

## Am I in a Partnership?

Many people do not realise how easy it is to form a legal partnership and indeed, may be in a partnership without realising it!

### What is a partnership?

It has become common in recent times to come across business structures such as **limited liability partnerships** (LLPs). These are formed by registering the partnership at **Companies House** and have annual filing requirements, similar to limited companies (albeit less complex). LLPs are generally preferred to a traditional partnership because of the more structured approach and also, because the partners have limited liability, whereas in a traditional partnership they do not. The advantage with a traditional **partnership** is that it is immensely simple to form. Unless the partners choose to prepare a **Partnership Agreement** to govern the relationship between them, a partnership can evolve naturally without anything having to be done.

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A partnership is defined as *‘the relationship which subsists between persons carrying on a business in common with a view of profit.’* This definition is broad and there has been substantial case law as to whether or not a partnership exists; most recently considered in the case of **Christie Owen & Davies plc v Raobgle Trust Corporation**.

### Why is it important to me?

Whether or not a partnership exists is important for a number of reasons. One of the main ones is that a partner is deemed to be **authorised to act as agent** on behalf of all of the other partners and the partnership as a whole. Each partner is therefore bound and responsible for the acts that he/she incurs and, in addition, is responsible for the acts of their fellow partners, like it or not.

It can be important, as highlighted in the case of **Christie Owen**, where a party to the

litigation was trying to prove that a partnership existed in order to be able to receive financial compensation through a contractual arrangement. In the case of **Christie Owen** the Court considered the stage at which a party's relationship crosses the threshold and it could be said that they are carrying on a **business in common with a view of a profit** and therefore deemed to be in partnership.

### The facts of Christie Owen

An agent agreed to sell a property on the basis that they would receive a commission where the seller sold to an individual that the agent introduced to them. The agent sourced a potential buyer (for the purposes of this article we will call him Mr A) Mr A and introduced him to the seller. Mr A was not able to raise sufficient funds to buy the property and therefore did not proceed with the sale.

At a later date Mr A decided that he did wish to proceed with the purchase of the property but would do so with Mr B and Mr C. The property at this stage was to be sold at auction. The 3 gentlemen secured a bank loan in their joint names to fund the acquisition and they made a bid at auction. Although the property failed to reach its reserve, the gentlemen approached the seller following the auction and they negotiated a purchase price. The sale proceeded and the seller sold to Mr B (he did not wish to sell to Mr A). Shortly thereafter the property was transferred from the name of Mr B to a company of which all 3 men had equal shares.

The agent was not paid any commission despite his claims that he had introduced Mr A to the seller and Mr A had eventually bought the property. The agent therefore took the seller to court on the basis that the 3 individual gentlemen – Mr A, Mr B and Mr C – had formed a partnership together. In the event that there was found to be a partnership then the agent would be entitled to his commission because Mr A was involved, albeit he had **acted through the partnership**.

### Why does the case of Christie Owen matter?

In deciding how to proceed, the court had to consider whether sufficient steps had been taken by Messrs. A, B and C to justify the finding of a partnership between them, i.e. was it sufficient that the parties had bought the premises or, to prove a partnership, did they need to have actually begun development of the property as a restaurant (the business which was the end intention)?

The court considered the case of **Khan v Miah** and stated that it was not necessary for trading to have begun to find that a partnership had been formed. The parties needed simply to have embarked on a **business activity** with an intention to make a profit.

It was clear here that all 3 gentlemen had begun on their business venture together. They had obtained the property and they intended to develop it as a restaurant. It did not matter that the property had simply been bought in the name of only one of the partners.

It may be thought that it was clear on the facts that a partnership had been entered into between Messrs A, B and C, after all they had obtained money together and had purchased the property to start a business. However, from a legal perspective, this case was important as it showed that the court will look at the steps leading up to the opening of a business to see what decisions were taken beforehand with a view to making a profit, and therefore whether a partnership was already in place even before it starts trading. This case is also important as it reiterates the fact that a partnership can exist at the very early stages of a relationship between the parties.

### Are you in a partnership?

If you are unsure as to whether or not you are in a **legal partnership** then please do get in touch with your usual Magrath contact.

For those who are in partnerships, it is always advisable to have in place a formal **Partnership Agreement**.

Although the formation of a partnership is very simple and straightforward (and there is no requirement for a specific document), in the absence of a formal agreement your partnership will be structured on the basis of the Partnership Act 1890. The provisions of the Partnership Act are very generic and will not necessarily suit the specific requirements of the arrangement between you and your partners.

# Signed, Sealed, Delivered?

In the recent case of *Bibby Financial Services Ltd v Magson* [2011] EWHC 2495 (QB), the courts gave a useful reminder of the importance of following strict legal requirements for creating a **valid deed**.

## Facts

Two **directors** of QCFS were entering into an invoice discounting facility with Bibby Financial Services Ltd (Bibby). The directors met with their relationship manager from Bibby at lunch and a number of documents were produced, including the agreement itself, personal guarantees and separate warranties for each of the directors.

The directors noticed certain errors on the documents and made manuscript amendments. The directors then signed them but intended such signatures only to be a gesture of their intent to proceed. When returning them to the relationship manager, they had expected “clean” copies for re-signing and re-dating.

A couple of years passed and QCFS were placed into **administration**. Bibby demanded **repayment** of the invoice discounting facility and sought to enforce the **personal guarantees** and **warranties** from the two directors.

The directors argued that as they had made handwritten amendments on the documents, they expected clean documents to be produced for them to sign and execute. They argued that



they did not intend to be bound by the copies they signed.

## Judgment

The High Court held each of the guarantees and warranties signed by the two directors was, in form, a deed. Therefore, they were required to be executed in the manner required by law. In order for a document to be enforceable as a **deed** it must be **signed, witnessed** (if necessary) and **delivered** as a deed. The concept of ‘delivery’ requires the person signing to have indicated he intends to be bound by the deed; simply signing and handing over the document is not enough.

On the facts of the case the High Court found in favour of the directors and held they did not intend these

documents to be a deed.

## Comment

As this case highlights, although a deed is presumed to have been delivered when it is dated and the deed is delivered when it is executed, this presumption can be revoked depending on the facts of the case. It is therefore critical to ensure the parties intend to be bound by the deed and that they demonstrate this intention. This can be done, for example, by including a clause in the deed to clarify when delivery is effective, e.g. ‘This document has been executed as a deed and is delivered and takes effect on the date stated at the beginning of it.’

# Earn-outs: Interpretation of Seller Protection Provisions

An **earn-out** is an expression covering any mechanism where, on the sale and purchase of a company's shares or of its business and assets, the purchase price is partially or wholly determined by reference to the future performance of the target company or business.

There is a risk that, where an earn-out structure is in place following the buyer gaining control of the company, the buyer may take steps which have a detrimental impact or effect on the earn-out payment. It is therefore common for the parties to negotiate contractual provisions in the **sale and purchase agreement** which:

- Require the buyer to take **specified positive steps** after completion towards **maximising the earn-out payment**, and/or
- **Restrict** the buyer from taking certain action that could have the effect of frustrating or artificially **reducing the earn-out payment**

The High Court had to consider these issues in *Porton Capital Technology Funds & Ors v 3M UK Holdings Ltd & Anor* [2011] EWHC 2895.

## Facts

In this case, 3M entered into a **sale and purchase agreement (SPA)** to acquire the entire issued share capital of Acolyte Biomedica Limited (Acolyte). Acolyte's business was the commercialisation of a diagnostic technology which was used to detect the hospital super-bug **MRSA**.



The SPA included an earn-out provision and the earn-out payment agreed was 100% of the net sales of the diagnostic technology achieved during the calendar year. The SPA also included the following obligations on the buyer to protect the seller:

1. To **actively market** the diagnostic technology in the US, EU, Canada and Australia;
2. To diligently seek **regulatory approval** for the technology in the US and Canada; and
3. Not to cease carrying out the business or development of the technology or marketing of the product without the written consent of the sellers, whose consent could not be unreasonably withheld or delayed.

Following completion of the sale, in late 2007 3M halted the **clinical studies** required to obtain regulatory approval as a result of unexpectedly poor results. 3M did not resume the clinical studies and ceased to take any further steps to seek regulatory approval.

In July 2008 3M sought to obtain the

seller's consent to terminate the Acolyte business. This request was repeated in August 2008. However, despite being offered \$1.07 million **compensation**, the sellers refused on the basis they should be paid the maximum potential earn-out entitlement of £41 million. On 31st October 3M again sought the seller's consent and this was again refused. Despite this latest refusal, 3M announced it was terminating the business and therefore no earn-out payment would be made to the sellers.

The Claimants (some but not all of the sellers), brought proceedings for damages against 3M for their lost share of the **earn-out payment**, claiming the Defendants:

- Breached the contractual obligation to seek regulatory approval;
- Breached the contractual obligation to actively market the product;
- That 3M's termination of the business was a **repudiation of the sale and purchase agreement**.

In defence, 3M argued:

- The earn-out payment was not payable due to failings with the product and the movement of the market against the product;
- The Claimants had unreasonably withheld their consent to the termination of the business and as such the Defendants were released from their obligations under the sale and purchase agreement;

- Alternatively, the Defendants had repudiated the agreement but the claimants had accepted this repudiation.

## Decision

The High Court upheld the Claimant's claims for the following reasons:

- 1) Obligation to seek **regulatory approval**: the obligation on 3M imposed a standard of reasonable application, industry and perseverance. The court found that 3M had breached this obligation by abandoning the clinical studies.
- 2) Obligation to **actively market** the product: the obligation required more than simply taking some active marketing steps; these efforts needed to be characterised by action. 3M were not making an effort to market the product to new customers

and effectively ceased marketing by the end of June 2008.

- 3) Whether the sellers acted unreasonably in withholding their **consent for termination** of the business: the court found the sellers had acted reasonably. The burden was on the Defendants to show the Claimants had acted unreasonably. The Claimants were entitled to have regard to their own interests in maximising the earn-out payment and it was reasonable for the Claimants not to accept all the explanations given by 3M for why the business was failing. It was reasonable for the Claimants to consider further inquiry and investigation was required and that the failure of the business had been contributed to by 3M's own breaches of the sale and

purchase agreement.

Furthermore, it was reasonable for the Claimants to believe that the business would have earned more than the \$1.07 million offered as compensation if the business had continued.

- 4) **Repudiation of the agreement**: 3M's letters were requests for consent from the seller's to terminate the business; it was not a repudiation of the sale and purchase agreement. Moreover, the seller's refusal to consent was not a repudiation; the sellers did not state they would never consent to termination of the business, it was simply a clear rejection of the proposals on offer. Therefore, 3M's termination of the business in December 2008 was a repudiation of the agreement.

# Practically Speaking – Shareholder Agreement

If you hold shares in a private limited company and do not have a Shareholders Agreement in place then you may be in a vulnerable position, particularly if you are a minority shareholder.

As we welcome in the New Year now is a good time to ensure that the time and money you have invested in the company is protected.

A well drafted **Shareholder Agreement** can provide you with greater rights than may be found in the **Articles of Association** and protect your investment. You may wish to consider the following:

- A Shareholder Agreement will govern decision making powers. If you are a **minority shareholder** you may be given greater rights to be consulted on important decisions affecting the future of the company. In some instances you may have the right to veto any high level decisions;
- The Shareholder Agreement will set out the basis on which shares can be transferred in the company. Unless there are **pre-emption rights** in place on a share transfer, either in a Shareholders Agreement or the Articles of a company, then a shareholder is ordinarily free to transfer their shares to any third party. Therefore, it could be that without the suitable protections in place you could turn up to a shareholder meeting one day to effectively find that another of the shareholders has given their shares to another individual or business (this may even be a competitor to the company);
- If you are a **majority shareholder** you may wish to include drag along rights in the share transfer provisions, which effectively mean that if you want to sell your majority shares in the company you are able to ensure that the minority shareholders also have to sell their shares and you are therefore not prohibited from realising your investment;
- Have you considered what would occur if one of the shareholders who works for the company (and may or may not have an **employment contract** in place) left and started working for another company? A Shareholder Agreement can be drafted to ensure that that individual cannot work for a competitor or take any of the clients or **confidential information** of the company;
- Financial return will be important to you and you may wish to have bespoke provisions put in place;
- Putting in place a Shareholder Agreement for you will ordinarily be far more cost effective than it will be to defend or bring a shareholder related action.

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