

# **PARTNERSHIPS**

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*Sources: Based on the New Civil Code of the Philippines, much of this work was taken from Helen Arevalo's reviewer supplemented by commentaries by Paras, Suarez and Tolentino. Also, some portions, albeit minimal, were taken from the reviewer prepared by Rene Callanta and the reviewer prepared for the class of Professor Roberto Dio.*

*Note: This reviewer is originally and specifically designed for the pre-review program of Accountancy graduates of Bicol University class of 2010 in preparation for the October 2010 CPA Board Exams. The author did not include all topics for the subject due to the fact that the schedule was only for one day, which he believes is not enough to cover the entire subject matter. However, he does believe that this reviewer can still be used for mid-terms purposes as this covers a significant bulk of the topics under partnership. Efforts are exerted in order to present the topics in a very convenient style, enriched with reasons and personal comments made by the author himself, for the very purpose of inculcating in the minds of the readers provisions embedded in the Civil Code for partnerships and for easy understanding... ☺*

**Definition:** It is a contract whereby two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing profits among themselves, or in order to exercise a profession. – taken from Art. 1767 of Civil Code

Since partnership is a contract, the general provisions of the Civil Code on Contracts are applicable. However, partnership has certain characteristics that are unique to it. Hence, it has its own separate provisions, in addition to the general provisions on contracts.

## **Characteristics (*What kind of a contract is partnership?*)**

- a. Consensual – perfected by mere consent.\*
- b. Nominate – has a designated name.
- c. Preparatory – its formation is followed by other contracts to carry out its purpose.
- d. Onerous – involves consideration.
- e. Bilateral or multilateral – entered into or stipulated upon by two or more persons.
- f. Principal – it can stand alone.

## **Essential Elements**

- a. There must be a **valid contract** – since a partnership is a contract, **all elements** of a contract such as **consent, object** and **cause** must be present.
- b. There must be two or more persons who have the **legal capacity** to contract – since consent is an essential element of a valid contract, the persons constituting a partnership must have the legal capacity to enter into a contractual relation. This

essential element, however, does not preclude **artificial entities** such as a partnership from forming another partnership. (**Q: Can 2 or more corporations create a partnership?**)

- c. There must be **lawful purpose** – as one of the basic principles of a contract, the parties have the liberty to create partnership for whatever purpose. However, such purpose must not be contrary to law, morals, good customs, public order or public policy. This is in conformance with Art. 1306 of Civil Code.

#### **Effects of an unlawful partnership**

- i. The contract is void *ab initio* and the partnership never existed in the eyes of the law
  - ii. The profits shall be confiscated in favor of the government – It would be immoral and unjust for the law to permit a profit from an industry prohibited by it. Besides, if profits are not confiscated, this would only give incentives to other persons to establish partnerships for the same illegal purpose because even if their contributions (see #4) are confiscated, they still have earnings or profit, which is basically the reason why they set up the partnership in the first place.
  - iii. The instruments or tools and proceeds of the crime shall also be forfeited in favor of the government
  - iv. The contributions of the partners shall not be confiscated unless they fall under #3
- d. There must be a **mutual contribution** of money, property or industry to a common fund.
  - e. The purpose is to **obtain profits** and to divide the same among the partners.
  - f. There must be **intent** to engage in lawful business, trade or profession. – Parties cannot, by using the word “partnership,” create such a relationship where the contract between them clearly provides that there was to be no community of interest.

#### **CONSEQUENCES OF THE PARTNERSHIP BEING A JURIDICAL ENTITY**

A Partnership has a juridical personality **separate** and **distinct** from that of each of the partners (Art. 1768).

1. its juridical personality is SEPARATE and DISTINCT from that of each partner
2. the partnership CAN in GENERAL:

- A) acquire and possess property of all kinds
  - B) incur obligations
  - C) bring civil and criminal actions
  - D) can be adjudged insolvent even if the individual members be each financially solvent
3. unless he is generally sued, a partner has no right to make a separate appearance in court if the partnership being sued is already represented

### **RULES TO DETERMINE THE EXISTENCE OF A PARTNERSHIP (Art. 1769)**

1. persons who are not partners to each other are not partners as to third persons  
EXCEPTION: PARTNERSHIP BY ESTOPPEL (WHEN 2 persons, who are partners, in connivance with a friend who is not a partner inform a stranger that said friend is their partner, a partnership by estoppel also result to the end that **the stranger** should **not** be **prejudiced**).
2. CO-OWNERSHIP of a property does not itself establish a partnership, even though the co-owners share in the profits derived from the incident of joint ownership.

*Example of Co-ownership: Rosalinda Margarita owns an apartment in Matnog, Sorsogon. On 11/11/2011, Rosalinda died, leaving her apartment to her twin daughters Jerelyn and Jirilin where it was stated in her last will and testament that such property will be shared by them. The girls are considered co-owners of the property.*

The reason why co-ownership is not considered a partnership is the fact that it lacks some of the essential elements of partnership such as **mutual contribution, intent to engage in business or profession** and **meeting of minds**, which is an essential element of a contract.

3. SHARING OF GROSS RETURNS ALONE does not indicate a partnership whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived

This can also be derived from the fact that mere sharing of gross returns, if without the **essential elements** of a partnership, cannot be considered a partnership.

4. the receipt of the share in the profits is a strong presumptive evidence of partnership  
HOWEVER, no such inference will be drawn if such profits were received in payment
  - A) as a DEBT by installments or otherwise
  - B) as WAGES of an employee
  - C) as RENT to a landlord
  - D) as an ANNUITY to a widow or representative of a deceased partner
  - E) as INTEREST on a LOAN, though the amount of payment vary with the profits of the business
  - F) as the CONSIDERATION for the sale of a GOOD WILL of a business or other property or otherwise

> creditors are not partners, for their only interest in the sharing of profits is the receipt or payment of their credits

### **FORM OF PARTNERSHIP CONTRACT**

Since a partnership is consensual in nature, it is perfected by mere consent. However, there

are exceptions to this general rule.

Exception: Where **immovable property contributed**, failure to comply w/ the following requisites will render the partnership contract void:

- 1.) The contract must be in a public instrument;
- 2.) An inventory of the property contributed must be made, signed by the parties, and attached to the public instrument.

An inventory is very important in a partnership to show how much is due from each partner to complete his share in the common fund and how much is due to each of them in case of liquidation.

The execution of a public instrument of partnership would be useless if there is no inventory of immovable property contributed because w/o its description and designation, the instrument cannot be subject to inscription in the Registry of Property, and the contribution cannot affect third persons.

HOWEVER: A partnership with a capital of at least P3,000, even if none of the properties is immovable, must have the following requirements:

1. The contract must appear in a public instrument;
2. It must be recorded or registered w/ the SEC.

However, failure to comply w/ the above requirements does not prevent the formation of the partnership or affect its liability and that of the partners to third persons. But any partner is granted the right by law to compel each other to execute the contract in a public instrument.

***Purpose of registration*** - Registration is necessary as a condition for the issuance of licenses to engage in business and trade. In this way, the tax liabilities of big partnerships **cannot be evaded** and the **public can determine more accurately their membership and capital** before dealing with them (TRUST and CONFIDENCE/TRANSPARENCY purposes).

## **CLASSIFICATIONS OF PARTNERSHIPS**

### ***As to extent of its subject matter -***

1. Universal partnership
  - a. Universal partnership of all present property - the properties that belong to each of the partners at the time of the constitution of the partnership becomes the common properties of all the partners. Profits derived from common properties become common properties as well but future properties acquired by individual partners in their own name shall not be considered part of the common properties.
  - b. Universal partnership of profits - the individual properties here continue to be owned by the partners, but the usufruct thereof passes to the firm.

## **DISTINCTIONS**

<b>ALL PRESENT PROPERTY</b>	<b>ALL PROFITS</b>
All the property actually belonging to the	Only the USUFRUCT of the properties of the

partners are CONTRIBUTED - and said properties become COMMON PROPERTY (owned by all the partners and by the partnership)	partners becomes COMMON PROPERTY (owned by them and the partnership); NAKED OWNERSHIP is retained by each of the partners.
Only those PROFITS DERIVED FROM COMMON PROPERTIES becomes COMMON PROPERTY except those stipulated.	ALL PROFITS acquired by the INDUSTRY or WORK of the partners become COMMON PROPERTY ( <b>regardless</b> of whether or not said profits were obtained through the usufruct contributed).

Persons who are prohibited by law to give donations cannot enter into a universal partnership for the reason that each of the partners virtually makes a donation. To allow it would be permitting them to do indirectly what the law expressly prohibits. *Example: Husband and Wife.*

A partnership formed in violation of this article is null and void. Consequently, no legal personality is acquired.

A husband and wife, however, may enter into a **particular partnership\*** or be members thereof.

2. Particular partnership - A particular partnership is one w/c is neither a universal partnership of present property nor a universal partnership of profits.

The fundamental difference between a universal partnership and a particular partnership lies in the scope of their subject matter or object. In the former, the object is vague and indefinite, contemplating a general business w/ some degree of continuity, while in the latter, it is limited and well-defined, being confined to an undertaking of a single, temporary, or *ad hoc* nature.

#### **As to liability of the partners -**

- 1.) General partnership: one consisting of general partners who are liable *pro rata* and subsidiarily and **sometimes solidarily** w/ their separate property for partnership debts.
- 2.) Limited partnership: one formed by two or more persons having as members one or more general partners and one or more limited partners, the latter not being personally liable for the obligations of the partnership. NOTE: A general partner is liable beyond his contribution while a limited partner is liable only to the extent of his contribution.

#### **As to duration -**

1. Partnership at will: one in w/c no time is specified and is not formed for a particular undertaking or venture and w/c may be terminated at any time by mutual agreement of the partners, or by the will of any one partner alone; or one for a fixed term or particular undertaking w/c is continued after the end of the term or undertaking w/o express agreement.
2. Partnership with a fixed term: one w/c the term for w/c the partnership is to exist is fixed or agreed upon.

### ***As to the legality of its existence -***

- 1.) De jure partnership: one w/c has complied w/ all the legal requirements for its establishment.
- 2.) De facto partnership: one w/c has failed to comply w/ all the legal requirements for its establishment. *Example: a partnership where real properties are contributed but public instrument was not executed.*

### ***As to representation to others -***

1. Ordinary or real partnership: one w/c actually exists among the partners and also as to 3<sup>rd</sup> persons.
2. Partnership by estoppel: one w/c in reality is not a partnership, but is considered a partnership only in relation to those who, by their conduct or admission, are precluded to deny or disprove its existence.

### ***As to publicity -***

1. Secret partnership: one wherein the existence of certain persons as partners is not avowed or made known to the public by any of the partners.
2. Open or notorious partnership: one whose existence is avowed or made known to the public by the members of the firm.

### ***As to purpose -***

1. Commercial or trading partnership: one formed for the transaction of business.
2. Professional or non-trading partnership: one formed for the exercise of a profession.

## **KINDS OF PARTNERS**

### ***Under the Civil Code -***

1. Capitalist partner: one who contributes money or property to the common fund.
2. Industrial partner: one who contributes only his industry or personal service.
3. General partner: one whose liability to 3<sup>rd</sup> persons extends to his **separate** property.
4. Limited partner: one whose liability to 3<sup>rd</sup> persons is **limited** to his capital contribution.
5. Managing partner: one who manages the affairs or business of the partnership.
6. Liquidating partner: one who takes charge of the winding up of partnership affairs upon dissolution.
7. Partner by estoppel: one who is not really a partner but is liable as a partner for the protection of innocent 3<sup>rd</sup> persons. He is one represented as being a partner but

who is not so between the partners themselves.

8. Continuing partner: one who continues the business of a partnership after it has been dissolved by reason of the admission of a new partner, or the retirement, death or expulsion of one or more partners.

9. Surviving partner: one who remains after a partnership has been dissolved by the death of any partner.

### **Other classifications -**

1. Ostensible partner: one who takes active part and known to the public as a partner.
2. Secret partner: one who takes active part in the business but is not known to be a partner by outside parties nor held out as a partner by the other partners. He is an actual partner.
3. Silent partner: one who does not take any active part in the business although he may be known to be a partner.
4. Dormant partner: (a.k.a. "sleeping partner) one who does not take active part in the business and is not known or held out as a partner. He would be both a silent and a secret partner.
5. Original partner: one who is a member of the partnership from the time of its organization.
6. Incoming partner: a person lately, or about to be, taken into an existing partnership as a member.
7. Retiring partner: one withdrawn from the partnership; a withdrawing partner.

## **OBLIGATIONS OF THE PARTNERS**

When two or more persons form a partnership, different relationships may arise:

1. Relations among the partners themselves;
2. Relations of the partners with the partnership;
3. Relations of the partnership with third persons;
4. Relations of the partners with third persons.

As a result of these relationships, different obligations and rights are formed. Beginning from the execution of the contract, which is the birth of a partnership, certain obligations and rights arise.

### **OBLIGATIONS WITH RESPECT TO CONTRIBUTION**

(This list was taken from Helen Arevalo's reviewer but I think the provisions on the duties of obligors apply [i.e. this really depends on what kind of thing the partner has promised to contribute - whether **generic, determinate, industry**, etc.] Therefore, this list is not exhaustive.)

1. To contribute at the beginning of the partnership or at the stipulated time the money, property, or industry he had promised
2. To answer for eviction in case the partnership is deprived of the determinate property contributed - warranty against eviction is considered a natural element inherent in partnership, which also exists in contracts of sale but Prof. Bautista states that the other warranties of sale (warranty against hidden defects and warranty for merchantability for purpose) should also be made applicable.
3. To answer to the partnership for the fruits of the property the contribution of which he delayed, from the date they should have been contributed up to the time of actual

- delivery - *consistent with the provision on fruits of obligations (see Obligations).*
4. To preserve said property with the diligence of a good father of a family pending delivery to the partnership - *consistent with the provisions on obligations/duties of an obligor (see Obligations)*
  5. To indemnify the partnership for any damage caused to it by the retention of the same or by the delay in its contribution. - *consistent with the provisions on the obligations/duties of an obligor (see Obligations).*

### **Effect of failure to contribute property promised**

Failure to contribute makes the partner a debtor of the partnership even in the absence of any demand.\*

### **Liability of partner for fruits of property in case of delay**

No demand\* is necessary to put the partner at fault. The injury to the partnership is constant.

### **Appraisal of goods or property contributed**

Appraisal is necessary to determine how much has been contributed by the partners.

The appraisal is made:

1. In manner prescribed by contract of partnership;
2. If no stipulation, by experts chosen by the partners and according to current prices.

After the goods have been contributed, the partnership bears the risk or gets the benefits of subsequent changes of value.

### **Obligations of industrial partner**

An industrial partner is one who contributes his industry, labor or services to the partnership. He is considered the owner of his services, which is his contribution to the common fund.

Unless the contrary is stipulated, he becomes a debtor of the partnership for his work or services from the moment the partnership relation begins. In effect, the partnership acquires an exclusive right to avail itself of his industry. Consequently, if he engages in business for himself, such act is considered prejudicial to the interest of the other partners.

Action for specific performance is not available against him due to his right against involuntary servitude (*consistent with the provisions on duties of an obligor whose prestation is service*).

### **Prohibition against engaging in another business**

**As regards an industrial partner** - Absolute prohibition: any kind of business. The reason of this prohibition is because an industrial partner contributes only his industry to the partnership, so he must devote **all his services** to the partnership. In short, the partnership is the owner of his services which he cannot use for his own benefit and to the detriment of the partnership (Suarez). This prohibition seeks to prevent any **conflict of interest** between the industrial partner and the partnership, and to insure faithful compliance by said partner with his prestation. The prohibition is absolute because if the industrial partner is engaged in other businesses, the partnership will be prejudiced because of the reduction of

the time or the effort which he will have for it (Limuco v Calinao, Court of Appeals case)

**As regards capitalist partners** - Prohibition extends only to any operation which is of the same kind of business in which the partnership is engaged. Methinks this prohibition prevents a partner from competing with the partnership (**conflict of interest**).

### **Extent of contribution to partnership capital**

Partners can stipulate contribution of unequal funds to the common fund, but in the absence of such stipulation, the presumption is that their contribution shall be in equal shares.

Obviously, this does not apply to an industrial partner unless he also contributes capital. In effect, he becomes a *capitalist-industrialist partner*.

### **Obligation of capitalist partner to contribute additional capital**

General rule: Capitalist partner not bound to contribute more than what he agreed to.

Except: In case of imminent loss of the business, and there is no agreement to the contrary, he is under obligation to contribute an additional share to save the venture. **If he refuses to contribute, he shall be obliged to sell his interest to the other partners.**

### ***Requisites for application of rule of sale of interest-***

- 1.) Imminent loss of the business of the partnership;
- 2.) Majority of capitalist partners are of the opinion that an additional contribution to the common fund would save the business;
- 3.) Capitalist partner refuses deliberately (not because he has no money) to contribute an additional share to the capital;
- 4.) There is no agreement that even in case of an imminent loss of the business the partners are not obliged to contribute.

The industrial partner is exempt. Having contributed his entire industry, he can do nothing further.

**Reason for the sanction** - Refusal of partner to contribute additional share reflects lack of interest in the continuance of the partnership. It is unjust for him to reap benefits when he doesn't also help.

## **RULES REGARDING COLLECTION OF PARTNERSHIP CREDIT**

### **Obligation of managing partner who collects credit**

**Rule**: If a partner authorized to manage collects a demandable sum, which was owed to him in his own name, from a person who owed the partnership another sum also demandable, the sum thus collected shall be applied to the two credits in proportion to their amounts, even though he may have given a receipt for his own credit only; but should he have given it for the account of the partnership credit, the amount shall be fully applied to the latter.

### ***Requisites for application of rule -***

- 1.) There exists at least two debts, one where the collecting partner is creditor, and the other, where the partnership is creditor;
- 2.) Both debts are demandable;

3.) The partner who collects is authorized to manage and actually manages the partnership.

**Reason for applying payment to partnership credit** - The law safeguards the interests of the partnership by preventing the possibility of their being subordinated by the managing partner to his own interest to the prejudice of the other partners.

This rule does not apply to partner **not authorized to manage**. Where manner of management not agreed upon and all partners participate in mgt, every partner considered managing partner.

**Right of debtor to application of payment** - Debtor given right to prefer payment of credit of partner if it should be more onerous to him.

### **Obligation of partner who receives share of partnership credit**

**Rule:** A partner who has received, in whole or in part, his share of a partnership, when the other partners have not collected theirs, shall be obliged, if a debtor should thereafter become insolvent, to bring to the partnership capital what he received even though he may have given receipt for his share only.

### **Requisites for application of rule -**

1. A partner has received, in whole or in part, his share of the partnership credit;
2. The other partners have not collected their shares;
3. The partnership debtor has become insolvent.

**Reason for imposing obligation to return** - the debt becomes a bad debt and is a loss which must be borne by all partners, including the partner who has already received his share in the partnership credit, because they have a community of interest and a proportionate share in profits and losses. It would be unjust for that one partner not to share in the loss.

### **Query**

Madam G owes a firm P 1 million. Bayani Fernando, a partner, was given his share of P500,000, there being only two partners. Later, Madam G becomes insolvent. Must Bayani share the P500,000 with the other partner?

### **Answer**

Yes, even if Bayani had given a receipt for his share only.

### **OBLIGATION OF PARTNER TO PARTNERSHIP FOR DAMAGE DUE TO HIS FAULT**

**General Rule:** Every partner is responsible to the partnership for damages suffered by it through his fault, and he cannot compensate them with the profits and benefits which he may have earned for the partnership by his **industry**.

This rule follows the general rule in obligations that any person guilty of negligence or fault in the fulfillment of his obligation shall be liable for damages. The partner's fault, however, must be determined in accordance with the nature of the obligation and the circumstances of the person, time and place.

**Reason for the rule** - the partner has the DUTY to secure benefits for the partnership; on the other hand, he has the DUTY also not to be at fault. Since both are duties, compensation should not take place, the partner being the debtor in both instances. Compensation requires 2 persons who are reciprocally *debtors* and *creditors* of each other. (Paras)

**My personal comment on the reason provided by Paras** - It seems that as a separate entity, the partnership has the corresponding obligation to remunerate the partner's services. Therefore, there now exist 2 persons (the partnership and the partner) who are reciprocally debtors and creditors of each other, which seems to comply with Compensation's requirement. HOWEVER, Arevalo stated in the reviewer she prepared that a partner is not the partnership's creditor as to its interest. This statement reinforces Paras' reason but I could not find where Arevalo lifted that concept from and she did not provide the reason why we cannot consider a partner as a creditor of the partnership. Furthermore, Article 1796, the article that provides for the obligations of a partnership did not mention that a partnership has the obligation to remunerate for the services of an industrial partner, which seems to affirm both Arevalo's statement and Paras' reason. Despite all these, I am not satisfied with Paras' reason so I came up with another reason which is similar as that of the obligation arising from penal offense where compensation would be improper and inadvisable because the satisfaction of such obligation is **imperative**. Both obligations (obligation arising from a penal offense and obligation of a partner arising from damages) are based on **injury or harm**, which makes me think why they should not be set off or compensated. Meanwhile, Tolentino did not provide any reason at all.

**Exception:** If unusual profits are realized through the extraordinary efforts of the partner at fault, the courts may equitably mitigate or lessen his liability for damages. This rule rests on **equity**.

## **RESPONSIBILITY OF PARTNERSHIP TO PARTNERS**

In the absence of stipulation to the contrary, every partner is an agent of the partnership for the purpose of its business. Hence, the partnership has the obligation to:

1. Refund amounts disbursed by the partner in behalf of the partnership plus interest from time expenses made
2. Answer for obligations the partner may have contracted in good faith in the interest of the partnership business.

Being a mere agent, the partner is not personally liable as long as he is free from fault and acted within the scope of his authority.

## **Rules for distribution of profits and losses**

### ***Distribution of profits -***

1. The partners share the profits according to their agreement
2. If there is no such agreement:
  - a. The share of each **capitalist** partner shall be **in proportion** to his **capital contribution**.
  - b. **Industrial** partner shall receive such share, which must be satisfied first before the capitalist partners shall divide the profits, as may be just and equitable under the circumstances. It is not fixed.

### **Distribution of losses -**

1. According to agreement.
2. If no such agreement, but contract provides for share in profits, share in losses in accordance with profit-sharing ratio, but industrial partner not liable for losses.
3. No profit-sharing stipulated, losses in proportion to capital contributions, but industrial partner not liable for losses.

**Reason why industrial partner is exempted from losses** - while capitalist partners can withdraw their capital, the industrial partner cannot withdraw any labor or industry he had already exerted. Moreover, in a certain sense, he already has shared in the losses in that, if the partnership shows no profit, this means that he has labored in vain. (taken by Paras from Manresa)

### **Problem**

A partnership was formed with the following contributions:

Dick - 50,000  
Eddie - 30,000  
Jamby - 20,000 + services  
JC - services

In 2011, the partnership gained a profit of 1,200,000. The partners believe that both Jamby and JC must receive 100,000 each year. How much would be the share of each partner in the profit?

### **Answer**

	<b>Salary</b>	<b>Share in the remaining profit (1,200,000 - 200,000 = 1,000,000)</b>	<b>Total</b>
<b>Dick</b>	-	50% x 1,000,000 = 500,000	500,000
<b>Eddie</b>	-	30% x 1,000,000 = 300,000	300,000
<b>Jamby</b>	100,000	20% x 1,000,000 = 200,000	300,000
<b>JC</b>	100,000	-	100,000

However, in 2012, the same partnership lost 500,000. How much would be the share of each partner in the profit?

### **SCOPE OF POWER OF A MANAGING PARTNER**

**General rule:** partner appointed as manager has all the powers of a general agent as well as all the incidental powers necessary to carry out the object of the partnership in the transaction of its business.

**Exception:** when powers of manager specifically restricted.

### **Where respective duties of two or more managing partners not specified**

**Each one may separately perform acts of administration -**

1. If one or more of the managing partners shall oppose the acts of the others, then the decision of the majority of the managing partners shall prevail. Right to oppose can be exercised only by those entrusted with mgt.
2. In case of tie, matter shall be decided by the vote of the partners owning the controlling interest.

#### ***Requisites for the application of the rule-***

1. Two or more partners have been appointed as managers;
2. There is no specification of their respective duties;
3. There is no stipulation that one of them shall not act without the consent of all the others.

#### **When consent of other partners stipulated**

***Concurrence necessary for validity of acts*** - The partners may stipulate that none of the managing partners shall act without the consent of the others. In such a case, the unanimous consent of all the managing partners shall be necessary for the validity of their acts. This consent is so indispensable that neither absence nor disability of any one of them may be alleged as excuse to dispense with requirement.

Exception: When there is **imminent danger of grave or irreparable injury** to the partnership then a partner may act alone without consent of partner who is absent or under disability.

***Consent of managing partners not necessary in routine transactions*** - The requirement of written authority refers evidently to formal and unusual written contracts.

#### **Rules when manner of management has not been agreed upon**

***All partners considered managers and agents*** - All partners shall have equal rights in the mgt and conduct of partnership affairs. All of them shall be considered mgrs and agents and whatever any one of them may do alone shall bind the partnership. If there is timely opposition, however, the matter shall be decided by majority vote. In case of tie, vote of partners representing controlling interest.

***Unanimous consent required for alteration of immovable property*** - The consent need not be express. It may be presumed from the fact of knowledge of the alteration without interposing any objection.

Prohibition only applies to immovable property because of the greater importance of this kind of property than personal property, and the alteration thereof must be important. Besides, upon dissolution, if possible, the property contributed should be returned to the partners in the same condition as when they were delivered to the partnership. This would be an act of **strict dominion**.

#### **EXTENT OF PROPERTY RIGHTS OF A PARTNER**

##### ***Principal rights -***

1. Rights in specific partnership property;
2. Interest in partnership;

### 3. Right to participate in management.

#### **Nature of partner's interest in the partnership**

The interest of the partner in the partnership has been otherwise described as the net balance remaining to him; after all partnership debts or claims against it have been paid and the equities and accounts between such partner and his copartners have been adjusted.

**Share of the profits and surplus** - The partner's interest in the partnership consists of his share in the undistributed profits during the life of the partnership as a going concern and his share in the undistributed surplus after its dissolution.

**Profits:** the excess of returns over expenditure in a transaction or series of transactions; or the net income of the partnership for a given period of time.

**Surplus:** the assets of the partnership after partnership debts and liabilities are paid and settled and the rights of the partners among themselves are adjusted. It is the excess of assets over liabilities. If the liabilities are more than the assets, the difference represents the extent of the loss.

**Extent of the partner's interest** - The interest in surplus alone w/c remains after the firm's debts have been paid and the equities between the partner and his co-partners have been adjusted and the partner's share has been ascertained and set apart.

#### **PARTNERS' OBLIGATIONS TO THIRD PERSONS**

##### **Requirement of a firm name**

**Meaning of word "firm":** The name, title, or style under which a company transacts business; a partnership of two or more persons; a commercial house. In its common acceptance, the term implies a partnership. The term is also used as synonymous with "company," "house," and "concern."

**Importance of having a firm name** - A partnership must have a firm name under which it will operate. A firm name is necessary to distinguish the partnership which has a distinct and separate juridical personality from the individuals composing the partnership and from other partnerships and entities.

**Right of partners to choose firm name** - The partners enjoy the utmost freedom in the selection of the partnership name. As a general rule, they may adopt any firm name desired.

**Use of misleading name** - The partners cannot use a name that is identical or deceptively confusingly similar to that of any existing partnership or corporation or to any other name already protected by law or is patently deceptive, confusing or contrary to existing laws, as to mislead the public by passing itself off as another partnership or corporation, or its goods or services as those of such other company.

##### **Liability for inclusion of name in firm name**

Persons who, not being partners, include their names in the firm name do not acquire the rights of a partner but shall be subject to the liability of a partner insofar as 3<sup>rd</sup> persons without notice are concerned. Such persons become partners by estoppel.

This does not cover the case of a limited partner who allows his name to be included in the firm name, or of a person continuing the business of a partnership after dissolution, who

uses the name of the dissolved partnership or the name of a deceased partner as part thereof.

### **Distinction between a liability and a loss**

The inability of a partnership to pay debt to a 3<sup>rd</sup> party at a particular time does not necessarily mean that the partnership business, as a whole, has been operated at a loss. The partnership may have outstanding credits which for the moment may be unavailable for the payment of debts, but which eventually may be realized upon and yield profits more sufficient to cover all losses.

While an industrial partner is exempted by law from losses (as between or among the partners), he is not exempted from liability to third person. The creditor of the firm can sue the partnership, all the partners, including the industrial partner. The partners are liable jointly or pro-rata **after** exhausting the partnership property. Later, the industrial partner who contributed his share may ask for reimbursement from the capitalist partners, unless there is contrary agreement (De los Reyes and Compania Maritima cases)

### **Liability for contractual obligations of the partnership**

**Partnership liability** - Partners are principals to the other partners and agents for them and the partnership. They are liable to 3<sup>rd</sup> persons who have dealt with one of them in the same way that a principal is liable to 3<sup>rd</sup> persons who have dealt with an agent. The general rule is that a partner has the right to make all partners liable for contracts he makes for the partnership in the name and for the account of the partnership.

**Individual liability** - A partner, however, may assume a separate undertaking in his name with a 3<sup>rd</sup> party to perform a partnership contract or make himself solidarily liable on a partnership contract. In such case, the partner is personally bound by his contract even if only the partnership is shown to have derived benefits from it.

### **Nature of individual liability of partners**

**Pro rata** - Equally or jointly, not proportionately. Pro rating is based on the number of partners and not on the amount of their contributions to the common fund, subject to adjustment among the partners. *It would be mindless to allow a proportionate share in the payment of obligations because if that happens, industrial partners would end up NOT paying (he does not have any contributions in the form of property or money to speak of).*

**Subsidiary or secondary** - It is subsidiary or secondary because the partners become personally liable only after all the partnership assets have been exhausted. Thus, the partners are liable as guarantors in favor of partnership creditors to the extent that the assets of the firm are not sufficient to meet its obligations. They may be joined as party defendants in the same action against the partnership subject to their right to prior exhaustion of partnership property.

Even the industrial partner who, ordinarily, is not liable for losses would have to pay but, of course, he can recover the amount he has paid from the capitalist partners unless there is an agreement to the contrary.

**Reason why industrial partners are not exempted from paying liabilities** - the commentaries by Paras, Suarez and Tolentino did not mention any supporting reason for this rule but I surmise, though I may not be correct, that the reason why the Civil Code included this provision is to give **convenience** to the partnership's creditors. As to the eyes of the partners, there are distinctions between capitalist and industrial partners but as to the eyes

of the creditor, it would be uneasy for him to determine who the industrial partners are and who the capitalist partners are. This is anchored on the remedy given by law to industrial partner that he can recover the amount he has paid from the capitalist partners. Furthermore, it would also be uneasy for him to determine the capital contributions and compute the amount he will receive from each partner if the liabilities of the partners be proportionate.

### **Stipulation against liability**

A stipulation among the partners contrary to the *pro rata* and subsidiary liability expressly imposed by law is void and of no effect insofar as it affects the rights of 3<sup>rd</sup> persons. It is valid and enforceable only as among the partners.

### **Power of partner as agent of partnership**

In the absence of an agreement to the contrary, all partners have equal rights in the management and conduct of the partnership business.

***As among themselves*** - When a partner performs an act within the scope of his actual, implied, or apparent authority, he is not only a principal as to himself, but is also for all purposes, an agent as to his co-partners or to the partnership, considered as a group. Principle of mutual agency.

***As to third persons*** - Limitations upon the authority of any one of the partners are not binding upon innocent 3<sup>rd</sup> persons dealing with the partnership who have the right to assume that every general partner has power to bind the partnership especially those partners acting with ostensible authority, by whatever is proper for the transaction in the ordinary and usual manner of the business of the partnership.

***No duty to make inquiries as to acting partner's authority*** - 3<sup>rd</sup> persons are not bound, in entering a contract with any of the partners, to ascertain whether or not the partner with whom the transaction is made has the consent of the other partners. His knowledge is enough that he is contracting with a partner.

***Presumption that acting partner has authority to bind partnership*** - There is a general presumption that each individual partner is an agent of the firm and that he has authority to bind the firm in carrying on the partnership transactions. The presumption is sufficient to permit 3<sup>rd</sup> persons to hold the firm liable on transactions entered into by any one of the members of the firm acting apparently in its behalf and within the scope of his authority.

***No right to assume that acting partner has unlimited authority*** - The apparent scope of the partner's authority is the whole scope of the partnership's customary business. However, 3<sup>rd</sup> parties should not assume that a partner has unlimited authority. Generally, a partner has no authority to do the acts enumerated in the 3<sup>rd</sup> paragraph of Article 1818.

### **Liability of partnership for acts of partners**

The acts of a partner mentioned in Article 1818 may be grouped into three:

1. ***Acts for apparently carrying on in the usual way the business of the partnership (par. 1)*** - Every partner is an agent and may execute such acts with binding affect on the partnership even if he has in fact no authority unless the 3<sup>rd</sup> person has knowledge of such lack of authority.

There are **two requisites** in order that the partnership will not be liable:

- a. The partner so acting has in fact no authority; and
  - b. The 3<sup>rd</sup> person knows that the acting partner has no authority.
2. **Acts of strict dominion** (*pars. 2 and 3*) - For acts which are not apparently for carrying on in the usual way of business of the partnership, the partnership is not bound, unless authorized by *all* the other partners or unless they have abandoned the business. The general rule is that powers not specifically delegated in a partnership agreement are presumed to be withheld. *Unlike act #1, it seems that the law does **not require knowledge by 3<sup>rd</sup> person** of lack of authority in this kind of act. In addition to acts that are **not apparently for carrying on the usual way of business**, Article 1818 enumerates other acts that need other partners' authorization:*
- a. Assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership - *reason: firm will be dissolved*
  - b. Dispose of the goodwill of the business - *goodwill is valuable property*
  - c. Do any other act which would make it impossible to carry on the ordinary business of a partnership - *evidently prejudicial*
  - d. Confess a judgment - *if done before a case is filed, this is null and void; if done later, firm would be jeopardized*
  - e. Enter into a compromise concerning a partnership claim or liability
  - f. Submit a partnership claim or liability to arbitration
  - g. Renounce a claim of the partnership

### **Liability arising from partner's tort or breach of trust**

**Nature of liability** - Articles 1822-24 provide for the **solidary** liability of the partners and the partnership to 3<sup>rd</sup> persons for the wrongful act or omission or breach of trust of a partner acting within the scope of the firm's business or with the authority of his co-partners. This is true even though the other partners did not participate in, or ratify, or had no knowledge of the act or omission.

This liability of the partners is different from their liability for *contractual* obligations as defined in Article 1816. Here, it is solidary, while in Article 1816, it is joint and subsidiary. Furthermore, while the liability in Article 1816 refers to partnership obligations, this article covers the liability of the partnership arising from the **wrongful acts or omissions** of any partner. The act or omission is called tort when it does not constitute a crime or felony punishable by law.

**Reason for imposition of wider liability** - Public policy. The obligation is solidary because the law protects him who, in good faith, relied upon the authority of a partner, whether such authority is real or apparent.

**Injured party may proceed against partnership or any partner** - Since the partners are liable solidarily, the party aggrieved has his election to sue the firm or to sue one or more of its members. He may even single out for suit a partner who, personally, was in no wise involved in the commission of the tort or breach of trust.

### **Requisites for liability:**

1. A partner must be guilty of a wrongful act or omission

2. He must be acting in the ordinary course of business, or with the authority of his co-partners even if the act is unconnected with the business.

The partnership is not liable if the partner acted on his own and not for the benefit of the partnership in the course of some transaction not connected with the partnership business. I believe that the provisions of Article 1818 apply to this.

## **OBLIGATIONS OF OUTGOING AND INCOMING PARTNERS**

### **Liability of incoming partner for partnership obligations**

**Limited to his share in partnership property for existing obligations** - When a partner is admitted as a partner into an existing partnership, he is liable for all obligations existing at the time of his admission as though he was already a partner when such obligations were incurred. For such obligations, his liability is limited to his share in the partnership property, unless there is a stipulation to the contrary.

**Extends to his separate property for subsequent obligations** - Only those who were already partners at the time when the obligations were incurred are liable with their separate property. For all the obligations accruing subsequent to the admission of the new partner, all the partners are liable with their separate properties.

### **Rights of existing and subsequent creditors**

Existing and subsequent creditors have equal rights as against partnership property and separate property of the previously existing members of the partnership while only subsequent creditors have rights against the separate estate of the newly admitted partner.

### **Liability of outgoing partner**

**Contract made before retirement or withdrawal** - Where a partner gives notice of his retirement or withdrawal from the partnership, he is freed from any liability on contracts entered into thereafter, but his liability on existing incomplete contracts continues. Thus, he is liable for goods sold and delivered after his retirement or withdrawal and notice thereof, if the same was pursuant to a contract made before such retirement or withdrawal.