

Partnership Dissolution: Winding-up and Managing Existing Obligations

The recent High Court decision in *Boghani v Nathoo* is a helpful guide to the general principles which apply when a partnership is dissolved but has outstanding obligations to fulfil. In particular, the Court commented on the scope of the relevant Partnership Act provisions in this area and how far the dissolved partnership could go in terms of entering into new obligations.

The Facts

Mr Boghani and Mr Nathoo carried on business together through a partnership at will (essentially, a partnership with no specific duration) which could be terminated at any time by notice from one party to the other (the “Firm”).

The Firm entered into major hotel management agreements with Intercontinental Hotels on 17 February 2009 and Hilton Hotels on 29 January 2010 relating to the development of new luxury London hotels (the “Agreements”).

On 01 April 2011 Mr Boghani served notice on Mr Nathoo to dissolve the Firm. Work had begun under both the Agreements but significant work was required to complete both projects.

The two partners each applied to the Court for different orders as to the status of the Firm’s obligations under the Agreements and how they should be dealt with following the dissolution.

The Consequences

Dissolution does not mean the same as winding-up in a partnership context. Dissolution in itself does not terminate all rights and obligations of the partners. It will terminate the partnership relationship between the partners going forward, however:

- the partners in the dissolved firm will remain bound by any obligations entered into prior to the dissolution;
- if appropriate notice of the dissolution is not given to other parties there is a risk that contracts entered into by one of the partners after dissolution could bind the firm; and
- section 38 of the Partnership Act 1890 states that after dissolution, the partnership relationship continues for the purposes of winding up the affairs of the partnership and completing transactions begun but not finished at the time of dissolution.

It was the last of these three points which was central in this case. The Court confirmed that the partners remained bound by the obligations in the Agreements even though the Firm had been dissolved.

However, this was not the same as saying that the partners had to personally complete the relevant contracts – their obligations could be discharged through, as well as performance, a release granted by the other party, payment of damages, or novating the obligations to a third party. The Court made it clear that section 38 should be viewed as a power, not a separate obligation on the partners to personally complete existing contractual obligations.

Further performance of the Agreements by the Firm would also have required additional external funding. The Court confirmed that when considering how far section 38 could extend in terms of allowing a partnership to enter into additional obligations after dissolution, in principle it could be relied to borrow money. However, this would only be the case where it was necessary for winding up the affairs of the partnership - in other words, *“to the extent [new obligations] are an inevitable part of satisfying the pre-existing contractual obligations of the Firm under a “transaction begun but unfinished at the time of dissolution”.*”

In the circumstances the court took the view that, given the Agreements both explicitly envisaged assignment/novation, and the expert evidence produced that third parties in the market would be willing to take on these obligations, it was not necessary for the Firm to complete the developments itself in order to wind up its affairs.

The Lesson

Because partnerships, unlikely LLPs and companies, do not have separate legal identities, complications may arise when a partnership dissolves with commitments outstanding.

Often it may be some time after dissolution before a winding-up of the partnership's affairs can be sensibly finalised, and this applies to both small two or three partner firms where there is a falling out between partners, or bigger concerns who are party to contracts worth tens of millions of pounds.

Although after dissolution the general authority of partners to bind the partnership ceases, the partnership relationship will continue as far as necessary to winding-up the affairs of the firm. Although this may extend to entering into new obligations where it is necessary to do so, the partners will need to consider the best way to go about winding-up in each case. As this decision shows, personally completing obligations is not always the most appropriate method.

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