideration of the case specific facts should be undertaken by a qualified lawyer.*