

Mutual Relation between partners

Chapter III (Ss 9-17), Partnership Act, 1932

The Partnership Act contains various provisions regulating the relationship between partners. The partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other and to render true account and true information of all things affecting the firm to any partner or his legal representative. Every partner has a right to take part in the conduct of the business. Every partner is bound to attend diligently to his duties in the conduct of the business. Any differences arising as to ordinary matters connected with the business may be decided by majority of the partners and every partner shall have the right to express his opinion before the matter is decided. No change can be made in the nature of the business without the consent of all the partners. Every partner has a right to have access to and to inspect and copy any of the books of the firm.¹

S.9. General duties of partners.- Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative.

The first portion of this section is more didactic than legal. But it is the basis of claims arising from unfair dealings between partners which are not provided for otherwise. This section is of vital importance and subsequent sections dealing with relation of partners to one another are no more than amplifications and illustrations of principles contained in s 9. Its opening general words come from a time-honoured clause, which used to be common form in English partnership articles, but do not appear any more in the corresponding s 28 of the English Act. Presumably, the reason for dropping them was that, considered as a legislative command, they have no definite operative effect. It would have done no harm to keep them, and it is certainly better to do so in India; they place, in conspicuous view, the general tradition of good faith and honour on which the whole law of partnership and the whole duty of partners are founded.

Partnership is based upon mutual confidence and trust. It is, therefore, necessary that no partner should gain any personal advantage at the cost of others. One of the duties mentioned in S 9 is that partners must carry on the business to the greatest common advantage. This provision is to be read with S 16 (a) of the Act according to which if a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm. In the case of *Bentley v Craven*,² a firm which had been established for refining sugar consisted of four partners. One of the partners, who was considered to be expert in the job, was authorised to purchase sugar for the firm for refining. Instead of purchasing sugar from the market, he supplied his own sugar which he had purchased earlier at much lower price and thus made considerable profit. He did not disclose this fact to other partners that he was making profit in this particular transaction. It was held that the firm was entitled to recover the profit thus made by this partner. In *Gardener v McCutcheon*,³ a number of persons were the joint owners of a ship which was to be employed for their common benefit. One of them, who was the master of the ship, traded on his own account and made considerable profit. It

¹ *Rashiklal & Co v CIT* (1998) 2 SCC 49, para 13.

² (1853) 18 Beav. 75.

³ (1842) 4 Beav. 543.

was held that the defendant was not entitled to use the partnership property for his private benefit and, therefore, he was bound to account for the profit to the other co-partners.

Another duty mentioned in this section is that the partners must be just and faithful to each other. As already noted, there is mutual agency between partners and every partner is the agent of all others and he can bind them to an unlimited extent. Every partner is, therefore, expected to be just and faithful to his co-partners. Thus s 33 provides that even if the contract between the partners authorised the expulsion of a partner, the fellow partners must exercise this power in good faith.

Rendering true accounts is another duty which is imposed by s 9. Every partner is, therefore, bound to keep and render true and complete accounts of all the partnership moneys with him. He also must make these accounts available to the other partners because every partner has a right to have access to and to inspect and copy any of the books, including the account books of the firm.⁴ The partnership funds in the hands of a partner must be spent by him properly for the purpose of the firm's business and the partner concerned should keep proper vouchers in respect of the expenses. He should not mix up his money with that of the firm nor should he wrongly spend or misappropriate the firm's money, otherwise he will be accountable for the same towards the firm.

Every partner is an agent of the firm. According to the law of agency, information to the agent is deemed to be information to the principal. S 9, therefore, makes it incumbent on every partner to pass on full information of all things affecting the firm to his other fellow partners. Concealment of the facts by a partner renders him liable to others.

The duties cast on the partners under s 9 is not 'subject to contract between the partners'. Therefore, it is absolute in its contents.

S.10. Duty to indemnify for loss caused by fraud. - Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm.

The firm is liable not only for the contract made by one of them on behalf of other but also for wrongful act or omission of a partner acting in the ordinary course of business of the firm. If a partner commits a fraud against a third party while acting in the ordinary course of business of the firm, the third party can make the firm liable for the same. S 10 entitles the firm to recover indemnity from the partner guilty of fraud because of which the firm had to suffer the loss. Unlike the provisions of Ss 12 to 17, the duty mentioned in this section is not subject to the contract between the partners. It is, therefore, not possible for a partner to negative his liability towards the firm for loss caused to the firm due to his fraud. This section in absolute terms provides that every partner shall indemnify the firm for any loss caused to the firm by his fraud in the conduct of the business of the firm and leaves no scope for the guilty partner to contract himself out of such liability.

⁴ S. 12 (d).

S.11. Determination of rights and duties of partners by contract between the partners. – (1) Subject to the provisions of this Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners, and such contract may be express or may be implied by a course of dealing.

Such contract may be varied by consent of all the partners, and such consent may be express or may be implied by a course of dealing.

(2) Agreement in restraint of trade. – Notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such contracts may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

S 11 (1) provides that, subject to the provisions of the Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners and such contract may be express or may be implied by a course of dealing. It further provides that the mutual rights and duties which may have been agreed upon between the partners may be subsequently varied by the consent of all the partners and such consent may be expressed or may be implied by a course of dealing. This section incorporates the general principle that the mutual rights and duties of the partners may be determined by a contract between themselves. They may themselves decide that how much investment or labour is to be put by whom, or whether a partner will be entitled to any remuneration, apart from sharing the profits, or what will be the profit sharing ratio, etc.

Sub-section (2) clearly provides that, notwithstanding anything contained in s 27 of the Indian Contract Act, the contract between the partners may provide that a partner shall not carry on any business other than that of a firm while he is a partner. Although according to s 27 of the Indian Contract Act, agreement in restraint of trade is void, but such an agreement entered into between the partners as stated above will be valid.⁵

The right of the partners to make any contract to regulate their mutual rights and duties is subject to the provisions of the Partnership Act. Certain duties of the partners are incorporated in Ss 9 and 10, which have to be adhered to by all the partners and they are not subject to contract between the partners. Thus, the disabilities suffered by the partners of an unregistered firm, as envisaged by s 69, are binding on every partnership and the partners cannot agree contrary to those provisions. Similarly, the provision contained in s 41 regarding compulsory dissolution of a firm on the happening of certain events is binding on every firm. In the same way, the right of the partners to file a suit for dissolution of a firm under s 44 is not subject to contract between the partners. S 11, which permits partners to make any contract for regulating their mutual relations, is subject to the provisions of the Act and S 44 is one such provision. Therefore, a partner can always invoke the jurisdiction of the court under S 44 for the dissolution of the firm.

As has been noted above, Ss 9 & 10 contain certain duties by which all the partners are bound and the duties cannot be negated by a contract between the partners. Ss 12 to 17 contain various other mutual rights and duties of the partners. Each one of those sections has been made 'subject to contract between the partners'. It means that the rights and duties

⁵ Exceptions to s 27, Indian Contract Act are also contained in ss 36 (2), 54 & 55 (3) of the Indian Partnership Act.

incorporated in ss 12 to 17 are to be applied to the partners, if they have not made any contract to the contrary. For instance, if the partners have agreed to the proportion in which they will be sharing profits and losses, then their agreement will prevail, but if the partners have not agreed to anything on this point, then according to s 13 (b) the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm.

Rights of the Partners

As already noted, the various rights and duties of the partners contained in ss 12 to 17 are 'subject to contract between the partners'. Therefore, unless it has been agreed otherwise, the following rights as contained in the above mentioned provisions are there:

1. Right to take part in the conduct of the business [S. 12 (a)]

According to s 12 (a), every partner has a right to take part in the conduct of the business. Since the business of partnership belongs to all the partners, every partner is entitled to take part in the conduct of the business. The partners are free to provide in their agreement that only some of them will take part in the conduct of the business and certain other partners will not. If such a right is wrongfully denied to a partner, he can seek the enforcement of the right through a court of law. If the right to manage the business has been conferred on only some of the partners, they alone will be entitled to this right.

2. Right to be consulted and express opinion [S. 12 (c)]

S 12 (c) contains the following provision with regard to the right of a partner to express opinion in the partnership matters:

(c) any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners, and every partner shall have the right to express his opinion before the matter is decided, but no change may be made in the nature of the business without the consent of all the partners;

The difference of opinion between the partners may be either (i) as to ordinary matters connected with the business, or (ii) matters of fundamental importance concerning the nature of the business.

When the difference of opinion pertains to an ordinary or routine matter connected with the business, the same may be resolved by a decision of the majority of partners. But before the matter is decided every partner must be provided with an opportunity to express his opinion. In this connection Lord Eldon observed, "I call that the act of all, which is the act of the majority, provided all are consulted, and the majority are acting bona fide, meeting not for the purpose of negating, what anyone have to offer, but for the purpose of negating, what, when they met together, they may, after due consideration, think proper to negative: For a majority of partners to say, 'We do not care what one partner may say, we, being the majority, will do what we please, is, I apprehended, what this Court will not allow.' The power of the majority has to be

exercised in good faith. If, for instance, the majority of the partners decide to expel a partner without sufficient cause, the expulsion would be set aside.”

When the matter is not an ordinary or a routine matter but is of fundamental importance concerning the nature of the business, consent of all partners is needed. For instance, admission of a new partner to the firm is a change in the nature of the business. This provision being subject to contract between the partners, they may decide that in all matters it is the decision of the majority which will prevail.

3. Right to have access to books of the firm [S 12 (d)]

Every partner has a right to have access to and to inspect and copy any of the books of the firm. This right is available to both active and dormant partners. This right is not only in respect of books of accounts but in respect of any book of the firm. A partner could exercise this right either personally or by engaging an agent for the purpose.

4. Right to share profits [S 13 (b)]

Every partner has a right to share the profits. Generally, the partners provide in their agreement as to what will be the proportion in which they will share the profits. For example, in a firm of three partners, it may be agreed that the profit sharing proportion will be 2/4: 1/4: 1/4. According to s 13 (b), in the absence of any such agreement, the partners are to share the profits equally and also to contribute equally to the losses sustained by the firm and not in the proportion in which various partners contribute capital.

Since every partner is entitled to share the profits, no other remuneration, as a general rule, is to be paid to a partner for the management of the firm's business. The rule contained in this regard in s 13 (a) is that a partner is not entitled to receive remuneration for taking part in the conduct of the business, unless otherwise agreed. Thus, it is only if the partners so agree, a partner may be entitled to additional salary, commission, etc. for the efforts made by him in running the business of the firm.

5. Right to interest on capital and advances [S 13 (c) & (d)]

Generally, no interest on capital subscribed by the partners is to be given because the partners share the profits of the business of the firm. In case the partners agree that interest on capital is to be given, according to s 13 (c), such interest shall be payable only out of profits.

Sometimes over and above the capital subscribed by the partners, the firm may need extra money. In case a partner makes any payment or advance beyond the amount of capital he has agreed to subscribe, he is entitled to interest thereon at the rate of six percent per annum, according to s 13 (d).

6. Right to indemnity [S 13 (e)]

A partner while acting on behalf of the firm may make certain payments and also incur some liabilities. According to s 13 (e), he is entitled to claim indemnity for the

same. The indemnity can be claimed for the acts done by a partner in the ordinary and proper conduct of the business and also for doing some act in an emergency for the purpose of protecting the firm from the loss.

Duties of the Partners

Besides the duties explained earlier under ss 9 and 10, the partners have the following duties under the subsequent provisions which are subject to contract between the partners. As already noted the duties mentioned in ss 9 and 10 are not subject to contract between the partners.

1. Duty to be diligent [Ss 12 (b) and 13 (f)]

According to s 12 (b), every partner is bound to attend diligently to his duties in the conduct of the business of the firm. If a partner is negligent in the performance of his duties, this may cause loss not to that partner alone but to the whole firm. It has, therefore, been provided in s 13 (f) that if the firm suffers any loss by the wilful neglect of a partner, he shall indemnify the firm for the same. The expression 'wilful neglect' means an act done intentionally and deliberately rather than by inadvertence or an accident. An act done in good faith and bona fide cannot be termed a wilful neglect. In *Cragg v Ford*,⁶ a partner who was made in charge for winding up the business of the firm made some delay in disposing of some bales of cotton, ignoring the suggestion of a fellow partner. The prices of cotton fell considerably and loss was caused due to the delayed sale. It was held that the defendant was not liable for the loss as there was no wilful neglect on the part of the partner concerned because he was acting bona fide and did not anticipate the sudden fall in the prices.

The partners are, however, free to make a contract that they will not be liable for the wilful neglect because this provision is subject to contract between the partners.

2. Duty to properly use the firm's property [Ss 14 and 15]

According to s 15, the property of the firm is to be used by the partners exclusively for the purposes of the firm's business rather than the private and personal use of a partner. Although every partner has an interest in the property but no one can deal with any specific item of property as his own. In *Addanki Narayanappa v Bhaskara Krishnappa*, the Supreme Court explained the nature of the rights of the partners in the following words:⁷

“... whatever may be the character of a property which is brought in by the partners when the partnership is formed or which may be acquired in the course of the business of the partnership, it becomes the property of the firm and what a partner is entitled to is his share of profits, if any, accruing to the partnership from the realisation of this property, and upon dissolution of the

⁶ (1842) 1 Y&C Ch. Cas. 280.

⁷ AIR 1966 SC 1300, at p 1303.

partnership to a share in the money representing the value of the property. No doubt, since a firm has no legal existence, the partnership property will vest in all the partners and in that sense every partner has an interest in the property of the partnership. During the subsistence of the partnership, however, no partner can deal with any portion of the property as his own. Nor can he assign his interest in a specific item of the partnership property to anyone. His right is to obtain such profits, if any, as fall to his share from time to time and upon the dissolution of the firm to a share in the assets of the firm which remain after satisfying the liabilities.”

The property of the firm has got to be used exclusively for the purpose of the business of the firm. If any partner derives any profit or personal advantage by the use of the property of the firm, he has to account for that profit and pay the same to the firm.⁸ This rule is subject to contract between the partners.

Property of the firm

S 14 defines the property of the firm as under:

The property of the firm. - Subject to contract between the partners, the property of the firm includes all property and rights and interest in property and rights and interest in property originally brought into the stock of the firm, or acquired by purchase or otherwise, by or for the firm, or for the purpose and in the course of the business of the firm, and includes also the goodwill of the business.

Unless the contrary intention appears, property and rights and interest in property acquired with money belonging to the firm are deemed to have been acquired for the firm.

According to the above mentioned provision, the property of the firm not only includes what is originally brought into the stock of the firm but also whatever is subsequently acquired, by purchase or otherwise. Partners may bring in immovable property also into the common stock and that becomes the property of the firm. When a partner brings in his personal asset into partnership firm as his contribution to the capital, an asset which originally was subject to his entire ownership, becomes now subject to the rights of other partners in it. What was his exclusive right in the asset becomes reduced to the shared right in it with other partners of the firm.⁹

Property of the firm also includes goodwill. Goodwill is an advantage acquired in the course of business.¹⁰ It is acquired by a business beyond the mere value of the capital, stock, fund and property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers.

⁸ S 16 (a).

⁹ Shivraj fine Art Litho Works v Purushottam AIR 1993 Bom 30 at 34.

¹⁰ Trego v Hunt (1896) AC 7.

It is an advantage which a business acquires by its reputation. A newly established business may not be able to attract many customers but when this business gets established and earns goodwill, it may be able to attract more customers giving it an obvious advantage of making more profits. Goodwill is composed of a variety of elements. It is a composite thing referable in part to its locality, in part to the way in which it is conducted and the personality of those who conduct it, and in part to the likelihood of competition, etc.¹¹ Goodwill being the property of the firm, it may be sold either separately or along with other property of the firm.¹²

Property purchased with the partnership money is deemed to be the property of the firm. If a partner purchases some property with partnership money in his own name, it is deemed to be the partnership property being held by the partner on behalf of the firm. Thus, land purchased with the partnership money but in the name of the partner,¹³ or shares purchased by a partner with the firm's money in a partner's name, or insurance policies taken on the lives of the partners the premium for which is paid by the firm, are deemed to be the property of the firm.¹⁴

When the property was purchased by a partner with the funds of the firm and the property was required by the firm, it was held to be the property of the firm rather than that of partner purchasing it. In such a case it was immaterial that the partner purchasing the property had not obtained the consent of the other partners as required by the partnership deed. The fact that the property was not shown in the assessment register of the firm did not per se prove that it was not purchased for the interest and profit of the firm.¹⁵

3. Duty not to earn personal profits or to compete S 16

The partnership business belongs to all the partners jointly. It is, therefore, expected of every partner that he will act to the greatest common advantage rather than acting for personal profit at the cost of other partners. He should also not engage in a competing business. S 16 contains the following provision as regards such duty.

S 16. Personal profits earned by partners.- Subject to contract between the partners-

- a) If a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;
- b) If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

A partner is the agent of the firm for the purpose of the business of the firm. According to the rules of the law of agency, no agent can deal on his own account in the business of agency

¹¹ Mehruy Belgum Vala v G. Bell & Co. AIR 1983 Mad. 351 at 353.

¹² S. 55 (1).

¹³ Forster v Halle 5 Ves 308.

¹⁴ In re Adarji AIR 1929 Bom 67.

¹⁵ Mohan Lal Bahri v K.L. Bahri AIR 1998 All 247.

without the consent of the principal.¹⁶ If an agent, without the consent of his principal, deals in the business of agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.¹⁷ S 16 (a) makes every partner accountable to the firm for any personal profit made by him:

- i. from any transaction of the firm,
- ii. from the use of the property or business connection of the firm, or
- iii. from the use of the firm name.

In *Bentley v Craven*,¹⁸ one of the partners in a firm of sugar refiners, who was considered an expert in the job, was entrusted with the duty of purchasing sugar for the firm for being refined. He himself was a whole-sale dealer in sugar. He supplied his own sugar, which he had purchased at a lower price, to the firm at the prevailing market rates and thereby made considerable profit. He did not let his co-partners know that he was selling his own sugar to the firm and thereby making profit out of this transaction of the firm. It was held that he was bound to account to the firm for the profit thus made by him.

In *Gordon v Holland*,¹⁹ a partner sold the land belonging to the firm to a bona fide purchaser and then repurchased that land himself, it was held that all the benefits made by this partner on re-purchase of the land had to be given to the firm.

A partner is supposed to devote himself solely to the business of the firm. He should not carry on a competing business. If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made in the competing business.

It has already been observed that the partners can lawfully make a contract that a partner shall not carry on any business other than that of the firm while he is a partner.²⁰ Such a contract protects the interests of the partners in partnership and has been declared to be valid in spite of the rule contained in s 27, Indian Contract Act, which declares an agreement in restraint of trade as void. If such an agreement has been entered into, then the question of any partner carrying on any other business, competing or non-competing, does not arise. Injunction can be obtained against a partner who after making such a contract tries to carry on some business other than that of the firm. However, even if there is no such agreement between the partners, it is expected that a partner shall not carry on a competing business, otherwise he will have to account for the profits of that business to the firm. If the business carried on by a partner is not of the same nature and is not in competition with the firm, the partner concerned may retain the profits of that business to himself. The above stated rule is subject to contract between the partners and, therefore, it is possible that a partner may be permitted by a contract to carry on competing business and also to retain the profits of that business with himself.

Effect of change in the firm

¹⁶ S. 215, Indian Contract Act.

¹⁷ S. 216, Indian Contract Act.

¹⁸ (1853) 18 Beav 75.

¹⁹ (1913) 108 L.T. Rep. 385.

²⁰ S. 11 (2).

Sometimes, after certain rights and duties of the partners are in existence, certain changes might occur in the firm. A question may arise as to what is to be the position of the rights and duties after the change. S 17 incorporates the following provision to explain the position in such a case:

17. Rights and duties of partners. - Subject to contract between the partners-

- a) **a change in the firm.- Where a change occurs in the constitution of a firm, the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before the change, as far as may be;**
- b) **after the expiry of the term of the firm, and where a firm constituted for a fixed term continues to carry on business after the expiry of that term, the mutual rights and duties of the partners remain the same as they were before the expiry, so far as they may be consistent with the incidents of partnership at will; and**
- c) **where additional undertakings are carried out. Where a firm constituted to carry out one or more adventures or undertakings carries out other adventures or undertakings, the mutual rights and duties of the partners in respect of the other adventures and undertakings are the same as those in respect of the original adventures or undertakings.**

This section contemplates three kinds of changes in a partnership firm:

1. Change in the constitution of the firm. – A change in the constitution of the firm occurs either when a new partner is admitted or a partner ceases to be a partner by retirement, expulsion, insolvency or death.
2. Business continued after the expiry of the term. – Partners may have originally agreed to carry on the business only for a fixed term, e.g., they become partners for a term of 5 years. It is possible that in spite of the completion of the term of 5 years,, partners do not close down the business, but continue to run the same.
3. Carrying out additional undertakings. – A firm may have been constituted to carry out one or more adventures or undertakings but subsequently the partners may decide to carry out some more adventures or undertakings.

In all such cases, the question arises that what will be the position of mutual rights and duties of the parties after the changes mentioned above take place. In spite of these changes, the mutual rights and duties of the partners continue to be the same as they were existing earlier. This rule is, however, subject to contract, between the partners. The partners may, by a contract vary their rights and duties when one or the other of the changes stated above take place.