

LAW ON PARTNERSHIP

Chapter III DISSOLUTION AND WINDING UP

**CIVIL CODE OF THE PHILIPPINES
Art. 1828-1842**



LAW ON PARTNERSHIP

Article 1828

The dissolution of a partnership is the change in the relation of partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of business. (n)

Article 1829

On dissolution, the partnership is not terminated, but continues until the winding up of partnership affairs is completed. (n)

Article 1830

Dissolution is caused:

- (1) Without violation of the agreement between the partners;
- (2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this article, by the express will of any partner at any time;
- (3) By any event which makes it unlawful for the business of the partnership to be carried on or the members to carry it on in partnership;
- (4) When a specific thing, which a partner had promised to contribute to the partnership, perishes before the delivery; in any case by the loss of the thing, when the partner who contributed it having reserved the ownership thereof, has only transferred to the partnership the use or enjoyment of the same; but the partnership shall not be dissolved by the loss of the thing when it occurs after the partnership has acquire the ownership thereof;
- (5) By the death of any partner;
- (6) By the insolvency of any partner or of the partnership
- (7) By the civil interdiction of any partner;
- (8) By degree of court under the following article. (1700a and 1701a)

- Dissolution is usually caused by change a change of relation between partners.
- If there is dissolution, no new partnership business may be undertaken
- Upon dissolution, partnership continues until winding up and liquidation is completed.

• CAUSES OF DISSOLUTION:

(1) WITHOUT VIOLATION OF AGREEMENT

- (a) Termination/expiration of term or specific undertaking
- (b) Upon express will of any partner if there is no term or specific undertaking AS LONG AS PARTERS ACT IN GOOD FAITH.
- (c) Upon the will of the partners whose interest is not assigned or charged.
 - Example:
A sold his interest to E, and B's interest is charged to F because he borrowed P50,000 from him. C and D are the only ones who can ask for dissolution since their interest is not assigned or charged.
- (d) Expulsion bona fide of a partner (a partner is expelled in good faith in accordance with agreement.
- (e) Expulsion has the effect of decreasing the # of partners.

(2) IN VIOLATION OF THE AGREEMENT

- Example:
A, B, and C agreed that the term of their partnership is only until Dec. 31, 2011. A goes to premature resignation (resigns early from partnership). No one can prevent A from resigning, but the partners can ask for damages for not staying with the agreement.
- (3) When it becomes unlawful for a partnership to carry on the business or partner to carry on his role
 - (4) When specific thing is contributed, and before deliver, it is lost.
 - If it is lost after delivery, partnership is not dissolved.
 - If use is contributed, it is lost before or after delivery (it doesn't matter when it was lost), partnership is dissolved.
 - If what is to be contributed is generic, and it is lost, there is no dissolution.

Article 1831

On application by or for a partner, the court shall decree dissolution whenever:

- (1) A partner has been declared insane in any judicial proceeding or is shown to be of unsound mind;
- (2) A partner becomes in any other way incapable of performing his part of the partnership contract;
- (3) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business;

- (4) A partner willfully or persistently commits breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him;
 - (5) The business of the partnership can only be carried on at a loss
 - (6) Other circumstances that will render dissolution equitable
- On the application of the purchaser of a partner's interest under Article 1813 or 1814:**
- (1) After the termination of the specific term or particular undertaking
 - (2) At any time the partnership was a partnership at will when the interest was assigned or when the charging order was issued. (n)

- When can a partnership be dissolved judicially?
 - (1) When a partner is DECLARED insane
 - (2) When he becomes incapable of performing his part in the partnership
 - (3) Misconduct of a partner prejudicially to the business
 - (4) Persistent breach of partnership agreement
 - (5) The business can only be carried out on a loss
 - (6) Other circumstances:
 - (a) Abandonment of the business
 - (b) Fraud
 - (c) Refusal to render an accounting
 - (7) On application of 3rd parties' (who purchased or have charged a partner's interest) right as per Articles 1813 and 1814

Article 1832

Except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not then finished, dissolution terminates all authority of any partner to act of the partnership:

- (1) With respect to the partners
 - (a) When the dissolution is not by the act, insolvency or death of a partner
 - (b) When the dissolution is by such act, insolvency or death of a partner, in cases where Article 1833 so requires
- (2) With respect to persons not partners, as declared in Article 1834

- General Rule:
When partnerships are dissolved, partners cannot engage in new business transactions because their authority to do so terminates upon the occurrence of dissolution.
- 2 Cases with are Contrary to the General Rule:
 - (1) During the WINDING UP of Business
 - Transactions relating to the winding up of business such as the liquidation of partnership assets can be entered into because the partners' authorities to do so shall continue.
 - (2) To complete unfinished transactions during dissolution
 - Example:
A and B are in a partnership where they have contracted with C to deliver goods in two installments. B resigns after the first delivery is made, thus dissolving the partnership. Can A and B cease to continue with their obligation?
NO. A and B must continue on with their obligation to complete unfinished transactions.
- If dissolution is not by an act, insolvency or death, the authority of partners as among themselves is terminated.
 - Example:
A partnership was dissolved due to the expiration of the term. If C transacts with D after this and he defaults, he will be the only one liable AS TO THE PARTNERS. If A & B are to pay D, C shall reimburse them.

Article 1833

Where the dissolution is caused by the act, death or insolvency of a partner, each partner is liable to his co-partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved unless:

- (1) The dissolution being by act of any partner, the partner acting for the partnership had knowledge of the dissolution
- (2) The dissolution being by death or insolvency of a partner, the partner acting for the partnership had knowledge or notice of the death or insolvency

- If dissolution is caused by an act, insolvency or death, then each partner shall share in the liability of the partnership due to the actions of a partner, unless he had knowledge of an act, insolvency or death, or notice of the insolvency or death.

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- Example:

- (1) B told A that he is resigning TODAY. The partnership is thus dissolved. Should A enter into a contract with D, who shall be liable?
As among themselves, only A because he had knowledge of B's resignation, thus knowing that they are no longer in a partnership.
- (2) If B texts his resignation to A because A is in Mindanao and A contracts with D, was his authority terminated when the text arrived?
No, A's authority was not terminated as he has only received a NOTICE. Mere notice cannot terminate the authority of partners because the grounds are BY AN ACT, and because of this it should be PERSONALLY KNOWN by the acting partner.
- (3) If C texts A that B had died, does their authority terminate once A gets the text message?
Their authority is terminated because in this case, the cause of dissolution is death. Mere notice is sufficient to terminate authority if the grounds are due to the insolvency or to the death of a partner.

Article 1834

After dissolution, a partner can bind the partnership, except as provided in the third paragraph of this article:

- (1) By an act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution
- (2) By any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction:
 - (a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of the dissolution; or
 - (b) Though he had not so extended credit, had nevertheless known of the partnership prior to dissolution, and, having no knowledge or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the place (or in each place if more than one) at which the partnership was regularly carried on.

The liability of a partner under the first paragraph, No. 2, shall be satisfied out of partnership assets alone when such partner had been prior to dissolution:

- (1) Unknown as a partner to the person with whom the contract is made; and
- (2) So far unknown and inactive in partnership affairs that the business reputation of the partnership could not be said to have been in any degree due to his connection with it

The partnership is in no case bound by any act of a partner after dissolution:

- (1) Where the partnership is dissolved because it is unlawful to carry on the business, unless the act is appropriate for winding up partnership affairs; or
- (2) Where the partner has become insolvent; or
- (3) Where the partner had no authority to wind up partnership affairs; except by a transaction with one who –
 - (a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of his want of authority; or
 - (b) Had not extended credit to the partnership prior to dissolution, and, having no knowledge or notice of his want of authority, the fact of his want of authority has not been advertised in the manner provided for advertising the fact of dissolution in the first paragraph, No. 2 (b).

Nothing in this article shall affect the liability under article 1825 of any person who after dissolution represents himself or consents to another representing him as a partner in a partnership engaged in carrying on business (n)

- Partners may still bind the partnership to transactions even after dissolution if the transactions are with respect to the winding up or the completion of unfinished transactions.
- The transaction will be binding if:
 - (1) Credit was extended without knowledge of the dissolution before the dissolution
 - (2) No credit was extended but there was knowledge of the partnership's existence and none of the dissolution
- The partnership is required to have the dissolution be announced in general circulation newspapers of the place of operations. As long as they do this, then it is sufficient notice to all third persons. (If you don't read broadsheets, that's your fault, not the partnership's)
- Liabilities shall be satisfied out of partnership assets alone if the partner being dealt with is a DORMANT partner.
- Upon dissolution, the partnership is no longer bound by transactions :
 - (1) When it becomes unlawful to carry on the business
 - (2) Insolvency of a partner

- (3) Unauthorized winding up, except when
 - (a) Credit was extended and there was no knowledge of the lack of authority
 - (b) No credit was extended and there was no knowledge of the dissolution because there was no advertisement of such
- In the case wherein "A" still represents himself as a partner even if the partnership has already been dissolved, then he is a PARTNER BY ESTOPPEL.

Article 1835

The dissolution of the partnership does not of itself discharge the existing liability of any partner.

A partner is discharged from any existing liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditor and the person or partnership continuing the business; and such agreement may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business.

The individual property of a deceased partner shall be liable for all obligations of the partnership incurred while he was a partner, but subject to the prior payment of his separate debts. (n)

- Dissolution does not discharge the partnership and/or the partners from existing liabilities
- EXAMPLE:
Suppose A, B and C are in a partnership (X & Co.) and owe D a sum of P 26,000.00. Total partnership assets equate to a sum of P 20,000.00.
 - (1) What if C dies and his total assets are worth P2,000.00?
The law says that C's individual property shall be used to clear his liabilities when he was still alive. In all cases, the PERSONAL CREDITOR has priority.
 - (2) What if A resigns? Can he ask to be discharged from his obligation to pay D?
A can only be discharged from his obligation to pay D the sum of P2,000.00 if it was agreed upon by all concerned parties. Agreement can be EXPRESSED or IMPLIED, based on our interpretation of the law.

Article 1836

Unless otherwise agreed, the partners who have not wrongfully dissolved the partnership or the legal representative of the last surviving partner, not insolvent, has the right to wind up the partnership affairs, provided, however, that any partner, his legal representative or his assignee, upon cause shown, may obtain winding up by the court. (n)

- Who can wind up partnership affairs?
 - (1) Whoever is so assigned by the agreement
 - (2) Partners who did not wrongfully cause the dissolution
 - (3) Legal representatives of the last surviving partner (who is not insolvent)
 - (4) The court in a judicial winding up of partnership affairs.

Article 1837

When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners and all persons claiming through them in respect of their interests in the partnership, unless otherwise agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners. But if dissolution is caused by expulsion of a partner, *bona fide* under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under the second paragraph of Article 1835, He shall receive in cash only the net amount due him from the partnership.

When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:

- (1) Each partner who has not caused dissolution wrongfully shall have:
 - (a) All the rights specified in the first paragraph of this article, and
 - (b) The right, as against each partner who caused the dissolution wrongfully to damages for breach of the agreement
- (2) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name either by themselves or jointly with others, may do so, during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any

damages recoverable under the second paragraph, No. 1 (b) of this article, and in like manner indemnify him against all present or future partnership liabilities.

(3) A partner who has caused the dissolution wrongfully shall have:

- (a) If the business is not continued under the provisions of the second paragraph, No. 2, all the rights of a partner under the first paragraph, subject to liability for damages in the second paragraph, No. 1 (b), of this article.
- (b) If the business is continued under the second paragraph, No. 2, of this article, the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damage caused to his co-partners by the dissolution ascertained and paid to him in cash, or the payment secured by a bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest the value of the goodwill of the business shall not be considered. (n)

- Suppose there is a situation wherein A, B and C are in a partnership, X & Co., with total assets of P 26,000.00 and liabilities to D amounting to P 20,000.00. If the partnership is dissolved WITHOUT VIOLATION OF ANY AGREEMENTS, naturally, the liability will be cleared because the partnership assets are more than enough, and the surplus will be given to each of the partners in proportion to their interest in the partnership or as per their agreement.
- What if the partnership was dissolved due to EXPULSION?
Suppose that A was the one expelled from the partnership, then he can only get a share in the NET PROCEEDS of the surplus that would have originally been his.
- What if the partnership was dissolved due to VIOLATION OF AGREEMENTS?
Determine the rights of the INNOCENT and GUILTY parties. Suppose that in this situation, A was the one guilty of violating an agreement. Then B and C will be allowed the following rights:
 - (1) Apply partnership assets to partnership liabilities and distribute the cash surplus amongst themselves.
 - (2) To be indemnified for the damages that A has caused.
 - (3) To continue the business up to the agreed term.
 - (4) To possess partnership property.While A will have the following rights:
 - (1) Partners decide not to continue the business
 - (a) Right to claim his share in the cash surplus, but only the net proceeds of such meaning, the cash surplus less damages.
 - (2) Continue the business
 - (a) Ascertain his interest in the business.
 - (b) Freedom from existing and future liabilities of the partnership.

Article 1838

Where a partnership contract is rescinded on the ground of the fraud or misrepresentation of one of the parties thereto, the party entitled to rescind is, without prejudice to any other right, entitled:

- (1) To a lien on, or right of retention of, the surplus of the partnership property after satisfying the partnership liabilities to third persons for any sum of money paid by him for the purchase of an interest in the partnership and for any capital or advances contributed by him;
- (2) To stand, after all liabilities to third persons have been satisfied, in the place of the creditors of the partnership for any payments made by him in respect of the partnership liabilities; and
- (3) To be indemnified by the person guilty of the fraud or making the representation against all debts and liabilities of the partnership. (n)

- Considers a case wherein a partner was induced to join the partnership by means of fraud or misrepresentation
- The victim can ask for the rescission or restitution of the contract of partnership (return of all his contributions)
- He has the right to the surplus for certain purposes
- He has the rights of a 3rd person or a subrogated creditor after the liabilities have already been paid to recollect what he paid when he entered into the partnership.
- He is entitled to be indemnified for all debts and liabilities that he paid for during his time in the partnership.

Article 1839

In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

- (1) The assets of the partnership are:
 - (a) The partnership property
 - (b) The contributions of the partners necessary for the payment of all the liabilities specified in No. 2
 - (2) The liabilities of the partnership shall rank in order of payment, as follows:
 - (a) Those owing to creditors other than partners
 - (b) Those owing to partners other than for capital and profits
 - (c) Those owing to partners in respect of capital
 - (d) Those owing to partners in respect of profits
 - (3) The assets shall be applied in the order of their declaration in No. 1 of this article to the satisfaction of the liabilities
 - (4) The partners shall contribute, as provided by Article 1797, the amount necessary to satisfy the liabilities
 - (5) An assignee for the benefit of the creditor or any person appointed by the court shall have the right to enforce the contributions specified in the preceding number.
 - (6) Any partner or his legal representative shall have the right to enforce the contributions specified in No. 4, to the extent of the amount which he has paid in excess of his share of the liability.
 - (7) The individual property of a deceased partner shall be liable for the contributions specified in No. 4
 - (8) When partnership property and the individual properties of the partners are in possession of a court for distribution, partnership creditors shall have priority on partnership property and separate creditors on individual property, saving the rights of lien or secured creditors
 - (9) Where a partner has become insolvent or his estate is insolvent, the claims against his separate property shall rank in the following order:
 - (a) Those owing to separate creditors
 - (b) Those owing to partnership creditors
 - (c) Those owing to partners by way of contribution (n)
- Considers the case of liquidation and the distribution of partnership assets
 - Liquidation is when all the assets of the partnership is converted to cash.
 - Total assets will include GOODWILL as well as the original CONTRIBUTIONS of the partners.
 - Order of payment during liquidation:
 - (1) 3rd persons/outside creditors
 - (2) Partner creditors (partners who have claims)
 - (3) Normal partners (all partners)
 - (a) In accordance with the agreement
 - (b) In proportion to their contribution

Article 1840

In the following cases, creditors of the dissolved partnership are also creditors of the person or partnership continuing the business:

- (1) When any new partner is admitted into an existing partnership, or when any partner retires and assigns (or the representative of the deceased partner assigns) his rights in partnership property to two or more of the partners, or to one or more of the partners and one or more third persons, if the business is continued without liquidation of the partnership affairs;
- (2) When all but one partner retire and assign (or the representative of a deceased partner assigns) their rights in partnership property to the remaining partner, who continues the business without liquidation of partnership affairs, either alone or with others;
- (3) When any partner retires or dies and the business of the dissolved partnership is continued as set forth in Nos. 1 and 2 of this article, with the consent of the retired partner or the representative of the deceased partner, but without any assignment of his right in partnership property;
- (4) When all the partners or their representatives assign their rights in partnership property to one or more third persons who promise to pay the debts and who continue the business of the dissolved partnership;
- (5) When any partner wrongfully causes a dissolution and the remaining partners continue the business under the provisions of Article 1837, second paragraph, No. 2, either alone or with others, and without liquidation of the partnership affairs;

- (6) When a partner is expelled and the remaining partners continue the business either alone or with others without liquidation of the partnership affairs.

The liability of a third person becoming a partner in the partnership continuing the business, under this article, to the creditors of the dissolved partnership shall be satisfied out of the partnership property only, unless there is a stipulation to the contrary.

When the business of a partnership after dissolution is continued under any conditions set forth in this article, the creditors of the dissolved partnership, as against the separate creditors of the retiring or deceased partner or the representative of the deceased partner, have a prior right to any claim of the retired partner or the representative of the deceased partner against the person or partnership continuing the business, on account of the retired or deceased partner's interest in the dissolved partnership or on account of any consideration promised for such interest or for his right in partnership property.

Nothing in this article shall be held to modify any right of creditors to set aside any assignment on the ground of fraud.

The use by the person or partnership continuing the business of the partnership name, or the name of a deceased partner as part thereof, shall not of itself make the individual property of the deceased partner liable for any debts contracted by such person or partnership. (n)

- Explains the rights of the creditor in case of partnership dissolution because of membership changes and the business is continued without liquidation.
- The membership changes include RETIREMENT, EXPULSION, DEATH or ADDITION.
- Note that the creditor of the OLD partnership will still be the creditor of the NEW partnership if there is still an old partner/original partner with the NEW partnership. (debt will not be cleared or discharged)
- The creditor will continue to be the creditor of the remaining/new partnership in all cases except when:
 - (1) Rights are assigned to other people (no old partners)
 - (2) Unless there is a promise to pay debt from the new partners or if the creditor can set aside the right of the new partners on the ground of fraud.

Article 1841

When any partner retires or dies, and the business is continued under any of the conditions set forth in the preceding article, or in Article 1837, second paragraph, No. 2, without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such person or partnership may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership; provided that the creditors of the dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner, shall have priority on any claim arising under this article, providing by Article 1840, third paragraph. (n)

- Suppose that A retires but B and C continue the business without liquidation. What are the rights of A?
The rights of A are as follows:
 - (1) That his interest be ascertained as of dissolution date
 - (2) Collect his interest in the partnership plus interest or profits by the use of his right to these as a creditorIf A dies, and the same situation occurs (he did not retire), then his legal representatives have the same rights as mentioned above.

Article 1842

The right to an account of his interest shall accrue to any partner, or his legal representative as against the winding up partners or the surviving partners or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary. (n)

- Who can demand to know how much his interest is in the partnership and from whom?
All involved parties can demand to know how much his interest is. He can demand to know these from the SURVIVING, CONTINUING and WINDING UP partners.