CHAPTER VI DISSOLUTION OF A FIRM

39. Dissolution of a firm:

40. Dissolution by agreement:

41. Compulsory dissolution:

42. Dissolution on the happening of certain contingencies:

43. Dissolution by notice of partnership at will:

44. Dissolution by the Court:

45. Liability for acts of partners done after dissolution:

46. Right of partners to have business wound up after dissolution:

47. Continuing authority of partners for purposes of winding up:

48. Mode of settlement of accounts between partners:

49. Payment of firm debts and of separate debts:

50. Personal profits earned after dissolution:

51. Return of premium on premature dissolution:

52. Rights where partnership contract is rescinded for fraud or misrepresentation:

53. Right to restrain from use of firm name or firm property:

54. Agreements in restraint of trade:

55. Sale of goodwill after dissolution:

39. Dissolution of a firm

On the dissolution of the partnership between all the partners, the firm shall stand dissolved.

> The dissolution of partnership between all the partners of a firm is called the dissolution of the firm.

Section 39 of the Indian Partnership Act, 1932 defines dissolution of a firm. It separates two ideas: dissolution of the *partnership* and dissolution of the *firm*. A partnership is dissolved whenever the relationship among the existing partners changes, for example when a partner retires, dies, is expelled or becomes insolvent, or when a new partner is admitted. In such cases the firm may continue under a reconstituted partnership with the remaining or new partners. A firm is dissolved only when the partnership ends among all the partners together. The business then stops as a partnership business, the firm's assets are realised, its debts are paid, and

any surplus is shared among the partners according to their rights (s. 48). Even after dissolution, partners keep limited authority to wind up the firm's affairs and complete unfinished transactions (s. 47). The Act lists the ways a firm may be dissolved: by agreement of all partners (s. 40), compulsorily, for example when all but one partner become insolvent or the business becomes unlawful (s. 41), on certain contingencies such as expiry of the fixed term or death of a partner, subject to contract (s. 42), by notice when the partnership is at will (s. 43), and by order of the court (s. 44). For example, A, B and C run a cloth business as partners in "ABC Traders". If C retires and A and B carry on the same business under the same name, the old partnership is dissolved but the firm is not, because the partnership has ended only as regards C. But if A, B and C all agree to close the business, sell the stock, pay the creditors and divide what is left, the partnership between all of them ends, and this is a dissolution of the firm under s. 39.

40. Dissolution by agreement

A firm shall be dissolved with the consent of all the partners or in accordance with the contract between them.

> A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners.

Section 40 of the Indian Partnership Act, 1932 lets the partners end their firm voluntarily, without going to court. Under s. 39, dissolving a firm means ending the partnership relation among all the partners, as opposed to a mere change among some of them, such as one partner retiring while the others carry on. Section 40 allows this in two ways. The first is the unanimous consent of all partners. Since the partnership arose from agreement, it can end by agreement, and this applies whatever the deed says and even if the firm was formed for a fixed term or a particular venture that is not yet finished. The second is a contract between the partners, usually a clause in the partnership deed that sets out how the firm may be dissolved: for example, by a majority vote, on notice by any partner, or when a named event occurs. Section 11 allows partners to settle their mutual rights and duties by contract, so such a clause binds all of them even if some partners disagree when the time comes. Dissolution by agreement does not by itself end the partners' liability to outsiders. Under s. 45, each partner stays liable for acts done after dissolution until public notice of the dissolution is given.

After dissolution, the firm's affairs are wound up and its accounts settled under ss. 46 to 48. For example, A, B and C run a cloth business under a deed that does not mention dissolution. If all three agree to close the business, the firm stands dissolved by consent under s. 40, even if C was reluctant at first but finally agreed. If the deed had instead said that "the firm may be dissolved by a resolution of the majority of partners", A and B could dissolve the firm by such a resolution even over C's objection, because C agreed to that term when he signed the deed. In either case, if the partners do not give public notice and A later buys goods on credit in the firm's name from a supplier who did not know of the dissolution, B and C may still be liable to that supplier under s. 45.

41. Compulsory dissolution

A firm shall stand dissolved when all its partners, or all but one, are adjudicated insolvent, or when an event makes its business unlawful.

> A firm is dissolved,
>
> (a) by the adjudication of all the partners or of all the partners but one as insolvent, or
>
> (b) by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership:
>
> Provided that, where more than one separate adventure or undertaking is carried on by the firm the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

Section 41 of the Indian Partnership Act, 1932 deals with compulsory dissolution, meaning dissolution by operation of law. It happens automatically, whatever the partners wish and whatever their partnership agreement says, so no notice, agreement or court order is needed. Clause (a) follows from the nature of partnership, which needs at least two persons (s. 4). A partner who is adjudicated insolvent ceases to be a partner from the date of the order (s. 34). If all the partners, or all but one, are adjudicated insolvent, fewer than two solvent partners remain who can carry on the business, so the firm comes to an end. If only some partners become insolvent and two or more solvent partners remain, the firm is not compulsorily dissolved under this clause, although the agreement or s. 42 may still bring about dissolution. Clause (b) covers supervening illegality. If

a law, order or event makes the firm's business itself unlawful, or makes it unlawful for these particular partners to carry it on together (for example, where one partner becomes an alien enemy on the outbreak of war), the firm is dissolved, because the law will not let an unlawful partnership continue. The proviso prevents this rule from being applied too harshly. Where a firm carries on several separate ventures, the illegality of one or more of them dissolves the firm only for those ventures, and the firm continues for the lawful ones. After dissolution, the partners' authority continues only so far as it is needed to wind up the firm's affairs (s. 47). For example, A, B and C run a firm that trades in liquor and also runs a restaurant. If the State government prohibits the sale of liquor, the liquor business becomes unlawful and the firm is dissolved for that business. Under the proviso, however, it continues to run the restaurant, which is still lawful. Separately, if A and B are both adjudicated insolvent, only C is left as a solvent partner, so the whole firm is dissolved under clause (a). If only A were adjudicated insolvent, he would cease to be a partner under s. 34, but B and C could carry on, and the firm would not be compulsorily dissolved.

42. Dissolution on the happening of certain contingencies

A firm shall stand dissolved, unless the partners agree otherwise, on the expiry of its fixed term, on completion of its undertaking, on the death of a partner, or on a partner's adjudication as insolvent.

> Subject to contract between the partners a firm is dissolved,
>
> (a) if constituted for a fixed term, by the expiry of that term;
>
> (b) if constituted to carry out one or more adventures or undertakings, by the completion thereof;
>
> (c) by the death of a partner; and
>
> (d) by the adjudication of a partner as an insolvent.

Section 42 of the Indian Partnership Act, 1932 lists four events that dissolve a firm automatically. Neither party needs to give notice and no court order is needed. Each one removes the basis on which the partnership was formed. Under clause (a), a firm formed for a fixed period ends when that period runs out. Under clause (b), a firm formed for a particular venture or undertaking ends once that venture is finished. Under clause (c), a firm ends

when a partner dies, because partnership rests on a personal relationship and mutual agency between the particular persons (s. 4). Under clause (d), a firm ends when a partner is adjudged insolvent, because that partner's property vests in the official receiver or assignee and he can no longer act as a partner. All four rules are "subject to contract between the partners." The partners may therefore agree in advance that the firm will continue among the remaining partners after a death or insolvency, or after the term or venture ends. In that case only the affected partner leaves the firm and the firm itself is not dissolved. Separately, s. 17(b) provides that if partners simply carry on business after a fixed term expires, their mutual rights and duties stay the same so far as they fit a partnership at will. For example, A, B and C form a firm to build a particular bridge for the State government. Under clause (b), the firm is dissolved when the bridge is completed and handed over. If B dies before the bridge is finished and the deed says nothing on the point, the firm is dissolved on B's death under clause (c). B's legal heirs then become entitled to his share on settlement of accounts. However, if the partnership deed provides that "the death of a partner shall not dissolve the firm, and the surviving partners shall continue the business", that contract prevails. A and C continue the firm and B's estate is paid out his share. Similarly, if C is adjudged insolvent, the firm is dissolved under clause (d) unless the deed provides otherwise. If it does, C ceases to be a partner from the date of the adjudication order (s. 34).

43. Dissolution by notice of partnership at will

43.1 A partnership at will may be dissolved by any partner giving written notice to all the other partners of his intention to dissolve the firm.

> (1) Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

Section 43(1) of the Indian Partnership Act, 1932 applies only to a partnership at will, which s. 7 defines as a partnership where the partners have fixed no period for its duration and no particular way for it to end. Because such a partnership has no fixed term, the law does not bind any partner to stay in it against his will. Any one partner may end the firm on his own, without the consent of the others and without going to court. Two

conditions must be met: the notice must be in writing, so an oral statement is not enough, and it must be given to all the other partners, so a notice served on only some of them does not dissolve the firm. Under s. 43(2), the firm is dissolved from the date stated in the notice. If no date is stated, it is dissolved from the date the notice is communicated. For example, A, B and C start a cloth business without agreeing how long the partnership will last, so it is a partnership at will. On 1 March, A sends a signed letter to both B and C stating that he intends to dissolve the firm with effect from 31 March. The firm stands dissolved on 31 March even if B and C object. If the letter had named no date, the firm would have been dissolved when B and C received it. If A had told them only orally, or had written only to B, the notice would not satisfy s. 43(1), and the firm would not be dissolved under this provision. The provision also would not apply if the partners had agreed to run the firm for five years, because it would then not be a partnership at will.

43.2 A firm at will shall stand dissolved from the date stated in the notice of dissolution or, if no date is stated, from the date the notice is communicated.

> (2) The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice.

Section 43(2) of the Indian Partnership Act, 1932 completes s. 43(1), under which a partnership at will may be dissolved by any partner giving written notice to all the other partners of his intention to dissolve the firm. A partnership at will is one where the partners have fixed no term for its duration and no other way for it to end (s. 7). Section 43(2) settles exactly when such a dissolution takes effect. If the notice names a date, the firm is dissolved from that date. If it names none, the firm is dissolved from the date the notice is communicated, meaning the date it reaches the other partners and not the date it was written or posted. The dissolution follows from the notice alone: the other partners' consent is not needed, and once the notice has been communicated it cannot be withdrawn without the consent of the others. Fixing the date matters because it is the cut-off for the partners' mutual rights and liabilities. Accounts are settled as on that date (s. 48), and partners stay liable to third parties for acts done after it until public

notice of the dissolution is given (s. 45). For example, A, B and C run a partnership at will. On 1 March, A sends B and C a written notice saying the firm shall stand dissolved on 31 March, and they receive it on 3 March. The firm is dissolved from 31 March, the date named in the notice. If A's notice had named no date, the firm would have been dissolved from 3 March, when B and C received it. Either way, B and C cannot keep the firm alive by refusing to agree.

44. Dissolution by the Court

The Court may dissolve a firm, at the suit of a partner, on any of the grounds specified in this section.

At the suit of a partner, the Court may dissolve a firm on any of the following grounds, namely:

(a) that a partner has become of unsound mind, in which case the suit may be brought as well by the next friend of the partner who has become of unsound mind as by any other partner;

(b) that a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner;

(c) that a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business;

(d) that a partner, other than the partner suing, willfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him;

(e) that a partner, other than the partner suing, has in any way transferred the whole of his interest in the firm to a third party, or has allowed his share to be charged under the provisions of rule 49 of Order XXI of the First Schedule to the Code of Civil Procedure, 1908 (5 of 1908) or has allowed it to be sold in the recovery of arrears of land revenue or of any dues recoverable as arrears of land revenue due by the partner;

(f) that the business of the firm cannot be carried on save at a loss; or

(g) on any other ground which renders it just and equitable that the firm should be dissolved.

Section 44 of the Indian Partnership Act, 1932 allows a partner to ask the Court to dissolve the firm where dissolution cannot be achieved by agreement (s. 40) or by notice (s. 43), as in a partnership for a fixed term. The power is discretionary: once a ground is proved the Court "may" dissolve the firm, but it is not bound to. The Court may order dissolution where a partner has become of unsound mind, and in that case the suit may be brought by the next friend of that partner as well as by any other partner. It may also order dissolution where another partner has become permanently incapable of performing his duties, or is guilty of conduct likely to harm the carrying on of the business, judged by the nature of that business. A further ground arises where another partner wilfully or persistently breaches the agreement on management of the firm, or otherwise behaves so that it is not reasonably practicable to carry on business with him. Dissolution may also be ordered where another partner has transferred his whole interest to a third party, allowed his share to be charged under Order XXI, Rule 49 of the Code of Civil Procedure, 1908^[1], or allowed it to be sold to recover arrears of land revenue. The Court may also dissolve the firm where its business can only be carried on at a loss. Finally, clause (g) is a residuary ground allowing dissolution wherever it is just and equitable, which covers situations such as deadlock between partners or the failure of the partnership's purpose. Under clauses (b) to (e), the suit must be brought by a partner other than the one at fault, so a partner cannot obtain dissolution by relying on his own incapacity, misconduct or breach. For example, A, B and C run a pharmacy under a ten-year partnership agreement that requires every partner to deposit the daily cash receipts in the firm's bank account. C repeatedly keeps the cash for himself and ignores A's and B's objections. Because the partnership is for a fixed term, A and B cannot end it by notice, but they may sue under s. 44(d) for persistent breach of the management agreement, and also under s. 44(c), since such conduct is likely to harm a pharmacy's business. The Court may then dissolve the firm, but C could not sue for dissolution on the basis of his own breach.

45. Liability for acts of partners done after dissolution

[1] Order XXI, Rule 49 of the Code of Civil Procedure, 1908 provides that partnership property cannot be attached or sold to satisfy a decree against an individual partner, but the Court may, on the decree-holder's application, charge that partner's interest in the partnership property and profits with payment of the decreed amount.

Partners shall remain liable to third parties for acts done in the firm's name after dissolution until public notice of the dissolution is given.

> (1) Notwithstanding the dissolution of a firm, the partners continue to be liable as such to third parties for any act done by any of them which would have been an act of the firm if done before the after dissolution, until public notice is given of the dissolution.
>
> Provided that the estate of a partner who dies, or who is adjudicated an insolvent, or of a partner who, not having been known to the person dealing with the firm to be a partner, retires from the firm is not liable under this section for acts done after the date on which he ceases to be a partner.
>
> (2) Notices under sub-section (1) may be given by any partner.

Section 45 of the Indian Partnership Act, 1932 covers the gap between the dissolution of a firm and the time the public learns of it. Dissolution ends the relationship among the partners, but outsiders who dealt with the firm may still believe it exists. To protect them, s. 45(1) provides that any act by a partner after dissolution that would have bound the firm if done before dissolution binds all the partners until public notice of the dissolution is given. The rule rests on holding out: partners who let the world believe the firm is still running are bound by that appearance. Under s. 72, public notice means publication in the Official Gazette and in at least one vernacular newspaper circulating in the district where the firm has its principal place of business, and, for a registered firm, also a notice to the Registrar of Firms (s. 63). Under s. 45(2), any partner may give the notice, so one partner can protect himself even if the others do nothing. The proviso exempts three persons from liability for acts done after they cease to be partners, even without notice. The first is the estate of a deceased partner and the second is the estate of a partner adjudicated insolvent; in these cases death or insolvency itself is treated as sufficient notice. The third is a retiring partner who was not known to the person dealing with the firm to be a partner, such as a sleeping partner, because that person never relied on his credit. This liability for new acts is separate from the partners' continuing authority under s. 47 to wind up the firm's affairs and complete unfinished transactions. For example, A, B and C, partners in a cloth business, dissolve their firm on 1 March but give no public notice. On 15 March, A buys cloth worth ₹2 lakh on credit in the firm's name from D, a regular supplier unaware of the dissolution. Since such purchases were within the firm's

business and no notice had been given, B and C are liable to D along with A, and may then recover from A. If C had died on 1 March, or had been a sleeping partner whom D never knew of, C's estate or C would not be liable. Had the dissolution been published in the Official Gazette and a local newspaper on 5 March, B and C would not be liable for A's purchase on 15 March.

46. Right of partners to have business wound up after dissolution

On the dissolution of a firm, the property of the firm shall be applied first in paying the firm's debts and liabilities, and the surplus shall be distributed among the partners according to their rights.

> On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representatives, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights.

Section 46 of the Indian Partnership Act, 1932 gives every partner, or the legal representative of a deceased partner, a personal right to have the firm's affairs properly wound up once the firm is dissolved. Each partner can enforce this right against all the other partners, so no partner, or group of partners, can take firm property for their own use or divide it among themselves before the firm's creditors are paid. The provision sets a fixed order. First, firm property must be used to pay the firm's debts and liabilities. Second, whatever is left over must be divided among the partners according to their rights under the partnership deed or the Act. The section protects partners as well as creditors. Paying firm debts out of firm property shields each partner's personal assets, because partners are otherwise jointly and severally liable for the firm's debts (s. 25). It also ensures that each partner gets their proper share of the surplus. The detailed order of payment is laid down in s. 48: debts to third parties are paid first, then advances made by partners beyond their capital, then each partner's capital, and any remaining residue is shared in the proportion in which profits were shared. Under s. 47, partners keep the authority needed to wind up the firm's affairs after dissolution. If the partners cannot agree, any of them can approach the court for winding up and, where necessary, the appointment of a receiver.

For example, A, B and C are partners in a firm that is dissolved. The firm owns property worth ₹12 lakh and owes ₹4 lakh to suppliers and a bank. A, who manages the shop, wants to sell the stock and keep the proceeds as his share before the creditors are paid. Under s. 46, B or C (or C's legal heir, if C has died) can insist that the ₹12 lakh of firm property be used first to pay the ₹4 lakh owed to creditors. The remaining ₹8 lakh must then be distributed under s. 48: repayment of any partner's advances, then return of capital, then the balance in the agreed profit-sharing ratio. If A refuses, the other partners can file a suit for dissolution and accounts and have the business wound up under the court's supervision.

47. Continuing authority of partners for purposes of winding up

After dissolution, each partner's authority to bind the firm, and the partners' mutual rights and obligations, shall continue only so far as is necessary to wind up the firm's affairs and complete unfinished transactions, but the firm shall never be bound by the acts of a partner who has been adjudicated insolvent.

> After the dissolution of a firm the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners continue notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise:
>
> Provided that the firm is in no case bound by the acts of a partner who has been adjudicated insolvent; but this proviso does not affect the liability of any person who has after the adjudication represented himself or knowingly permitted himself to be represented as a partner of the insolvent.

Section 47 of the Indian Partnership Act, 1932 deals with the period after a firm is dissolved. Dissolution ends the partnership relation, but the firm's affairs cannot close at once. Its assets have to be realised, debts collected and paid, and pending contracts completed. So the Act keeps the partners' implied authority, and their rights and duties towards one another, alive for these purposes, but only for these purposes. A partner may still bind the firm by acts such as collecting debts due to it, selling its stock, paying creditors, or performing a contract entered into before dissolution. He cannot bind the firm in any new business, because any act beyond winding up and

completing unfinished transactions falls outside his continuing authority. The proviso adds an absolute exception for insolvency. A partner adjudicated insolvent ceases to be a partner from the date of the order (s. 34), so the firm is not bound by anything he does afterwards, even as part of winding up. However, under the principle of holding out (s. 28), the proviso does not protect a person who, after the adjudication, represents himself as a partner of the insolvent, or knowingly allows himself to be represented as one. That person remains personally liable to anyone who deals with the insolvent on the strength of that representation. For example, A, B and C run a cloth business, and the firm is dissolved on 1 March. Before then, the firm had agreed to supply 500 metres of cloth to D, but the supply was still pending. After dissolution, A may deliver the cloth to D and collect the price, and A may sell the remaining stock to pay the firm's creditors, and the firm is bound by these acts because they are necessary to wind up its affairs and complete an unfinished transaction. But if A orders fresh cloth from a supplier in the firm's name to start new trading, the firm is not bound, since that is new business and not winding up. If B is adjudicated insolvent and later, while purporting to wind up, signs a promissory note in the firm's name, the firm is not bound by it. Still, if C, knowing of B's insolvency, lets B tell a lender that C is still his partner, C may be personally liable to that lender.

48. Mode of settlement of accounts between partners

On the dissolution of a firm, losses shall be made good first out of profits, next out of capital, and lastly by the partners personally in their profit-sharing ratio. The assets shall then be applied first to the firm's debts to outsiders, next to partners' advances, next to partners' capital, and any surplus shall be divided among the partners in their profit-sharing ratio.

> In settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:
>
> (a) losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits;

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

(i) in paying the debts of the firm to third parties;

(ii) in paying to each partner rateably what is due to him from the firm for advances as distinguished from capital;

(iii) in paying to each partner rateably what is due to him on account of capital; and

(iv) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Section 48 of the Indian Partnership Act, 1932 sets out how a firm's accounts are finally settled after dissolution. The rules apply unless the partners have agreed on a different method. Clause (a) deals with losses, including a deficiency of capital, which arises when the assets are not enough to return the partners' capital. Such a loss is first absorbed by any undistributed profits and then by capital. If it is still not covered, the partners must pay in the shortfall from their own pockets, sharing it in the ratio in which they shared profits rather than in the ratio of their capital. Clause (b) fixes the order in which the firm's assets are applied, and any sums the partners contribute to make up a deficiency count as assets for this purpose. Debts owed to outside creditors are paid first. Partners' advances come next: these are loans a partner made to the firm over and above his capital. Capital is returned after that. If there is not enough money to pay advances or capital in full, each partner is paid rateably, in proportion to his claim. Any surplus left at the end is divided in the profit-sharing ratio. This order puts outsiders ahead of partners, and it puts a partner's claim as a lender ahead of his claim as an owner. The firm's own property is applied this way before the partners' private estates are touched (s. 49). For example, A, B and C share profits equally. On dissolution their capitals are A ₹50,000, B ₹30,000 and C ₹5,000. A has also lent the firm ₹20,000, the firm owes outside creditors ₹60,000, and its assets realise ₹1,35,000. The total claims come to ₹1,65,000, so there is a loss of ₹30,000, which each partner bears equally at ₹10,000 under clause (a). This reduces A's capital to ₹40,000 and B's to ₹20,000. It wipes out C's capital of ₹5,000, and C must pay in a further ₹5,000, which raises the assets to ₹1,40,000. Under clause (b), the creditors are paid ₹60,000 first, which leaves ₹80,000. A's

loan of ₹20,000 is repaid next, which leaves ₹60,000. That sum is then returned as capital, ₹40,000 to A and ₹20,000 to B, with nothing left over to divide. If the partners had agreed beforehand to share losses in their capital ratio, that agreement would have replaced clause (a).

49. Payment of firm debts and of separate debts

The property of the firm shall be applied first to the firm's debts, and the separate property of a partner first to his separate debts.

> Where there are joint debts due from the firm, and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm, and, if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of his separate debts, and the surplus (if any) in the payment of the debts of the firm.

Section 49 of the Indian Partnership Act, 1932 applies where a firm owes debts jointly and one or more partners also owe personal, or separate, debts. It usually comes into play on dissolution or insolvency, when two sets of assets have to be shared between two sets of creditors. The firm's property goes first to the firm's creditors. Only the surplus left after all firm debts are paid is divided into the partners' shares, and each share is then used to pay that partner's separate debts, or is handed to him if he has none. In the same way, a partner's separate property goes first to his own separate creditors, and only what is left after they are paid in full can be used for firm debts still unpaid. Each group of creditors therefore has first claim on the assets it most directly relied on, and can reach the other pool only after the creditors entitled to that pool are satisfied. The provision does not remove the partners' joint and several liability for the firm's acts (s. 25); it only fixes the order in which assets are applied, while accounts between the partners themselves are settled under s. 48. For example, A and B are equal partners in a firm whose property is ₹6 lakh and whose debts are ₹8 lakh. A has separate property of ₹5 lakh and separate debts of ₹2 lakh, and B has separate property of ₹1 lakh and separate debts of ₹1 lakh. The firm's ₹6 lakh goes to the firm's creditors, leaving ₹2 lakh of firm debt unpaid and no surplus for the partners' separate creditors. A's ₹5 lakh first pays his own creditors their ₹2 lakh in full, and the remaining ₹3 lakh then clears the

firm's unpaid ₹2 lakh. B's ₹1 lakh is used up by his own separate creditors, so nothing from it reaches the firm's creditors. Had the firm's property instead been ₹10 lakh against debts of ₹8 lakh, the ₹2 lakh surplus would be split into shares of ₹1 lakh each, and each share would go towards that partner's separate debts or to the partner himself.

50. Personal profits earned after dissolution

A surviving partner, or the representative of a deceased partner, shall account to the firm for any personal profit earned from the firm's business, property, connections or name after the firm is dissolved by death and before its affairs are wound up.

> Subject to contract between the partners, the provisions of clause (a) of section 16 shall apply to transactions by any surviving partner or by the representatives of a deceased partner, undertaken after the firm is dissolved on account of the death of a partner and before its affairs have been completely wound up:
>
> Provided that where any partner or his representative has bought the good will of the firm, nothing in this section shall affect his right to use the firm name.

Section 50 of the Indian Partnership Act, 1932 extends the partner's duty to account, found in s. 16(a), into the period after dissolution. Under s. 16(a), a partner who earns a profit for himself from any transaction of the firm, or from the use of the firm's property, business connection or name, must account for that profit and pay it to the firm. Ordinarily these duties belong to a running firm. However, a firm dissolved by a partner's death does not disappear at once: its assets still have to be realised, its debts paid and the surplus shared. During that time the surviving partners, or the deceased partner's representatives, may still control the firm's assets and connections. Section 50 ensures they cannot use that position to make private gains at the cost of the others, including the deceased partner's estate. Such profits belong to the firm and go into the common pool for distribution on winding up. The rule applies "subject to contract", so the partners may agree otherwise in the partnership deed. The proviso makes an exception: a partner or representative who has bought the goodwill of the firm may use the firm name, because goodwill includes the right to use the name, and that use does not have to be accounted for. This matches s. 55(3), which allows a buyer of goodwill to represent himself as carrying on the firm's business.

For example, A, B and C run a cloth business as partners, and the firm is dissolved when C dies. Before the accounts are settled, A uses the firm's supplier contacts and its name to buy a large consignment at a trade discount and sells it on his own account, making a profit of ₹2 lakh. Under s. 50, A must account for the ₹2 lakh to the firm, and C's legal heirs will receive their share of it on winding up. If, instead, B buys the firm's goodwill when the assets are sold, B may carry on business under the firm's name, and he does not have to account to the others for the profits he earns by doing so.

51. Return of premium on premature dissolution

A partner who paid a premium to join a partnership for a fixed term shall be repaid a reasonable part of it if the firm is dissolved before that term ends.

> Where a partner has paid a premium on entering into partnership for a fixed term, and the firm is dissolved before the expiration of that term otherwise than by the death of a partner, he shall be entitled to repayment of the premium or of such part thereof as may be reasonable, regard being had to the terms upon which he became a partner and to the length of time during which he was a partner, unless
>
> (a) the dissolution is mainly due to his own misconduct, or
>
> (b) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

Section 51 of the Indian Partnership Act, 1932 protects a person who pays a premium, meaning a lump sum paid to the existing partners for admission into the firm, on the understanding that the partnership will last for a fixed period. If the firm is dissolved before that period expires, the incoming partner has not received the full benefit he paid for, so the law allows him to recover the whole premium or a reasonable part of it. In fixing the amount, the court considers the terms on which he became a partner and the length of time he actually remained a partner compared with the agreed term, which usually results in a refund roughly proportionate to the unexpired period. The right does not arise in three cases. It does not arise where the firm is dissolved by the death of a partner, since death is a risk both sides are taken to have accepted. It does not arise where the dissolution is mainly due to the claiming partner's own misconduct, since he cannot profit from his own wrong. Nor does it arise where the firm is dissolved under an

agreement that makes no provision for returning the premium, since the partners are presumed to have settled all their claims in that agreement. For example, A joins B's firm for a fixed term of 10 years and pays B a premium of ₹5 lakh. After 2 years, the court dissolves the firm because of B's persistent breach of the partnership agreement. Since the firm ended 8 years early and not through A's fault, A may claim a reasonable refund, possibly about ₹4 lakh, reflecting the unexpired 8 years. A would, however, be entitled to nothing if the dissolution had been mainly caused by A's own misconduct, such as misappropriating the firm's funds, if the firm had ended because of B's death, or if A and B had agreed to dissolve the firm and their agreement had been silent about the premium.

52. Rights where partnership contract is rescinded for fraud or misrepresentation

A partner who rescinds a partnership contract for fraud or misrepresentation shall be entitled to a lien on the firm's surplus assets for his purchase money and capital, to rank as a creditor for payments he made towards the firm's debts, and to be indemnified by the guilty partner against all the firm's debts.

> Where a contract creating partnership is rescinded on the ground of the fraud or misrepresentation of any of the parties thereto the party entitled to rescind is, without prejudice to any other right, entitled,
>
> (a) to a lien on, or a right of retention of, the surplus or the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and for any capital contributed by him;
>
> (b) to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm; and
>
> (c) to be indemnified by the partner or partners guilty of the fraud or misrepresentation against all the debts of the firm.

Section 52 of the Indian Partnership Act, 1932 protects a person who was induced to join a firm by the fraud or misrepresentation of another party. Such a contract is voidable at the option of the deceived party (Indian Contract Act, 1872, ss. 17 to 19), and once he rescinds it, the law aims to put him back, as far as possible, in the position he was in before joining. For this purpose the section gives him three rights. First, under clause (a), he has

a lien on, or a right to retain, the surplus or assets of the firm that remain after the firm's debts have been paid. The lien secures any sum he paid to buy a share in the firm and any capital he contributed, so he is repaid out of those assets before the other partners take anything. Outside creditors are paid first, because the lien attaches only to what is left after them. Second, under clause (b), if he paid any of the firm's debts out of his own pocket, he ranks as a creditor of the firm for that amount, instead of treating it as an ordinary partner's contribution. Third, under clause (c), the partner or partners guilty of the fraud or misrepresentation must indemnify him against all the debts of the firm. Rescission between the partners does not by itself free him from liability to outsiders for debts incurred while he was a partner, so this indemnity lets him shift that burden onto the wrongdoer. All three rights are "without prejudice to any other right", which means he may also claim damages for the fraud, or restitution, under the general law of contract. For example, B falsely tells A that the firm earns ₹10 lakh a year, when he knows it actually runs at a loss. Relying on this, A pays B ₹4 lakh for a share in the firm and contributes ₹6 lakh as capital. He later pays ₹2 lakh of his own money to settle a debt the firm owes a supplier. On discovering the fraud, A rescinds the partnership contract. Under s. 52, A has a lien for ₹10 lakh on whatever firm assets remain after outside creditors are paid, and he ranks as a creditor of the firm for the ₹2 lakh he paid the supplier. If a bank later sues A for a loan the firm took while he was a partner, B must indemnify A for whatever A has to pay. A may also sue B separately for damages for the fraud.

53. Right to restrain from use of firm name or firm property

After dissolution, no partner shall carry on a similar business in the firm name or use firm property for his own benefit until the firm's affairs are completely wound up.

> After a firm is dissolved, every partner or his representative may, in the absence of a contract between the partners to the contrary, restrain any other partner or his representative from carrying on a similar business in the firm name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up:
>
> Provided that where any partner or his representative has bought the goodwill of the firm, nothing in this section shall affect his right to use the firm name.

Section 53 of the Indian Partnership Act, 1932 protects the partners' shared interests during the winding up of a dissolved firm. When a firm is dissolved, its business does not end at once. Debts still have to be paid, assets sold and the surplus divided among the partners (ss. 46 and 48). During this period the firm name and the firm property still belong to all the partners together. Section 53 therefore lets every partner, or the legal representative of a deceased partner, obtain an injunction restraining any other partner or representative from doing two things. The first is carrying on a similar business under the firm name, which would trade on the firm's reputation and could expose the other partners to liability to third parties. The second is using any firm property for personal benefit, which would reduce the assets available for paying creditors and for distribution. The restraint lasts only until the affairs of the firm are completely wound up. It also applies only in the absence of a contrary contract, so the partners may agree otherwise, for example by allowing one partner to keep the name. The proviso makes an exception for a partner or representative who has bought the firm's goodwill: such a buyer may use the firm name, since the right to the name is part of the goodwill purchased (see also s. 55). For example, A, B and C run a cloth business called "Patna Textiles", and the firm is dissolved. Before the accounts are settled, C opens his own cloth shop under the name "Patna Textiles" and uses the firm's stock and delivery van there. A or B may obtain an injunction stopping C from using the firm name and from using the stock and van for his own benefit until the winding up is complete. If, however, C had bought the goodwill of the firm at the time of dissolution, A and B could not stop him from using the name "Patna Textiles", though they could still prevent him from using the other firm property for himself.

54. Agreements in restraint of trade

Partners may, upon or in anticipation of dissolution, validly agree not to carry on a similar business within a specified period or specified local limits, provided the restrictions are reasonable.

> Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits; and notwithstanding anything contained in section 27 of the Indian Contract Act,

1872, (9 of 1872), such agreement shall be valid if the restrictions imposed are reasonable.

Section 54 of the Indian Partnership Act, 1932 is an exception to Section 27 of the Indian Contract Act, 1872, which makes every agreement that restrains anyone from carrying on a lawful profession, trade or business void. Under Section 54, partners may agree that some or all of them will not carry on a business similar to the firm's after the firm comes to an end. Two conditions apply. First, the agreement must be made upon the dissolution of the firm or in anticipation of it, for example in the dissolution deed or in the original partnership deed providing for what happens on dissolution. Second, the restriction must be limited to a specified period, specified local limits, or both, and must be reasonable. Reasonableness depends on the nature of the business, the area it actually served and the time needed to protect the goodwill of the continuing partners or a purchaser of the business. The exception exists because when a firm is dissolved and its goodwill is taken over by some partners or sold, the value of that goodwill would be destroyed if the outgoing partners could immediately set up a rival business and win back the old customers. A restriction that goes beyond what is needed to protect that interest, such as a bar covering the whole of India or lasting for the partner's lifetime when the firm traded in one city, is unreasonable and void under Section 27. The Act makes similar exceptions for restraints during the partnership (s. 11(2)), on an outgoing partner (s. 36(2)), and on a partner who sells the goodwill of the firm (s. 55(3)). For example, A, B and C run a pharmacy in Patna. On dissolution, A and B take over the business and its goodwill, and C agrees not to run a pharmacy within the Patna municipal limits for three years. This restraint is valid under Section 54 because it is tied to dissolution, limited in time and area, and reasonably protects the goodwill A and B have acquired. If C opens a pharmacy in Patna within that period, A and B can obtain an injunction or claim damages. But if C had agreed never to run a pharmacy anywhere in Bihar, the restriction would most likely be held unreasonable and void, leaving C free to carry on business.

55. Sale of goodwill after dissolution

55.1 On dissolution, the goodwill of the firm shall be treated as an asset of the firm and may be sold, either separately or together with the other property of the firm.

> (1) In settling the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets, and it may be sold either separately or along with other property of the firm.

Section 55(1) of the Indian Partnership Act, 1932 applies when a firm is dissolved and its accounts are settled among the partners. Goodwill is the benefit of the firm's reputation and connections, which makes customers likely to keep coming to the business. Although it cannot be touched, it has real money value, so it counts as property of the firm just like its stock, furniture or cash. When the accounts are settled, its value must be included in the firm's assets, and the sale proceeds are shared among the partners like the other assets. It may be sold separately, for example to a buyer who wants only the firm's name and customer base, or together with the business as a whole. The words "subject to contract between the partners" mean the partners can agree otherwise. For instance, the partnership deed may provide that goodwill will not be valued, or that one partner will take it at a fixed price. Sub-sections (2) and (3) then deal with the position after the sale. A partner may still carry on a competing business, but he may not use the firm's name, represent himself as carrying on the firm's business, or solicit the firm's former customers. He may, however, agree with the buyer not to compete for a reasonable time or within reasonable local limits. For example, A, B and C run a well-known sweet shop called "Patna Mishthan Bhandar" and dissolve the firm. The shop's equipment is worth ₹5 lakh, but because of its name and loyal customers, D offers ₹15 lakh for the business. The extra ₹10 lakh represents goodwill. It must be counted as a firm asset, and the proceeds are divided among A, B and C. Unless their deed says otherwise, none of them can keep that value for himself. They may also sell the name and goodwill alone to D and sell the equipment separately to someone else. After the sale, A may open his own sweet shop, but he cannot call it "Patna Mishthan Bhandar", claim to be continuing the old business, or approach its former customers to win them over.

55.2 Where the goodwill of a firm is sold after dissolution, a partner may compete with the buyer and advertise his business, but he shall not

use the firm name, represent himself as carrying on the firm's business, or solicit the firm's former customers, unless the buyer agrees otherwise.

> (2) Where the goodwill of a firm is sold after dissolution, a partner may carry on a business competing with that of the buyer and he may advertise such business, but, subject to agreement between him and the buyer, he may not,
>
> (a) use the firm name,
>
> (b) represent himself as carrying on the business of the firm, or
>
> (c) solicit the custom of persons who were dealing with the firm before its dissolution.

Section 55(2) of the Indian Partnership Act, 1932 deals with the position of a partner after the goodwill of a dissolved firm has been sold. Goodwill is the benefit a business gets from its name, reputation and connection with customers, and under s. 55(1) it forms part of the firm's assets on dissolution and may be sold with or without the other property. The provision balances the interests of the buyer, who has paid for this goodwill, against those of the former partners. A partner keeps his freedom to earn a living, so he may start a similar business, even one competing with the buyer, and may advertise it publicly in a general way. He may not, however, do anything that takes back the very goodwill the buyer has paid for: he cannot use the firm name, cannot hold himself out as continuing the old firm's business, and cannot approach the firm's former customers to win their business. The line is drawn between passively serving customers who come to him on their own, which is allowed, and actively canvassing the old firm's customers, which is not, a rule that follows the English decision in *Trego v Hunt* [1896] AC 7. These restrictions apply "subject to agreement between him and the buyer", so the buyer may relax them by contract. Under s. 55(3), the partners may also accept a wider restraint and agree not to carry on a similar business at all within a specified period or local limits, and such an agreement is valid despite s. 27 of the Indian Contract Act, 1872 if the restrictions are reasonable. For example, the firm "Sharma & Verma Opticians" of Patna is dissolved and its goodwill is sold to Z. Sharma may open his own optical shop in the same locality and advertise it in newspapers as a new optical shop run by A. Sharma. He may not name his shop "Sharma & Verma Opticians", nor put up a board saying "formerly

Sharma & Verma, now at a new address", since that would represent him as carrying on the old firm's business. Nor may he write to or visit the old firm's regular customers asking them to buy from him instead of Z. If an old customer walks into Sharma's new shop on his own, Sharma may serve him. If Sharma breaches s. 55(2), Z may obtain an injunction and claim damages, but if Z had expressly allowed Sharma to contact certain old customers, that agreement would govern.

55.3 A partner who joins in selling the goodwill of a firm may validly agree with the buyer not to carry on a similar business.

> (3) Any partner may, upon the sale of the goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits and, notwithstanding anything contained in section 27 of the Indian Contract Act, 1872 (9 of 1872), such agreement shall be valid if the restrictions imposed are reasonable.

Section 55(3) of the Indian Partnership Act, 1932 is an exception to Section 27 of the Indian Contract Act, 1872. Section 27 makes void any agreement that restrains a person from carrying on a lawful profession, trade or business. When a firm's goodwill is sold, the buyer pays for the firm's reputation, its connections and the likelihood that old customers will keep coming back. That value would be destroyed if a partner of the selling firm could immediately start a competing business and draw those customers away. Section 55(3) therefore lets any partner, on the sale of the goodwill, agree with the buyer not to carry on a business similar to the firm's. The restraint must be limited to a specified period or to specified local limits (or both). The agreement is valid only if the restrictions are reasonable, and courts judge this by the nature of the business, the area the firm actually served, and the length of time needed to protect the goodwill the buyer purchased. A restraint that is wider than this, such as one covering unrelated businesses, the whole country for a local trade, or an excessive period, is unreasonable and void. The provision is a parallel to Exception 1 of Section 27 of the Contract Act, which protects a seller of goodwill in the same way, and to s. 36(2) and s. 54 of the Partnership Act, which permit similar restraints on outgoing partners and on partners after dissolution. For example, A, B and C run a sweet shop, "Mithai Ghar", in Patna, and they sell the business together with its goodwill to D. As part of the sale, A

agrees not to open a sweet shop within 5 km of Mithai Ghar for three years. This restraint is limited in both area and time and only protects the goodwill D bought, so it is reasonable and valid under s. 55(3) despite s. 27 of the Contract Act. D can obtain an injunction if A opens a sweet shop next door within that period. But if A had agreed never to run any food business anywhere in Bihar, the restriction would go well beyond what is needed to protect D's purchase, and it would be unreasonable and void.