

Reviewing partners' liability principles

David Schmitz analyses the liability to one another of partners who are negligent but who acted in good faith

IN RECENT YEARS it has become clear that partners can claim damages against one another for breaches of their duties of good faith, and that they are not necessarily to be confined to such relief as may avail them in an account taken on dissolution. See *Mullins v Laughton* [2003] Ch 250, where a partner who had been expelled from a firm in breach of his former partners' duty of good faith was held entitled to recover damages for loss of reputation and disruption to his career.

There is surprisingly little authority, however, on the question of whether one partner or group of partners can claim successfully against another partner or group of partners for negligence which does not amount to a breach of their duty of good faith to one another. The classic case, cited in Lindley, is *Bury v Allen* (1845) 1 Colly 589, but the reference to negligence is casual. It is also obiter, as the headnote clearly discloses a case of breach of duty of good faith.

There are three cases which bear on negligence that is unaccompanied by a breach of the duty of good faith, one from England, one from Australia and one from Scotland.

In the English case, *Winsor v Schroeder* (1979) NLJ 1266 two partners had purchased a property together for the purpose of doing it up and selling it. A slump in the property market occurred, one of the partners went overseas leaving it to the other partner to sell it and the partner left behind turned down an offer which an estate agent had obtained (some £3,000 below the price which he had been advised was the market price) and withdrew the property from the market.

Eventually the property was sold for an even lower price. Woolf J held that the partner who had the conduct of the sale was liable to the other partner, and said, after observing that the duties of care of a trustee and of a partner in the circumstances were identical, said "W as a trustee would not be liable for making an innocent mistake as long

as he acted in good faith. W had acted honestly and in good faith but his rejection of P's offer was much more than an error of judgment. W was required not to act below the standards of a reasonable businessman in the situation in which he found himself. He acted wholly out of accord with the standard. If he did not feel convinced by the advice which he received from the estate agents he had retained, he should have sought further advice or at least made some enquiries as to the state of the property market in the area."

Not bear all the losses

It is submitted that this case does not set out any principles of general application and that on its facts it places too high a burden on a partner. One partner should not normally be made to bear all of the losses consequential on his failing to sell a property on an estate agent's advice, and the case will probably be distinguished should it be cited. In England, therefore, there is little to go on, other than the passing reference to the possibility for suing in negligence which is found in *Bury*.

In the Australian case *Lane v Bushby* [2000] NSWSC 1029 solicitors sued a partner in respect of a claim made against the firm by clients for damages arising out of the negligent failure to ensure the execution of a deed of trust in connection with the purchase of land, which failure gave rise to a stamp duty charge against the clients. No formal partnership agreement had ever been made, and the judge refused to imply into the informal agreement a term that, in the event of the partnership incurring a liability to a third party because of the negligence or default of a particular partner, such partner would be liable to indemnify the other partners in respect of their liability to the third party. The judge then went on to consider the Australian Partnership Act 1892 s 24, which is in identical terms to s 24 of the English Partner-

ship Act 1890, and which provides: "(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm".

The judge held, firstly, that if it were appropriate to imply the terms alleged by the plaintiff and to give them the effect claimed, it would seem appropriate to imply such or similar terms into all partnership agreements, and that if such were the case, one would then expect s 24 to provide expressly for such a term by way of an exception to the passage quoted above. He then noted that the section provides that the firm must indemnify every partner in respect of payments made and personal liabilities incurred in the ordinary and proper conduct of the business of the firm, and noted further that as the section has been interpreted over the years, it is only in cases of wilful misconduct or gross or culpable negligence that a partner will be required to bear any loss himself without the benefit of such indemnity. The judge then held that in the case before him: "[T]he defendant was acting for the clients in a conveyancing transaction which was part of the ordinary and proper business of the partnership. His negligence was in failing to have the contract for the purchase of the land executed prior to the deed of trust. Whilst such an act was... negligent... it was the kind of thing which could easily occur (although it should not) in the ordinary day to day practice of a busy solicitor; and could not be characterised as gross or culpable negligence."

Gross negligence

This approach leaves little room for a partner to bear the burden of liabilities which his negligence has caused the firm, firstly because the firm will not generally be liable for his negligence at all except in cases where



he has acted in the ordinary conduct of the business of the firm (thus bringing the partner within the protection of the indemnity provision of s 24), and secondly because the term "gross negligence" (that is the term used in *Bury*) has long been regarded as shedding little light, gross negligence being described as no more than "ordinary negligence with a vituperative epithet" (per Willes J in *Grill v General Iron Screw Collier Co* (1866) LR 1 CP 600, 612).

The Scottish case of *Ross Harper & Murphy v Scott Banks* [2000] SCLR 736 adopts a different approach. First of all, it rejected the following suggestion in Erskine that partners are not liable to one another for negligence in the conduct of the firm's business: "It also proceeds from the mutual confidence inherent in this contract [of partnership] that the several partners are not always obliged to use that middle kind of diligence which prudent persons employ in their own affairs; they are secure if they manage the company's concerns as they would do their own. If therefore a partner should fall into an error of management, for want of a larger share of prudence or skill than he was truly master of, he is not answerable for the consequences. *He did his best, and the other partners have themselves to blame that they did not make choice of a partner of greater abilities.*" [emphasis added].

Standard of care

The judge then held: "[A] standard of care based exclusively on that referable to the individual alleged to have been at fault

seems less satisfactory, even in the context of a partnership relationship. *On the other hand, the standard of care owed by partners among themselves must, in my view, reflect the nature of the partnership relationship and must also be affected by the incidents and practices within the particular partnership where the issue arises.*"

He concluded: "A partner may in certain circumstances be liable in damages to his firm. . . for loss sustained by reason of liability incurred to a third party and that these circumstances are not restricted to those where the offending partner has been responsible for fraudulent or illegal activity; the duty extends, in my view, to a duty of care. . . The more difficult and uncertain question is whether breach of that duty will occur my "mere" or "ordinary" negligence or only where something more ("gross negligence" or "recklessness" or the like) occasions the loss. In the absence of clear and binding authority I favour a standard which requires the exercise of reasonable care in all the relevant circumstances.

Those circumstances will include recognition that the relationship is one of partnership (*which may import some mutual tolerance of error*), the nature of the particular business conducted by the partnership (including any risks or hazards attendant on it) and any practices adopted by that partnership in the conduct of that business. . . *In respect of liabilities incurred by the firm to a third party, it is, however, important to notice that breach of a duty of reasonable care to the third party will not of itself import a breach by the "delinquent" partner of his*

obligation to the firm. The legal relationships are different." (emphases added).

It is submitted that this "hybrid standard", as the editor of *Lindley* calls it, is the key to the solution, notwithstanding that the learned editor says that it leaves many unanswered questions. Where partners' dealings with one another are under consideration, they are not to be judged as strictly as the firm is judged when it undertakes duties of care to its clients.

On the other hand, when the partners of the firm are judged on their dealings inter se, there should be standards, breach of which gives rise to liability to fellow partners, even if the partner was honest and even if he observed the standards of care which he applied to the conduct of his personal affairs.

Ultimately, the question of liability must depend upon the facts of the case, and in particular upon whether or not the particular partners in the particular business or profession should be held to have undertaken the risk that one of their number might commit negligence of the nature or degree in question.

Matters such as the standing of the partner, the availability of insurance to cover the full extent of the loss and past warnings should all be relevant. It is in such considerations that one fleshes out the hybrid standard.

The editor of *Lindley* observes that there needs to be guidance in England on whether the applicable standard should be objective (that which is reasonable) or subjective (that which the particular partner would do with regard to his own affairs). His view is that for the moment the balance of authority is in favour of a subjective standard (notwithstanding *Winsor v Schroeder*).

It is to be submitted that the correct standard to be applied to a partner's dealings with the firm should be a hybrid – between the objective and the subjective – taking into account both that which is generally reasonable and that which is appropriate to the character and circumstances of the particular partner. Such hybridisation exists elsewhere in the law. Thus, s 174 of the Companies Act 2006 states that the director of a company should be judged by: "(a) the general knowledge skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and (b) the general knowledge, skill and experience that the director has."

Perhaps partnership lawyers should derive inspiration from this provision.

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