

You've been in the renovation business with Julie for two years. In the beginning, you both agreed to be equal partners, and each of you put in \$10,000 cash. Today, you often disagree on the amount of work each of you should do. For the past six months, you've been spending at least 60 hours a week on the business whereas your partner Julie has put in 40 hours at most. However, she claims to be entitled to half the profits from the business. You find this unfair and want to do something about it. A simple solution is a partnership contract.

In the following pages, the Quebec Bar Foundation describes the rules governing the partners of a general partnership. Whether you are recent or long-time partners, you will learn about the importance of discussing with your partners, agreeing on and drawing up a partnership contract that meets your needs. ■

your RIGHTS your Business

Your General Partnership Contract

You may wonder in what situations a partnership, as the legal form of a business, is the better choice than a sole proprietorship or a corporation.

First, as soon as there are two or more people who want to start a business, a sole proprietorship is no longer an option, as it only involves one owner.

A corporation cannot be used to carry on a profession. You may also prefer a partnership over a corporation due to its lack of formalism. Contrary to a corporation, there is no need to fill out forms to set up a partnership, or to keep records and adopt minutes of meetings during the year. Many entrepreneurs also prefer a partnership because it is inexpensive to set up. The only cost is the \$51 registration fee. However, if you choose to have a partnership contract drawn up by a lawyer, you can expect to pay a few hundred dollars in fees.

For more information, read *Booklet 1 "The Legal Form of Your Business"*.

General partnership

There are three types of partnership: a general partnership, a limited partnership and an undeclared partnership. A corporation (formally called a "company"), on the other hand, is a legal person governed by specific rules. The three types of partnership are governed by the *Civil Code of Québec*. The rules that apply to each of these forms of partnership may be different in certain respects.



PARTNERSHIP — a winning combination

As most business people who choose to run their business as a partnership opt for a general partnership, this booklet will only cover this form of partnership.

The following elements must be present if you want to set up a general partnership.

1. Not be in business alone

To be part of a general partnership, you must first go into business by joining up with one or more people and remain at least two partners at all times. If you find yourself alone at some point, such as after your partner leaves, you have 120 days to replace him. After that time,

your business will no longer be considered a general partnership.

2. Have a contract

In all cases, a contract is needed to set up a general partnership. It can be verbal, but it is better if it is in writing. A partnership contract is an agreement through which the parties agree, in a spirit of cooperation, to run a business and contribute to it by pooling property, knowledge or activities and to share the resulting profit with each other.

For example, Charles and Karen agreed to invest a few thousand dollars each to

start up a general partnership specialized in web site design. They chose not to have a written contract but this does not mean that they are not bound by a partnership agreement. However, their verbal contract could be less complete than a written one. If it does not cover everything, the *Civil Code of Québec* will govern the partnership and the partners' conduct.



3. Intend to make a profit and share it

As a partner, you have to plan to share not only the expenses, but also the income you earn from running your business. It is essential that you provide in your partnership contract how you will share the profits, losses and assets of the partnership, especially if you want to share in them other than 50/50. If you join with others for the sole purpose of sharing expenses, such as rent or the cost of a secretary, you will not be setting up a partnership. The lack of intention to share the profits of a common activity prevents a partnership from being formed.



4. Provide a contribution

You and each of your partners will also have to agree on making a contribution to the partnership, which can come in many forms: a sum of money, property, time spent on the business, knowledge or special expertise, etc. Each partner's contribution does not have to be of equal value. It is recommended that you agree from the outset on the type of contribution to be made by each partner as well as its value, to avoid potential disputes.

5. Intend to form a partnership

You and each of your partners must be able to show your intention to work together and do business in a spirit of cooperation. This test is often the decisive factor in determining whether the agreement binding the parties is a general partnership contract.

The partnership's internal operation

Several rules govern the day-to-day operation of a general partnership.

One of those rules is that one or more partners may act as the administrator on behalf of the partnership. The administrator is the person who manages the partnership and represents it. He acts as the partners' agent in certain situations, such as

before the courts. It is also possible to appoint someone other than a partner to act as the administrator.

It is up to you and your partners to appoint the administrators. If you don't, the law provides that each partner acts as an administrator.

The law also provides that each partner of a general partnership is entitled to one vote, regardless of the amount of money invested in the business. It is important to know that

provide for the percentage of votes required for a decision to be considered accepted.

However, certain rules apply to all partners of a general partnership and they cannot be derogated from by providing otherwise in the partnership contract.

For example, Stephen agreed with his two partners, Frank and Isobel, to include in their partnership contract a clause stating that he is the only person authorized to make any deci-



most decisions to be made in a partnership require a "50% + 1" majority. However, some decisions require a higher percentage (ex. a decision to change the partnership contract or terminate the partnership).

In certain cases, the "50% + 1" rule can be changed by the partners in their partnership contract. In this regard, it is recommended that you draw up a list of decisions you consider to be the most important and, where applicable, that you

sions about the partnership. In fact, even though Frank and Isobel agree with this and signed the partnership contract, the clause is invalid for certain decisions. It is prohibited to remove a partner's right to vote on decisions affecting all the partners, such as the decision to wind up the partnership.

LIABILITY of the PARTNERS for the debts

When a business is run in the form of a general partnership, the liability of the partners toward the partnership's creditors is unlimited and the partners are solidarily liable for the payment of the partnership's debts. To find out more about solidary liability, see *Booklet 1 "The Legal Form of Your Business"*.

LIABILITY TOWARD CREDITORS

The legal rules regarding the payment of the partnership's debts to its creditors are imperative; they apply to all the partners. In practice, this means that if the business cannot pay its creditors, they may turn to the partners directly to obtain payment of what they are owed, notwithstanding the presence of a verbal agreement or clause to the contrary in the partnership contract.

For example, Mary sets up a general partnership with Allen. The partnership's financial institution is asking it to repay a \$15,000 loan. If the partnership is unable to pay, Mary or Allen may be held personally liable to pay this creditor the full amount of the debt.

In other words, the financial institution may force Mary to pay the \$15,000 out of her savings or, after obtaining a judgement, have her personal property seized (car, house, cottage, etc.) in order to be paid.

Contrary to popular belief, it is not possible to provide a clause in a partnership contract reducing the liability of the partners toward the creditors of the business. Such a clause cannot be enforced against the financial institution claiming repayment of a loan.

LIABILITY AMONG PARTNERS

The legal rules respecting the liability of the partners among each other only apply in the absence of an agreement between the parties. In such a case, the sharing of the debts among the partners equally or unequally can therefore be provided or a clause can even be included which completely excludes a partner from sharing in the partnership's debts.

In our example, if the financial institution demands that Mary repay the entire loan, she must pay it in full; it's the law. Mary can then turn to Allen, her partner, to have him reimburse her part of this amount.

If, for example, Allen is required by contract to pay 30% of the debts among the partners, Mary will only be able to claim \$4,500 from him out of the \$15,000 paid. In the absence of a special clause in the partnership contract or a verbal agreement between the partners, each of them is bound to pay the debts among the partners equally, i.e. \$7,500 each. If Allen turns out to be insolvent, Mary will have to bear the \$15,000 loss alone. This is another reason to carefully choose your partners and make sure you know them well.

Summary Table

	The Law	The Partnership Contract	Our Example
Toward creditors <i>Toward creditors</i>	<ul style="list-style-type: none"> ❖ The rules prescribed by law are imperative. They apply to everyone. ❖ The laws provides for solidary liability among the partners, i.e. each of them is liable for the entire debt. 	<ul style="list-style-type: none"> ❖ The clauses of the contract that are contrary to the law are invalid. 	<ul style="list-style-type: none"> ❖ Mary or Allen may be held liable toward the financial institution for the entire debt, i.e. \$15,000.
Among partners <i>Among partners</i>	<ul style="list-style-type: none"> ❖ The rules prescribed by law are suppletive. They apply in the absence of a verbal agreement or a clause in the partnership contract. ❖ The law provides that, in the absence of an agreement on the sharing of the property, profits or debts of the partnership, the partners are liable for the debts 50/50. 	<ul style="list-style-type: none"> ❖ Each of the partners is liable according to the % set out in the partnership contract. Their share may be equal or unequal. 	<ul style="list-style-type: none"> ❖ In the absence of an agreement on the sharing of the property, profits or debts among the partners, if Mary makes the \$15,000 payment to the financial institution, she can force Allen to pay her \$7,500.



The partnership contract

Your partnership contract may be written or verbal. If it is verbal, it is important that you clearly establish your intention, as well as that of your partners, to carry on a business for the purpose of earning a profit and for each of you to act as partner and not in some other capacity, such as an employee or volunteer.

However, it is preferable to set out your agreement in writing. That way, it is easier to prove what you and your partners had in mind. It also avoids difficulties of interpretation and proof in the event of a dispute with your partners before the courts.

Before setting out your ideas in writing, take the time to talk to your partners and agree on how your business will be run. How will decisions be made within your partnership? How will you share the profits produced by the partnership? What will a normal work week look like?

This exercise will often allow you to find solutions and come to a consensus before problems arise. For a more detailed description of what a partnership contract might contain, don't hesitate to consult a lawyer, who could also give you good advice on how to resolve conflicts among the partners.

If you don't have a written agreement even though you've

been in business for several years, it's never too late to sign a partnership contract. Many people wrongly believe that the legal provisions respecting partnerships will resolve all their conflicts. While it is true that the law proposes solutions, those solutions might not suit you. A partnership contract represents the law of the parties in several regards. If it is well written, it will reflect your view of things.

For example, Caitlin, Martina and Fred decide to become partners. After some discussion, they all decide that Caitlin will be the only partner entitled to bind the partnership for expenses of \$5,000 or less. For purchases of a greater amount, they agree that all the partners will be consulted and have to agree on the proposed purchase. This is a special clause which derogates from the legal



FORMALITIES to be completed

A general partnership is subject to two essential formalities.

1. THE NAME

The name of the partnership must include the words "General Partnership" or the acronym "G.P.". For example, Claudia and Paul carry on business under the name *Every Which Way Outdoor Clothing, G.P.*

2. REGISTRATION

The partners must also register their partnership by filing a registration declaration with the Enterprise Registrar, the *Agence du Revenu du Québec* or with certain Superior Court clerks (at the courthouse) within 60 days of setting up the partnership. This formality is designed to protect the public, i.e. to allow the public to find out about the type of business being carried on, the people who are running it, the partnership's address, etc. It does not confer any other right, but it is mandatory. It costs approximately \$51 to register.

Be careful! It is not enough to file a registration declaration with the Enterprise Registrar to be in compliance with the law throughout the life of the partnership. You must also file an annual update each year.

Also, don't delay in letting the government know when changes in the partnership occur. Ask the Enterprise Registrar for the updating declaration form.

If you do not follow these requirements, the partnership and the administrators may be fined from \$200 to \$2,000.

Don't forget! Indicating the acronym "G.P." or "General Partnership" after the name and registering are two essential formalities for setting up a general partnership. If you don't, your partnership becomes an undeclared partnership. The operation of an undeclared partnership is subject to different rules from those of a general partnership. For example, the law provides that, in the case of a general partnership, the death or bankruptcy of a partner leads to his withdrawal from the partnership, not the end of it. However, in the case of an undeclared partnership, the law provides that the death or bankruptcy of a partner leads to the end of the existence of the partnership with respect to all the partners.



The end of a general partnership

provisions respecting general partnerships under the *Civil Code of Québec*.

The clauses of a partnership contract may be infinitely varied. It is not recommended to copy a friend's contract or to use a model you happen to find in a book. You are strongly advised to see a lawyer to ensure that the partnership contract truly meets your needs and your particular situation.

It is always possible to end a general partnership with the consent of the partners. In such a case, all you have to do is file a notice of dissolution with the Enterprise Registrar confirming the end of the business, along with a notice of appointment of a liquidator (who may be one of the partners). If you forget, you may not only be subject to a fine, you may also extend your liability for the debts of your partnership, even after your business is gone. ■



REMINDER

GENERAL PARTNERSHIP

The requirements

- ✓ be at least two people;
- ✓ have a written or verbal partnership contract;
- ✓ contribute something to the partnership as a partner;
- ✓ have the intention to pool resources in order to carry on a business in a spirit of cooperation;
- ✓ have the intention to earn a profit and share it.

Formalities to be completed

- ✓ indicate the words "General Partnership" or the acronym "G.P." after the name of the partnership;
- ✓ register the business with the Enterprise Registrar, the *Agence du Revenu du Québec* or certain Superior Court clerks (at the courthouse);
- ✓ file your annual update with the Enterprise Registrar if you have been in business for more than one year;
- ✓ file your updating declaration with the Enterprise Registrar if certain changes have been made to the partnership since the registration declaration or the last annual declaration was filed.

What the partnership contract should cover

- ✓ each partner's proportion with respect to the sharing of the profits, assets and debts of the business;
- ✓ the contribution of each partner to the partnership, such as an amount of money, assets, experience and knowledge, etc.;
- ✓ how decisions will be made in the partnership;
- ✓ the desired outcome if certain unwanted events occur, such as the death, illness, disability, etc., of one of the partners.

IF YOU NEED HELP

Enterprise Registrar

2050 Bleury, RC 10 Floor
Montreal QC Tel.: 1-877-644-4545
www.registreentreprises.gouv.qc.ca

Agence du revenu du Québec

Complexe Desjardins, P.O. Box 3000 Succ. Desjardins
Montreal QC H5B 1A4 Tel.: 514-864-4155
www.revenu.gouv.qc.ca

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Quebec City: www.barreau.qc.ca/quebec
Elsewhere in Quebec: www.barreau.qc.ca/aap

If a **PARTNER** leaves



I. THE FORCED DEPARTURE OF A PARTNER

Your partnership contract should cover the possibility of the forced departure of one of the partners. Your partnership is not sheltered from death, bankruptcy, gross negligence committed by a partner, etc.

What happens in these situations? The law provides that the death of a partner generally gives the estate the right to claim the value of his share in the partnership. The same applies in the case of bankruptcy: the partner is entitled to be reimbursed his share in the partnership. Also, if one of your partners seriously breaches his obligations or harms the partnership's activities, you and your partners can vote to expel him.

In the absence of an agreement among you, the value of the share of the partner forced to leave the partnership is determined by an expert or the court. This can be a long and costly process. In this sense, a verbal agreement or the inclusion of a clause in your partnership contract providing a mechanism for determining the value of your share can be very useful and complete what is provided for by law, taking your wishes into account. If applicable, why not set out terms of payment? You can also mention in your contract other situations which could give rise to a departure: change of career, illness, conflict or an irreconcilable difference.

2. VOLUNTARY DEPARTURE OF A PARTNER

It can be very beneficial for you and the partnership to draw up certain rules to be followed when a partner decides to voluntarily end his participation in the business.

What the law provides

If there is no specific clause in the partnership contract providing what formalities have to be carried out in order to voluntarily leave a partnership, the *Civil Code of Québec* states what rules must be followed. When the duration of the partnership is not determined, the law provides that a partner may withdraw from the partnership, if he does so in good faith and at a time which does not cause the partnership harm.

For example, David has been a partner in a dentists' office for 15 years. He has decided to end his association with his two colleagues. No special rule is included in the partnership contract respecting the voluntary departure of one of the partners and no term was indicated regarding the duration of the partnership. If he is in good faith and does so at a time that does not cause harm to the partnership, David only has one obligation, that of informing his two partners of his intention to withdraw from the partnership.

If the duration of the partnership is determined in advance, the law provides that a partner can only withdraw from the partnership with the consent of the majority of the other partners. For example, two years ago, Bill, Joan and Sylvester signed a five-year partnership contract. However, Sylvester wants to end his association with the others during the next few months. By law, he must obtain the consent of both his partners.

Make your own law!

If you wish, you can ignore all or some of the legal provisions in whole or in part. There is nothing to prevent you from simplifying or completing these provisions as you like. For example, a clause in your partnership contract may require that a partner wishing to leave provide a minimum of three months' written notice.

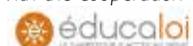
Whether a departure is voluntary or forced, don't forget to file an updating declaration with the Enterprise Registrar indicating the partner's departure. If you don't, the partner who has left could be held liable for the partnership's debts toward third parties, despite the fact that he is no longer part of it.

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**The information found in this booklet is general and does not constitute a legal opinion.
If you have specific questions or a legal problem, don't hesitate to consult a lawyer.**

In this text, the masculine form is used to refer to both men and women.

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