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IN THE HIGH COURT OF NEW ZEALAND
HAMILTON REGISTRY

B.243/83

IN THE MATTER of the Insolvency Act 1967

AND

IN THE MATTER of M WARD

A Bankrupt

705

Appeal reported [1985] 2 NZLR as Re Ward (a bankrupt)

BETWEEN THE OFFICIAL ASSIGNEE IN BANKRUPTCY of the property of M WARD

Applicant

AND J DIVER

Respondent

Hearing: 5 June 1985

Counsel: P R Heath for the Applicant
B J Paterson for the Respondent

Judgment: 23 JUL 1985

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JUDGMENT OF BISSON J

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The Official Assignee in Bankruptcy of the property of M Ward has applied under s.85 of the Insolvency Act 1967 for the Court's direction, opinion or advice on the following question:

> "Is the respondent entitled to claim priority either by way of set off or otherwise, of a capital and current account liability of the bankrupt to a partnership of which the bankrupt and the respondent were the sole members.?"

In an affidavit sworn and filed by the applicant there is evidence that the bankrupt, M Ward, was adjudicated a bankrupt on a creditor's petition in the High Court Hamilton on 1 March 1984. In or about April 1982 the bankrupt and the respondent J Diver entered into a partnership known as the "Bay of Island Motel Partnership". The object of the partnership was to acquire a motel in the Bay of Islands. A written partnership deed was entered into and is dated 30 April 1982. It was agreed in this deed that the parties would hold the land comprising the Bay of Islands Motel, which they had agreed to purchase, upon the basis that the respondent would be entitled to a 60% share thereof and the bankrupt to a 40% share thereof as at the date of settlement namely 30 April 1982. The deed also provided that the bankrupt assumed full liability for payment of part of the principal sum namely $30,000 in respect of the second mortgage to be secured in favour of Bay of Islands Motels Limited and the respondent assumed full liability for repaying the balance of the said mortgage namely the sum of $20,000 upon the repayment date 1 June 1984 or such earlier date as the parties may agree. It was then agreed that upon the terms relating to the respective liabilities of the parties in respect of the said mortgage being satisfied the contributions by each party to the partnership assets would then be deemed to have equalised and thenceforth the parties would be equal partners. It was accepted by the applicant that the bankrupt did not pay his proportionate share of the second mortgage in

terms of that provision. The purchase of the motel was financed by the respondent's contribution of $55,000.00 and by a temporary loan of $200,000.00. The Bankrupt borrowed $42,000.00 to contribute to the partnership but that amount was not so contributed as the monies were appropriated from the trust account of the bankrupt's solicitor to another partnership in which the bankrupt and the respondent were partners along with other persons. The motel property has been sold and the bankrupt's proportionate share of the sale proceeds after payment of debts of the partnership is being held in a solicitor's trust account in the joint names of the applicant and the respondent pending determination of the question before the court.

The view which the applicant has taken is that the respondent is entitled to 60% of the net proceeds of the sale of the motel property and the applicant is entitled to the bankrupt's 40% of the proceeds. The applicant has also taken the view that the respondent will need to prove in the bankrupt's estate for the capital which the bankrupt had agreed to pay but which he did not pay. The reason for taking that view is that the applicant considers that the respondent should stand in no better position than other unsecured creditors of the bankrupt. However the respondent claims that he is entitled to take from the bankrupt's share of the proceeds of the sale of the motel property the sum of $42,000 being the capital which the bankrupt had agreed to contribute and other

monies for brokerage fees and expenses advanced to the partnership. I agree with Mr Paterson that the question is to be resolved in accordance with the provisions of the Partnership Act 1908 and having regard to the terms of the deed of partnership. The partnership was dissolved by the Court order adjudging the debtor M Ward bankrupt. The deed contained a provision for a partner wishing to sell his share and for a partner dying but it made no reference to the bankruptcy of a partner. Accordingly s.36(1) of the Act applies. It reads:

> "36.Dissolution by death, bankruptcy, or charge - (1) Subject to any agreement between the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.

As the deed contained no provision for the settling of accounts between partners on dissolution (other than a surviving partner's first option to purchase the share of a deceased or outgoing partner) s.47 applies. It reads:

> "47.Distribution of assets on final settlement of accounts - In settling accounts between the partners after a dissolution of partnership the following rules shall, subject to any agreement, be observed:
>
> (a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits:
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> (b) The assets of the firm, including the sums (if any) contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:
> (i) In paying the debts and liabilities of the firm to persons who are not partners therein:
> (ii) In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital:

> (iii) In paying to each partner rateably what is due from the firm to him in respect of capital:
> (iv) The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible."

In this case s.47(b)(i) has already been complied with, and the respondent is entitled to repayment of his advances under paragraph (ii). Thereafter paragraphs (iii) and (iv) would apply to the extent that funds allowed.

However, in this case, the bankrupt partner has defaulted in the payment of $42,000.00 to the capital of the partnership. For the purposes of s.47(b)(iii) the question is "what is due" to each partner from the firm in respect of capital? One must turn to s.42 which reads as follows:

> "42.Rights of partners as to application of partnership property - On the dissolution of a partnership every partner is entitled as against the other partners in the firm, and all persons claiming through them in respect of their interests as partners, to have the property of the partnership applied in payment of the debts and liabilities of the firm, and to have the surplus asssets after such payment applied in payment of what may be due to the partners respectively after deducting what may be due from them as partners of the firm; and for that purpose any partner or his representatives may, on the termination of the partnership, apply to the Court to wind up the business and affairs of the firm."

In accordance with that section, Mr Ward, as a partner was entitled to receive his share of surplus assets, after payment of the debts and liabilities of the firm, and after repayment of advances by his co-partner, only after there had been deducted what was due by him to the firm, that is, his unpaid capital of $42,000.00. However, on account of Mr Ward's bankruptcy, his interest in the partnership vests upon his

adjudication in the applicant as the Assignee of the bankrupt's property by s.42(1) of the Insolvency Act 1967. Accordingly, the applicant is a person for the purposes of s.42 of the Partnership Act "claiming through" the bankrupt partner in respect of his interest as a partner and the deduction to which I have referred is binding on the applicant pursuant to that section. It is only after this deduction by way of the bankrupt's contribution of his capital in the partnership, has been brought to account, that the amount "due from the firm to him (now the applicant claiming through him) in respect of capital" can be determined.

Mr Heath attempted to go behind the provisions of s.42 of the Bankruptcy Act and placed reliance on Smith v de Silva 98 ER 1191 in which it was held by Lord Mansfield in 1776 that the bankrupt estate was entitled to a full third share of the profits, and that the other partners had no more than a right of proof in the bankruptcy for the unpaid balance of capital as a debt due to the commencement of bankruptcy. Mr Paterson endeavoured to distinguish that case on its facts and cited the following passage from the judgment of Lord Tenderden CJ in Holderness v Schackels 108 ER 1170, 1172:

> "The case of Smith v De Silva (Cowp. 469), is a very entangled case, and the facts stated in the report are not very clear or perspicuous. It appears that De Silva had originally made advances, not as part-owner of the ship, nor even as partner in the adventure, but as a person appointed by all the part-owners to manage the adventure for them, rather as their agent than as their partner. He afterwards acquired an interest by purchasing a part of the ship, and so became a partner

> in the adventure; but he was not an original partner. Smith v De Silva may, therefore, have been properly decided, without breaking in on the general principle to which I have adverted."

Lord Tenterden stated the general principle in these words:

> "Now, it is clearly established as a general principle of law, that if one partner becomes a bankrupt, his assignees can obtain no share of the partnership effects, until they first satisfy all that is due from him to the partnership."

That principle was reproduced in statute by s.39 of the Partnership Act 1890 (U.K.) and by s.42 (supra) in New Zealand which as I have said governs the situation in this case. The application of s.42 gives rise to what is known as a partner's lien as stated in the following passage from 35 Halsbury's Laws of England (4th Edn) paragraph 132 p.74:

> "132. Nature of partner's lien. On the dissolution of a partnership, each partner has a general lien on the firm's surplus assets, which arises out of his statutory right to have surplus assets, after payment of the firm's debts and liabilities, applied in payment of what may be due to the partners respectively after deducting what may be due from them as partners to the firm. (See the Partnership Act 1890 s.39)"

Mr Heath referred to the Article "The So-Called Lien of a Partner" by Walter Raeburn K.C., M.A. in (1949) 12 MLR 432. He concludes his Article as follows:

> "Once the cases have been carefully examined and understood, the only real difficulty in sorting out the interests of partners respectively in the assets of the firm on a dissolution is caused by the introduction of the word 'lien'. It may be that in the course of time the expression will be fully received into legal terminology in a third category as a 'partner's lien', with a well defined meaning, as distinct either from a 'common law lien' or an 'equitable lien' as the latter is from the former. It may indeed insinuate itself by the same entrance as the 'equitable lien' also used to acquire acceptance as such, notwithstanding that it deserved no recognition as a lien, except by courtesy.

> But perhaps, before it is too late, judicial ingenuity will devise a compendious term that will be understood accurately as denoting no more and no less than that right which, on a dissolution of partnership every partner enjoys pursuant to the provisions of section 39 of the Partnership Act, 1890."

The term "lien" appears in s.44 which confers the entitlement to a lien on a partner entitled to rescind where a partnership is rescinded on the ground of fraud or misrepresentation of one of the parties. Although the Act does not expressly confer a lien under s.42 on a dissolution, the right to make the deduction claimed by the respondent is provided by s.42 and the applicant is bound by it. The extent to which a partner's lien may exist and afford the respondent any greater right need not be considered in this case.

Mr Heath submitted that the applicant by virtue of the commencement of the bankruptcy, on a creditor's petition, relating back to the time of the act of bankruptcy on which the order of adjudication is founded (s.42(4)(a) of the Insolvency Act 1967) "took an interest in the partnership" at a date prior to adjudication. The submission is supported by the following passage in Williams and Muir Hunter on Bankruptcy (19th Edn) at p.215:

> "The dissolution, where a partner is separately adjudicated, dates from the act of bankruptcy. From that date, the bankrupt's authority to deal with the partnership assets is determined, and the accounts between the trustee of the bankrupt partner and the solvent partners are made up, except as to profits made by the solvent partners subsequent to the bankruptcy, of which the trustee is entitled to an account..." (See also Spratt and McKenzie's Law of Insolvency (2nd Edn) at p.208)

However the administration of the partnership business remains in the hands of the solvent partner who usually attends to the winding up of the partnership consequent upon its dissolution. The Assignee does not become a partner but becomes a tenant in common with the other partner or partners.

In this case there is no evidence to suggest there might be any difference of significance in the surplus assets of the partnership for the purposes of s.42 at the date of adjudication rather than at the date of the available act of bankruptcy.

The position is stated as follows in Lindley on Partnership (15th Edn) at p.807:

> "When one of several partners is adjudicated bankrupt his trustee becomes entitled to all his separate property, and to all his interest in the joint property; but subject to the qualification alluded to below (transactions void as against the trustee), the trustee can claim no more than the bankrupt; and every lien available for his co-partners against him is equally available for them against his trustee. Consequently the trustee can claim nothing as the bankrupt's share until all the joint creditors have been paid, and the partnership accounts have been duly taken and adjusted."

The property of the bankrupt which vests in the Assignee so far as his share in the partnership is concerned is a chose in action. It is not until dissolution of the partnership that the value of the chose in action can be quantified. Failing agreement to the contrary expressed in the

partnership deed, the fractional interest of the bankrupt partner in the partnership is quantified as a share in the surplus available. By application of ss.42 and 47 of the Partnership Act 1908 the respondent is entitled by way of deduction from the surplus monies held in trust to priority in respect of the capital and current account liability of the bankrupt to the partnership. That is the answer to the question before the Court.

Costs are reserved for submissions if necessary.

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