



Open Access

**QLANTIC**  
 JOURNAL OF  
 SOCIAL SCIENCES

## Limitation and the Extent of a Partner's Authority and Liabilities in Relation to Third-party and its Legal Implications on a Firm

Saifullah Hassan <sup>1</sup> Waheed uz Zaman <sup>2</sup> Muhammad Hamza <sup>3</sup>

**Abstract:** *Sharing of liabilities amongst partners is one of the reasons for the formation of a partnership firm, meaning, thereby, the sole proprietorship distinguishes from the partnership in various aspects, including sharing of liability. On the occasion of insolvency, the sole proprietor risks all his assets, savings, and investments towards the satisfaction of liabilities and incumbrances of his particular line of business. However, in contrast, the partners share not only the profits but also the risks on the occasion of insolvency at the ratio predetermined in their partnership agreement. However, there are extents and limitations as to the authority and liabilities, which may be drawn either by the partners themselves or under the Partnership Act 1932. This article will address the legal implications of the authority and liabilities of partners while dealing with a third party. Further, it would identify the legal impact of a specific act of a partner towards his firm.*

**Key Words:** Partnership, Partner's Liability, Implied Authority

### Introduction

The partnership is one of the promising types of business organizations in Pakistan. It has distinct features from the sole proprietorship or, in limited circumstances, better than the option of a private company. The partnership can be defined as the association formed by two or more individuals, including legal persons that have a common interest in carrying out the business through the participation of all or any of them working on behalf of others and agreed upon sharing of profits (*The Partnership Act, 1932*, section 4). However, the broader concept has been elaborated as “a voluntary association of two or more persons who jointly own and carry on a business for profits” (Black's Law Dictionary, 9<sup>th</sup> Edition). However, under section 4 of the *Partnership Act 1932*, the law does not require the factor of sharing of losses between partners, meaning, thereby, the loss sharing is not the essential part of establishing the relationship of partnership. Rather, it depends on the terms of a partnership agreement between partners, or the partners shall be liable by operation of law if the share of losses has not already been prescribed in the terms of their agreement. A generalized question may be asked: “Was a partnership formed?” it is a unified question but comes with distinct results, like “1) duties among the partners, 2) the contractual liability of partners to a third party, and 3) the vicarious tort liability of partners to a third party” (Bayern, S, J. 2016). The liability of every partner is contingent on the act of a partner done on behalf of the entire firm, meaning thereby, under the principle of mutual agency, every partner is also to be considered as the agent of a firm while performing his part's obligations either assigned in the partnership agreement or by the mutual agreement amongst all partners. In furtherance, the third party can cause the firm to be liable for the actions of her partner, done as to the course of conduct of the firm's business, although a partner is jointly as well as separately liable to the third party for any default of his firm. The legal issue regarding the extent and restriction of the implied authority of a partner has yet to be elaborated under distinct circumstances or market practices.

<sup>1</sup> Lecturer, College of Law, The University of Sargodha, Sargodha, Punjab, Pakistan.

<sup>2</sup> Lecturer, College of Law, The University of Sargodha, Sargodha, Punjab, Pakistan.

<sup>3</sup> Lecturer, College of Law, The University of Sargodha, Sargodha, Punjab, Pakistan.

▪ **Corresponding Author:** Saifullah Hassan ([saif.hashmio41@gmail.com](mailto:saif.hashmio41@gmail.com))

▪ **To Cite:** Hasan, S., Zaman, W. U., & Hamza, M. (2023). Limitation and the Extent of a Partner's Authority and liabilities in Relation to Third-party and its Legal Implications on a Firm. *Qlantic Journal of Social Sciences*, 4(4), 268-272. <https://doi.org/10.55737/qjss.972961898>

## Authority Recognized Under Partnership Agreement

The concept of "authority" is defined as "the right or permission to act legally on another's behalf, esp., the power of one person to affect another's legal relations by acts done in accordance with the other's manifestations of assent" (Black's Law Dictionary, 9<sup>th</sup> Ed.). The partnership agreement prevails over the operational provisions of the Partnership Act (Pak), and the principle of 'sanctity of contract' and the *pacta sunt servanda* "agreement must be kept" or "promises must be fulfilled" has before now liberalized the freedom of parties to the partnership agreement. Under section 11 of the Act (Pak) it has been cleared the duties, rights and obligations of partners, if defined in the contract or agreed orally amongst partners, such terms would prevail; otherwise, in case of the absence of existence of such provisions, then the Act, 1932 would be applicable to each circumstance.

## Statutory Standard as to the Implied Authority

As discussed above, the partnership agreement expressly defines the authority of a partner; meanwhile, if certain authority is not expressly mentioned in the agreement, then those acts that fall under the implied authority of such partner shall bind the firm and third-party can approach the court either for the specific performance or for compensation in case of breach of terms by the firm. There is a test of implied authority in The Partnership Act (1932) section 19, and it is as follows.

- i) The act must be done by the partner to carry on a business of a similar kind conducted by that firm.
- ii) To conduct business, such acts done in implied authority fall in the category of doing similar bus in the usual way.
- iii) The partner has executed the instrument or act done in his position of being a partner of the firm. (The Act, 1932, section 22).
- iv) Such an act of a partner made for the firm's name (The Act, 1932, section 22)

However, the above-prescribed essentials should be narrowly interpreted because the element of good faith can be mitigated if a partner has the ability or reasonable time to contact other partners of his firm. However, it is an absolute duty of a partner to act for common advantage and in a just and utmost manner of faithfulness towards other partners (The Act, 1932, section 9).

The High Court Lahore, while deciding a suit filed by a Bank for recovery of finance against a firm, has decided that once the finances were taken from the bank by exercising his implied authority and in the presence of admission in this regard, the other partners, later on, cannot absolve themselves by challenging the authority of such partner who was dealing on behalf of firm (*Saudi Pak Commercial Bank Ltd V Messrs Shaikh Agro Industries, 2016*). In coherence, the authority is, by the conduct of the principal, intentionally given to the agent, and it includes the former acquiescence of the acts of an agent by such principal (Black's Law Dictionary, 9<sup>th</sup> Ed.).

## Extent and Limitation in Exercise of Authority

However, there are certain legal restrictions imposed by the statute on the specific category of act that does not fall without the trade customs usages of conducting such business, in the meaning of implied authority, meaning thereby, if such restricted acts done by a partner; even fulfilling and satisfy the above-mentioned requirements does not legally bind the firm towards third-party (The Act, 1932, section 19 (2)). These restrictions on the partner's implied authority are as follows.

- a) A dispute related to the firm's business cannot be submitted to arbitration.
- b) Restriction on opening an account in his own name, in a bank on the firm's behalf.
- c) To relinquish, compromise on any claim or cancel any portion of the claim to the third party.
- d) Unilaterally withdraw the legal proceedings or suit filled in a court of law by the firm.
- e) To make admission regarding the liability claimed by a third party in a legal proceeding or suit that has been filed against the firm.
- f) To purchase an immovable property, without express authority, in the name of the firm.
- g) To dispose of or sell his firm's immovable property to any third party.
- h) Execute a document of partnership with other persons on the firm's behalf.



"The tendency of the mod modern cases, however, is to limit the implied power of sale to the property which is held for the purpose of sale, and not to include the property kept for the purpose of carrying on the business" (H.R.C, [1912](#)). In the age of fast methods of communication via WhatsApp, phone calls, electronic mail, or video links, now, the exercise of implied authority would be doubtful on the ground that such a partner can immediately contact the general partners or get assent from the majority of partners on an unprecedented situation. However, the ability to act with the ability of an ordinary person's prudence is fading with the passage of time and due to technological advancements.

### Authority while Dealing with Third-party

In the preceding paragraphs, it has been clear that the authority of a partner is based on a) the express terms of the partnership agreement, b) the trade customs and prevailing usages of such type of business, and lastly, c) the implied authority exercisable by a partner in exceptional circumstances.

The firm is bound by the terms agreed between the acting partner and the third party, although the liability of the firm is absolute in those cases that fall in the exercise of the first two types of authority. On the other hand, the leverage of liability of a firm may fall on a partner who fails to satisfy the required essentials in the exercise of implied authority. This does not affect the claim and right of third parties to enforce the terms of the agreement against the firm.

### Firm's Liability towards Third-party

It is a broadly accepted approach that the firm is not an entity that is different from its partners, meaning that the partners and firm cannot be separated legally. Generally, the firm acts through its partners and a partner while negotiating or executing a contract with a third party is considered to be the agent of the firm, and all the specifications and expressions of the contract of agency *mutatis mutandis* apply here. Therefore, the "law of agency" has absolute relevance when the firm and its partners deal with outsiders (Barron, M, L. [2003](#)). Hence, the firm is always liable to the third party for the actions of its partners done in three capacities, as discussed above.

The Karachi High Court has held that where one of the partners opened an account in a Bank and issued the promissory note, then all the partners will be liable to third-party, severally and jointly (*National Bank of Pakistan V Umer & Brothers and three others*, [1987](#))

Whether a firm is bound by a particular act of a partner or such partner shall be liable personally to the third party with whom he was dealing at first instance; the following matters may be scrutinized to determine:

- a. The source of the particular partner's authority;
- b. The nature and extent of that authority;
- c. The particular act or event in question;
- d. The knowledge of the third party dealing with the business.

(Clarke, A., [1996](#)). These elements may be examined by considering the apparent authority, implied authority, or express authority of a partner (Clarke, [1996](#)). The implication of determining the liability between the partner and the firm depends on the terms of the partnership agreement, statute, and the trade customs and usages.

### Firm's Liability for Wrongful and Prejudice Act of a Partner

Any injury or financial loss caused to a third party by omission or wrongful action of a partner done fundamentally under the ordinary course and scope of the firm's business, then the extent of liability of the firm shall be the same as to the partner's liability. As far as the illegal acts of a partner are concerned, the firm is not liable to the third party for the personal wrongful actions or illegalities committed by a partner outside the scope of business. It may be the ground for expulsion of a partner, but it requires considering "strong policy reasons for exercising caution in devising judicial remedies in the situation of partner expulsion" (Ribstein, L, E, [2000](#)). However, the courts should have to consider factors pertaining to the injuries to the firm, expelled partner and potential injury to their clients. interests (Ribstein, [2000](#)).

## Firm's Liability for the Misapplication or Wrongful Use of Funds by Partner

Acting in the greatest common advantage and remaining faithful and just towards each other is the inviolable absolute duty of every partner of the firm; however, contrary to that, a firm may be dissolved either by the partners or the aggrieved partner can approach the court to dissolve the firm on the ground of lack of faithfulness, fraud, breach of partnership covenant or related factors. (The Act, 1932, Section 44). Partnership Act (1932) section 27 describes the liability of the firm in the following words.

“Where

- a. A partner acting within his apparent authority receives money or property from a third party and misapplies it or
- b. A firm, in the course of its business, receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.”

## Statutory Exceptions as to the Exclusion of Firm's Liability for Partner's Admission in Favor of Third-party

Similar to the statutory limitations on the exercise of implied authority and the extent of the firm's liability, as discussed above, the Act has also prescribed the extent of legal implication of representation or admission by any partner in favor of a third party and against the firm's interest. Under section 23 of the Partnership Act (1932), an admission by a partner first does not give rise to the absolute liability of the firm against a third party. Secondly, such admission of a partner can only be considered as evidence against the firm if it fulfills two conditions: initially, the statement must relate to the acute business affair of the firm, and such admission is expressed through the ordinary way of doing the firm's business. The Supreme Court held that a partner's admission in his individual capacity does not have a binding effect on the co-partner. Further, the statement regarding admission is an appreciable factor in adduced evidence (*Zeeshan Bhatti V Maqbool Bhatti and another*, 2001).

## Partner's Individual Liability

Suppose a partner entered into an agreement with a third party by exceeding his authority and misrepresenting himself as an authorized person by the firm, and such transaction does not have any impression of the partner to be authorized ostensibly. The firm will be liable for any fraud or illegal act done by a partner to another person. However, that partner shall be personally liable to such third party, and in certain circumstances, his personal assets may be utilized or attached by the court of law in connection to satisfying the losses caused to the third party. In circumstances where a partner has been administered bankrupt, it would automatically dissolve the firm, and the joint assets will be liquidated to satisfy the personal liabilities of such insolvent partner to avoid a multiplicity of suits (Virginia Law Register, 1927)

## Protection of Third-Party's Interest

In furtherance to govern the relationship of the firm with partners and the relationship amongst partners, chapter IV of the Partnership Act (1932) has protected the interests of third parties acting bona fide while entering into business transactions with the firm. However, the scope of authority of the partner, especially in an emergency or implied authority, is directly proportional to the liability of the firm towards third parties. However, the Supreme Court held that on the occasion of a dispute between partners, a partner writes a Bank to restrict further financing of the firm, although later on, such a person remains the partner to the firm. Despite a written letter to the Bank, it does not discharge or exonerate the partner from his liability jointly and severally unless and until he remains intact with the firm (*Muhammad Ahmed Khan V The Bank of Punjab and others*, 2015).

## Conclusion and a Way Forward

It is a broadly accepted approach that the firm is not separate from its partners. Therefore, the leverage of liabilities shall fall both on the firm and severely on the partners. As far as the procedure of binding the



firm is concerned, the actions of the partner that have been done while conducting business, as discussed earlier, and have done in the firm's name, bind the firm, meaning thereby, co-partners cannot converge to challenge the validity of such action.

There are three factors that affect the relationship of a firm with a third party, namely, the act of a partner lies within the ambit of his express authority and the acts that are justifiable in the exercise of his implied authority or apparent authority. Here, the knowledge of a third has a significant impact on the validity of the transaction, about the existence or non-existence of certain authority which a partner claims to possess.

In conclusion, the rights, obligations and liabilities that arise out of the exercise of implied, apparent and express authority of a partner shall, without any opposition, bind the firm. Nonetheless, the third party's bona-fide act protects its interests against the probable denial of a partner's authority. The superior courts of Pakistan have also recognized the different types of partner authority discussed above.

This article has limitations in addressing the liabilities of partners' firms and the legal implications of their relationship with outsiders or third parties. However, there is a need to conduct further research on the applicable theories of partnership firms as separate entities; the concept was submerged in the 18<sup>th</sup> century and faded with the emergence of artificial person-like companies.

## References

- Bayern, S. J. (2016). Three Problems (and Two Solutions) in the Law of Partnership Formation. *University of Michigan Journal of Law Reform*. 49(3), 605. <https://ir.law.fsu.edu/cgi/viewcontent.cgi?article=1212&context=articles>
- Barron, M, L., & Fletcher, R. J. A. (2003). *Fundamentals of Business Law*. McGraw-Hill Australia. 4<sup>th</sup> Ed. (Australia).
- Clarke, A. (1996). *Business Entities: A Practical Guide*. Sweet & Maxwell. (London). ISBN: 0 421 50490 0
- Garner, B, A. et al. (2009). *Black's Law Dictionary*. 9<sup>th</sup> Edition. <https://www.amazon.com/Blacks-Law-Dictionary-Standard-Ninth/dp/0314199497>
- H. R. C. (1912). Right of One Partner to Sue His Co-Partner in Conversion. *Michigan Law Review*. 10(8), 632-634. <https://doi.org/10.2307/1274618>
- Muhammad Ahmed Khan V The Bank of Punjab and others, 2015*). 2015 SCMR 126.
- National Bank of Pakistan V Umer & Brothers and 3 others, 1987*). 1987 MLD 594 (Karachi).
- Ribstein, L. E. (2000). Law Partner Expulsion. *The Business Lawyer*. 55(2), 845-881. <https://www.jstor.org/stable/40687944>
- Saudi Pak Commercial Bank Ltd V Messrs Shaikh Agro Industries, 2016*) 2016 CLD 521 (Lahore)
- The Contract Act, (1872).
- The Partnership Act, (1932).
- Virginia Law Register, (1927). Effect of Discharge of Partner or Partnership in Bankruptcy. *Virginia Law Review*. 13(8), 449-455. <https://www.jstor.org/stable/1107921>
- Zeeshan Bhatti V Maqbool Bhatti and another, 2001*). PLD 2001 Supreme Court, 79.