ARBITRATION

United we stand, divided we fall?

The current economic climate has put undue pressure on partnerships causing all kinds of disputes to arise. What role has arbitration to play?

By Dr Michael Reynolds
Illustration: Giles Mead

PARTNERSHIP DISPUTES CAN BE THE most trying of all types of arbitration matters contested. Like family disputes they involve personalities and money, but more importantly, perhaps, livelihoods and careers. In domestic matters, the range of disputes depends on the nature of the business. Arbitrators can find themselves dealing with disputes as to partnership property, breaches of fiduciary duty, claims over profit share, goodwill, as well as claims arising out of a partner's negligence.

Disputes which arise in partnerships may be protracted and complex. The first stage in resolving any dispute should be by negotiation. The firm may have its own particular process for dealing with matters informally and internally in order to see whether the matter can be reconciled without recourse to a more formal process involving outside third parties.

In our book *Partnership Disputes* (Nova Law and Finance, 2013), my co-author James Davies and I suggest a form of internal process that may save both money and time. Alternatively, the next best option would be for the partners to appoint a mediator who understands the nature of the business and is capable of facilitating a reasonable solution acceptable to the partnership.

Regrettably, however, many cases cannot be resolved by mediation or negotiation because relationships have irretrievably broken down and it is very difficult to mend them. Where the dispute involves competing interests, reconciliation and settlement may be achieved through negotiation or mediation. However, where it involves complex legal issues and, in particular, legal rights, such as title to property, ownership of assets and breaches of fiduciary duty, arbitration is more appropriate. This is because the more complex disputes require evidence to be adduced, claims to be proved and an award to be given in a judicial manner. In addition, arbitration, as a private process does not expose businesses to risk-averse publicity, unlike litigation.

It is also arguable that such matters, in many cases, are far too important to the partners to be determined without recourse to law and consequently arbitration may provide an appropriate recourse to justice.

In many cases there is no cheap, quick fix and one-size-fits-all solution but with an experienced arbitrator the process may be cheaper and speedier than litigating, depending on the arbitrator's availability.

Despite political commentators' optimistic predictions for an economic recovery, history suggests that such severe contractions in the economy as recently experienced take time to rebalance. Small businesses usually bear the brunt and many are partnerships. One example is the contraction of many smaller

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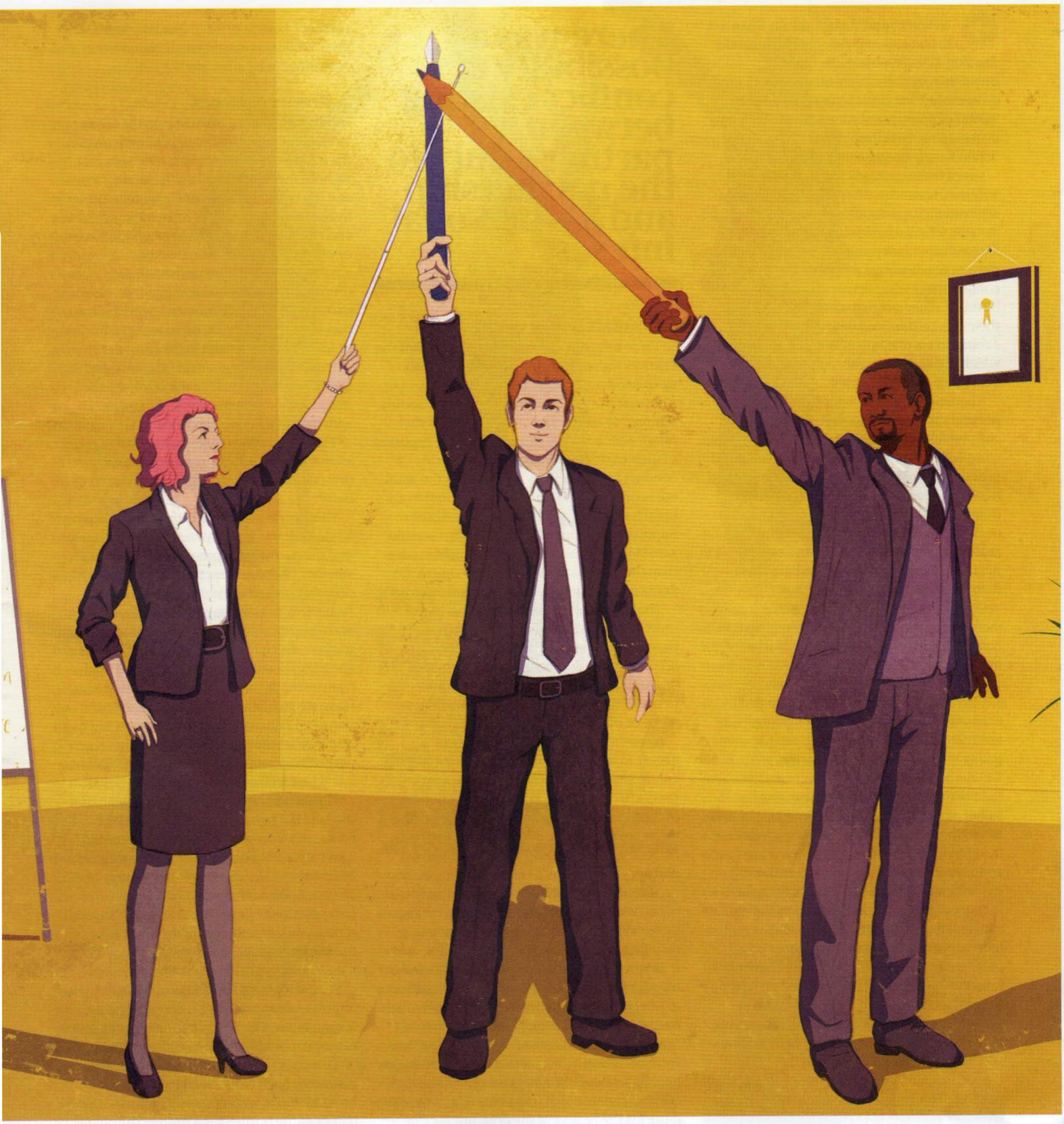
CAN WE HELP?

Do you have a dispute?
Contact Waj Khan at CIArb's Dispute Appointment Service.
Email wkhan@ciarb.org



PARTNERSHIP DISPUTES

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law firms and the enormous financial pressures on those that had legal aid funding. Whether it is those types of businesses or others they may be reluctant to go to arbitration considering mediation as a matter of practicality. Alternatively, they may be forced to resile from their rights and take no action simply because they cannot afford it.

Given these contradictory considerations why then should partnership disputes be arbitrated? Such disputes should be arbitrated in cases where a judicial process is required without attendant publicity. Matters relating to partnership business are primarily confidential to the partners running the business. They neither want the world, nor their competitors, to know their business. Arbitration is one way of keeping the dispute which could damage the reputation of the business out of public view.

The essential ingredient in any partnership is that the partners act in concert for the benefit of the firm, exercising complete trust in one another. Professional practices were established on that basis and hence the partners of a firm owe fiduciary duties to one another without which no partnership could survive. Put simply, it really is a case of all for one and one for all in partnerships. If that is not the case then disputes are more likely to occur.

The likelihood of such disputes has increased not only because of the collapse in confidence in the economy in 2008, but because over the past two decades professional organisations, no doubt encouraged by optimistic, but misguided economists, and the so called Big Bang, radicalised professional practices with younger and inexperienced partners facilitated by easy credit.

At the same time, under the mirage of so called globalisation, English practices, whose strength and credibility rested on their traditional ethics, threw such tradition to the winds embracing globalisation and rapid expansion. In the short term this resulted in more work, but it is already imploding causing many firms to cut back and increasing the enormous pressures on all partners in many fields. It is here that one foresees "substantial headwinds" or "choppy waters" as Sir Mervyn King, the former Governor of the Bank of England, suggested. In that context, the possibility of difficulties and disputes is high.

So in this austerity climate we must ask what kinds of disputes are arising, and what are the issues for arbitrators to consider?

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1. Conflict issues

In these uncertain times one can sense that the chances for conflicts between the interests of the partners are much greater. As an example, a partner in a professional firm may be unduly tempted to appropriate the business of the firm for his or her personal gain at the expense of their partners. Obviously, this type of conduct fundamentally undermines the whole ethos of a partnership and may amount to a breach of the partner's statutory obligations imposed by sections 28-30 of the Partnership Act 1890. Such instances may be higher today than they were a decade or so ago due to the fierce competitiveness in a depressed market.

The obligations extend so that partners must avoid conflicts of duty between the partnership and their personal interests; to account to the firm for any benefit derived from the partnership or from any transaction or use of the property of the partnership, its name or business connection.

Interesting cases may arise, such as occurred in *Don King Productions Inc v Warren*, concerning the obligation to account for profits. Here, there was a significant possibility of conflict existing between a partner's duty to the partnership and his personal interest. In this case the question was as to whether a partner entering into a transaction for his own benefit had effected that transaction by reason of his fiduciary position in the partnership or by reason of any opportunity or knowledge resulting from it.

When the defendant, Warren, purported to transfer the benefit in certain boxers' contracts to King it was argued that these were personal and not partnership property. The Court of Appeal disagreed holding that these contracts were not assignable as personalty. Thus, it was held that where a partner entered into several contracts, renewal of some contracts would inure for the benefit of the firm, not for the partner's benefit prior to dissolution of the firm. While this matter was litigated it is of a type that can be arbitrated.

2. Property issues

Arbitrators dealing with this type of dispute would find it speculative to pronounce upon the nature of a particular partner's interest without the fullest examination of the facts and the context. This is made more important by the provisions of the Partnership Act itself and whether or not the property, whether real or personal is, in the words of the Act:

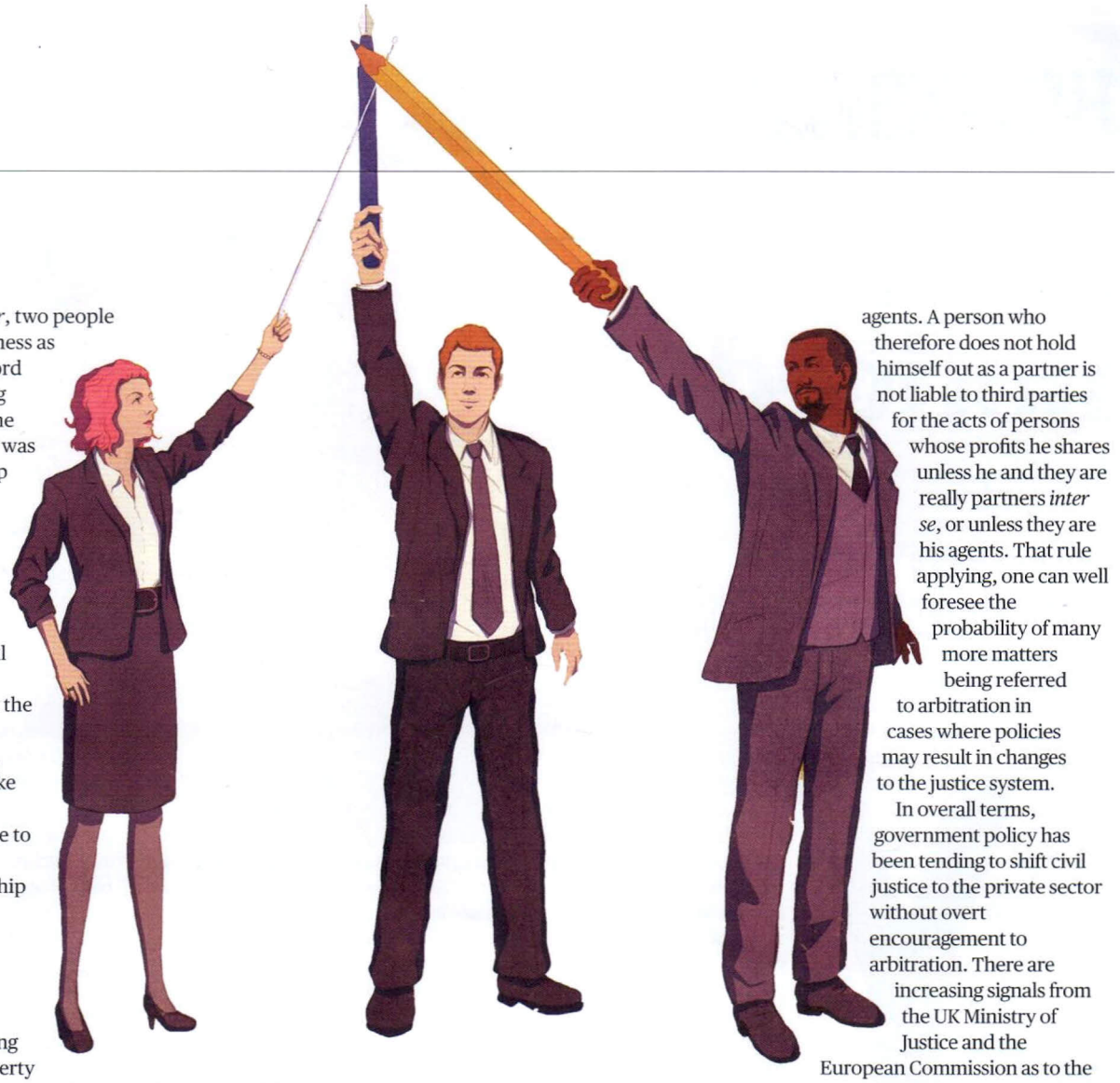
"Property and rights and interests in property originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm, or for the purposes and in the course of the partnership business... and [are] held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement."

This is all a matter of evidence and identification that can only be adduced through careful analysis of the evidence before the arbitrator.

Thus, in order to avoid litigation or dispute it is important, from a practical point of view, that the partnership agreement identifies whether the premises are partnership property owned by the partners in their respective contributions, or whether the premises are simply for the use of the business partner who has a licence to practice there. Lawyers appreciate that it is vital that land transferred to the partnership is vested in at least two partners and no more than four partners. The partnership agreement must declare that the property will constitute partnership property. If this is not spelled out it will lead to arguments on interpretation.

The ownership of land does not mean that the land is a partnership asset even if the profits are shared by co-owners as profits. This may lead to disputes when the property has been used by the firm for some time and it has been taken for granted that it is partnership property. Businesses will invest in renewal and maintenance, they may expand the workplaces, but caution is required here as it may not be partnership property.

For example, in *Davis v Davis* it was held that improvements made to business property (expanded workshops) were outside the scope of the partnership ie, not an asset. This is unfortunate because many think that land which has been considered to have been brought into a partnership by reason of the nature of the business is a partnership asset.



In *Waterer v Waterer*, two people were partners in business as nursery gardeners. Lord Justice James, in giving judgment, held that the land used in the trade was part of the partnership property, and therefore personal estate. The house and land not used for the partnership business, but let to tenants, remained real estate. So although a partnership may exist the property may not be partnership property. Thus, the arbitrator like the judges in these seminal cases will have to consider those two aspects as to partnership existence and title to property. Thus, a knowledge of law in these areas is a prerequisite.

The arbitrator dealing with partnership property cases will therefore be required to consider the usage of the asset by the business and whether that constitutes a partnership asset. This will require detailed scrutiny of the nature of the business, the particular usage of the asset in question, and how title to it arises. If the asset was purchased with partnership funds then there will be a presumption in favour of the partnership, which may make the arbitrator's task slightly easier, but the complexity of some of these cases cannot be underestimated.

3. Profit share

The quintessential commercial objective of a business partnership is to make a profit. The current problem in this economic cycle is that too many firms make no profit or run at a loss. This can be true of many small firms today especially those servicing, for example, the construction industry where profit margins have been cut to the bone to secure new work. In these situations the probability of tension and disputes arising is obviously greater. Such disputes involve arguments as to who bears the loss and who takes the profit and in what proportions.

Such matters may be resolved in arbitration where the arbitrator will decide who is entitled or who is liable to the profit or loss. With the benefit of profit comes the burden of loss so that the rule of law requires that such a recipient who shares the profits of a business is also liable for its debts and obligations, as De Grey, CJ said in *Grace v Smith*: "Every man who has a share of the profits of a trade, ought also to bear his share of the loss."

However, this rule effectuates only where, according to *Cox v Hickman*, the sharing of profits of the business does not result in those sharing the profit assuming the liability unless they personally carried on the business, or it is carried on by others as their real or ostensible agents. A person who therefore does not hold himself out as a partner is not liable to third parties for the acts of persons whose profits he shares unless he and they are really partners *inter se*, or unless they are his agents. That rule applying, one can well foresee the probability of many more matters being referred to arbitration in cases where policies may result in changes to the justice system.

Government policy has been tending to shift civil justice to the private sector without overt encouragement to arbitration

In overall terms, government policy has been tending to shift civil justice to the private sector without overt encouragement to arbitration. There are increasing signals from the UK Ministry of Justice and the European Commission as to the need to look at alternatives to court procedures driven by the economic decline, but also by an increasingly sceptical general public. While mediation has undoubted benefits to those who can resolve matters of competing interests, arbitration has the advantage of being able to resolve conflicts as to rights.

The fact is that arbitration has an excellent framework, as designed by Lord Saville and his team, that has stood the test of time so providing excellent opportunities for appropriately qualified arbitrators in this area. If one considers the popularity of construction adjudication and the outstanding contribution of international and maritime arbitration in London one can suggest possibly that arbitration might well become a preferred choice of dispute resolution process for partnership disputes for the reasons given.

Dr Michael Reynolds FCIArb is a Solicitor, practising Chartered Arbitrator and Programme Associate at the Socio-Legal Centre, University of Oxford. He was formerly a member of the Editorial Board of Arbitration and has authored books on expert witnesses, construction litigation and arbitration. He has written numerous articles in professional and academic journals on comparative legal systems and dispute resolution.