

Using Mediation to Address Business Owners' Predicament in Dissolving a Conventional Partnership

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Abstract: *Dissolving a conventional partnership affects the business relationship between the partners and their clients. However, the partners are still required to carry on with the management affairs of the partnership until it reaches a stage when all assets and debts are satisfactorily divided or settled. The inability to handle the situation will spark notable implications for the partners and clients that will result in prolonged litigation if an amicable settlement cannot be reached. Thus, this study examined the issues of the dissolution of partnerships and potential solutions by using mediation. The study utilised a doctrinal approach and analysed legal and non-legal sources relating to the effectiveness of mediation in resolving issues on the dissolution of partnerships. This study mainly finds that mediation offers a systematic way of resolving disputes arising during a partnership's dissolution. Mediation additionally provides a flexible and organised approach that assists partners in reaching a mutually agreeable solution, often without relying on costly and time-consuming litigation.*

Keywords: Mediation, Business, Dissolution of Partnership, Malaysia

1. Introduction

In Malaysia, one common type of business entity is the conventional partnership with a cap of 20 members, except for professional partnerships. Conventional partnerships ('partnerships') are governed under the Registration of Businesses Act 1956, Partnership Act 1961 [Act 135] (Malaysia) and Companies Commission of Malaysia (Suruhanjaya Syarikat Malaysia). A business partnership involves individuals who consent to share the benefits of establishing a business (Pandey, 2021). Business partnership dissolution refers to the legal and managerial process of terminating a partnership. Based on statistics released by the Companies Commission of Malaysia (SSM), the total number of dissolved businesses from March 18 to June 9, 2020, was 9,675 whereas, for the period from June 10 to September 2020, a total of 22,794 businesses also ceased operations (Siaran Media, 2020). Under Act 135, a partnership may be dissolved without a court order under the prevailing circumstances: by agreement, operation of law, death or bankruptcy, charging on shares, and supervening illegality. The termination of a business partnership registered under the Registration of Businesses Act 1956 [Act 197] must be notified to the Registrar (section 5D of Act 197). Despite the increase in dissolved businesses, dissolving a conventional partnership is always complex, especially if the partners are in dispute. The dissolution gives rise to several legal, financial, and operational issues. Partners need to nurture trust in each other for effective strategic planning (Lai, Lee, &

Hsu, 2009; Dietz, 2004). In addition, the dissolution of a partnership also affects the interests of the partnership's customers. The partners are required to give notice of dissolution to all customers of the partners, failing which customers are entitled to treat all the former partners as continuing partners (*Tower Co Ltd v Ingram* [1949] 2 KB 397). These challenges must be addressed cautiously to ensure a smooth transition for the partners and the business. Resolving issues of dissolution of partnership through the courts can be complicated. This is because certain disadvantages are attached to partnerships in Malaysia. Firstly, a conventional partnership holds every partner jointly and severally liable for the debts and liabilities of the business (Section 14, Act 135). For instance, every partner is susceptible to being sued by creditors considering a bankruptcy action against any partners. Secondly, every partner is required to disclose personal profits for income tax purposes. Finally, court action can be complicated if issues of dishonesty and fraudulent conduct are raised during trials. Therefore, business partners must be guided throughout the dissolution process to preserve business relationships in the long run and to avoid litigation.

There are numerous studies on mediation as a dispute mechanism to resolve issues in marriage partnerships. For instance, León, & Suarez (2023) analysed the efficacy of mediation in dealing with marital disputes, Gold (1982) studied mediation processes in marital contexts, and Bourassa et al. (2019) studied the function of mediation in dealing with the effects of marital dissolution, and Stannard et al. (2022) analysed the involvement of mediators in intergenerational programs related to partnership dissolution. However, there is insufficient research on using mediation to resolve issues in the dissolution of conventional partnerships. The study by Mohr & Spekman (1994) shows that the effective management of conventional partnerships is dependable on certain attributes that are present in conventional partnerships, namely trust, behaviour, commitment, communication, and dispute resolution methods in solving joint problems. In addition, limited studies show these attributes are relevant when dealing with the issues of partnership dissolution. Accordingly, the main objective of this study is to examine the potential of mediation in resolving issues relating to the dissolution of partnerships. The specific objectives of this study are to identify the main issues relating to the dissolution of partnerships; and to analyze the effects of using mediation to resolve the issues relating to the dissolution of partnership.

The structure of the study is as follows: Section 1 is an introduction to the study. Section 2 describes the methodology used in the study. Section 3 discusses the literature and analyses the issues relating to the dissolution of partnerships and mediation as a dispute resolution mechanism. Section 3 describes the methodological framework of the study. Section 4 analyzed the findings of this study and discussed the effects of using mediation to resolve problems relating to the dissolution of partnership. Finally, Section 5 concludes the study with recommendations to encourage using mediation to resolve partnership issues. This study is important to business partners and entrepreneurs since applying appropriate dispute resolution procedures contributes to sound choice and viable decision-making in dissolving a business amicably. According to Donovan & Ho (2022), members of the public should be exposed to other non-adversarial dispute resolution mechanisms to resolve their disputes. Since small business partnerships are not exposed to properly structured contracts; this study bears novelty in the sense that it promotes using appropriate dispute resolution in making informed managerial decisions relating to the dissolution of a partnership and avoids relying on the court as the sole forum to resolve disputes relating to partnership.

2. Research Methodology

This study relied mainly on doctrinal legal research that focuses on the strict interpretation of the letters of the law rather than the practical application of the law. This methodology entails conducting a detailed analysis of legal rules found in primary sources, such as case reports, statutes, or regulations. The researcher used a descriptive and comprehensive analysis of legal and non-legal sources to analyse the effectiveness of mediation in resolving issues relating to the dissolution of partnerships. Primary data includes relevant Acts, Enactments, court rules, and decided cases. Secondary data includes journal articles, proceeding papers, newspaper reports, and electronic materials. Both types of data were analysed using critical and analytical approaches. In addition, the study also relies on the content analysis technique to analyse the effects of mediation in resolving issues relating to the dissolution of partnerships.

3. Literature Review

Issues arising from the dissolution of a conventional partnership

A partnership can be dissolved in unintentional ways (Broomberg, 1964). The death of a partner dissolves the partnership (Sloan, 2017). This condition requires the surviving partners to plan a future relationship. In addition, the representatives of the deceased partner must be appointed via a new agreement, or under existing laws (Gould, 1896; Frederickson, 1963). The issues are stated below:

Legal Grounds as Reasons for Dissolution

Automatic Dissolution: A partnership may dissolve automatically if an existing partner dies, happens to go bankrupt, or if the partnership was established for a fixed term that has expired (section 34(1)(a) Partnership Act 1961; Berry, 2011). A partnership that operates for an undefined period, may also be dissolved by any partner giving the other partner(s) notice of his intention to end the partnership (Section 34(1)(c) Partnership Act 1961 and the case of *Sukhinderjit Singh Muker v Arumugam Deva Rajah* [1988] 2 MLJ 117). In Malaysia, death and bankruptcy are two reasons for the dissolution of a partnership (unless otherwise agreed between the contracting partners (see section 35(1), Partnership Act 1961 and the wealth of cases such as *Khoo Yoke Wah & Ors. v Lee Choo Yam Holdings Sdn Bhd & Ors* [1991] 1 MLJ 414; *Mat Shah bin Mohamed & Anor. v Foo Say Meng & Ors.* [1984] 1 MLJ 237; *Chia Foon Tau & Anor (suing as the executrix of the estate of Chong Tzu Chieh, deceased) v Lim Pey Lin* [1997] 2 MLJ 68). Section 37, Partnership Act 1961 stipulated that a partner may apply to the court for an order to dissolve a partnership due to misconduct of a partner, breach of partnership agreement, or if it is just, and equitable to do so. The issue is that an adjudged bankrupt will not be liable jointly for any debts, thus allowing creditors to pursue other partners to pay the full amount of any joint debts incurred with the bankrupt partner. In addition, the bankrupt partner may be reluctant to accept the fact he is an adjudged bankrupt and may intend to apply for a discharge that must be obtained from the Director General of Insolvency a certificate specifying the number of creditors of whom the Director has notice irrespective of whether they have proved their debts.

Voluntary Dissolution: Partners may mutually agree to dissolve a partnership by stating this in their partnership agreement. Instances are such that the duration of the partnership as stated in the contract has expired and if the partners mutually agree to dissolve the partnership.

Court-Ordered Dissolution: Section 37, Partnership Act 1961 specifies that a partner may apply to the court for an order to dissolve a partnership due to misconduct of a partner, breach of partnership agreement or if it is just, and equitable to do so.

In cases where the reasons for dissolution are disputed, then any of the dissatisfied partner(s) may need to apply to the court so that the court may order the dissolution of the partnership in any of the following situations: insanity of a partner (section 37(a), Partnership Act 1961; permanent incapacity of a partner that affect his ability to perform his duty(ies) under section 37(b), Partnership Act 1961; conduct calculated to prejudicially affect the carrying out of the business Section 37 (b), Partnership Act 1961). Cases have shown that any partner can apply to the court to dissolve the partnership if dishonesty, gross misconduct and conduct that is prejudicial to the business (Carmichael v Evans [1904] 1 Ch. 486; M.M. Lewis & Ors. V. W.E. Balasingam [1970] 1 MLJ 133; and Clifford v Timms [1908] A.C.12.

Distribution of Assets and Liabilities

In Malaysia, the Partnership Act 1961 outlines that all debts and liabilities must be settled by the partners in a dissolved partnership. Any remaining assets are shared among the partners according to their agreed profit-sharing ratio or as specified in the partnership agreement. Distributing a partnership's assets and liabilities is a primary concern during dissolution. Generally, the share of a partner refers to his proportional division of the joint asset after conversion into money and after payment of the joint debts and liabilities (Garbett v Veale [1843] 5 QB 408. Potential disputes arise when there is unclear agreement on the method of division of assets. In the absence of such a clause, the unanimous consent of all the partners is needed (Byrne v Reid (1902) 2 Ch 735 and section 26(g), Partnership Act 1961). Partners who fail to address the distribution of firm assets upon dissolution invite future disagreement and the risk of litigation (Reinstein, & Johnson, 2004).

Valuation of Partnership Assets

Partners must properly evaluate partnership assets (physical or intellectual) and goodwill. Disputes may arise if any partners disagree on the valuation method of the partnership assets. The valuation of such assets might be complicated because of the need to consider the difference between the basis of the property to the partnership and its market value when it is accepted as a partnership asset (Caudill, 2006).

Handling of Debts and Liabilities

Upon the dissolution of a partnership, every partner is entitled to have the property of the partnership be used to pay debts and liabilities of the firm before any surplus assets (after payment of the debts) be distributed among the partners (see section 41, Partnership Act 1961; Chartered Bank v Yong Chan [1974] 1 MLJ 157; and Chia Foon Tau & Anor (suing as the executrix of the estate of Chong Tzu Chieh, deceased) v Lim Pey Lin [1997] 2 MLJ 68). The partners share joint liability for the partnership's debts. However, conflict may arise if any partner feels he is shouldering an unfair share of the burden.

Contractual Obligations

After the partnership's dissolution, the partners' authority continues only to the extent of winding up the partnership's affairs and completing uncompleted transactions (section 40, Partnership Act 1961; Chartered Bank v Yong Chan [1974] 1 MLJ 157). Partners are jointly liable for all obligations under a contract (Bromberg, 1992; Rahman, 2023) and the contractual obligation to negotiate in good faith (Hoskin, 2014; Rakoff, 2006). An issue might arise when

one or more partners breach a duty of care to a client but refuse to take responsibility for such action. wish to continue the business under a new business structure.

Tax Implications

The dissolution of a partnership inevitably invites serious attention among partners about tax and stamp duty deliberations, particularly concerning the transfer of real property. Thus, dissolution may cause various tax obligations and, in this account, partners must be familiar with payment of taxes under various statutory acts, namely the Real Property Gains Tax Act 1976 (Malaysia), Income Tax Act 1967 (Malaysia) and the Stamp Duty Act 1949 (Malaysia). Key financial complications arise from the potential for capital gains tax, income tax, and stamp duty when assets are transferred during dissolution. The income generated by the partnership must be allocated among the partners because each partner is taxed individually based on their share of the partnership's profits. The partners must agree to the computation of the final taxable income of the partnership at the point of dissolution. Profits and losses are incurred by individual partners based on their share of ownership or profit allocation as mentioned in the partnership agreement. Any income made before the dissolution must be reported and taxed accordingly.

Mediation as a dispute resolution procedure

Resolving disputes arising from the dissolution of a partnership can be addressed via litigation based on the numerous cases heard in the court. The existence of a dispute resolution clause in a partnership agreement works as a guide to ease the resolution of disputes among partners. The appropriate time to adopt mediation is before the existence of a dispute (Koçoğlu, 2020). In Malaysia, several court reports indicated that parties must honour a dispute resolution clause of an agreement as a pre-condition before initiating court action. This requirement was shown in the reported cases of *Juara Serata Sdn Bhd v Alfarich Sdn Bhd* [2015] 6 MLJ 773, *Emirates Trading Agency LLC v Prime Mineral Exports Private Limited* [2014] EWHC 2104 (Comm), *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177, and *Yong Ah Huat & Anor v Toshiba Corp* [2018] MLJU 262).

Dispute resolution clauses typically state the involvement of a third-party neutral in resolving disputes (Chappe, 2014). The third-party neutral guides the parties throughout the dispute resolution process and lets them control how to resolve their dispute (Todorović, & Harges, 2021). This process allows the parties to decide how to resolve their disputes amicably. Mediation carries this feature. However, court reports and the views of previous authors have shown inadequate treatment to address the possibility of resolving such disputes via mediation. Resolving conflicts relating to partnership via mediation is economical compared to litigation where the parties often face communication issues (Yenice Ceylan, 2023; Marcil, & Thornton, 2008). Mediation is therapeutic (Stoica, 2011) for it promotes business ethics and improves social and partnership relations in the long run (Kokoeva et. al 2022).

4. Results and Discussion

The study shows that mediation is effective for resolving disputes that arise during the dissolution of a partnership. It offers a flexible and organised approach that assists partners in reaching a mutually agreeable solution, often without relying on costly and time-consuming litigation. Mediation can solve issues on dissolution of the partnership in the following ways:

Assists in Free Communication

A partner's share is his proportional division of the jointly acquired assets after paying all debts and liabilities (*Garbett v Veale* [1843] 5 QB 408). Potential disputes arise when there is unclear agreement or mutual understanding on how assets should be divided fairly. Strained relationships during the dissolution of a partnership might hamper effective communication among the partners thus hampering discussion on the distribution of the partnership's assets and liabilities. Tensions might become high when, for instance, one or more partners initiates court action for determining the division of assets and liabilities under section 37 (b), Partnership Act 1961.

Cases have shown that any partner is entitled to seek the court to dissolve the partnership in the existence of dishonesty, gross misconduct, and conduct that is prejudicial to the business (*Carmichael v Evans* [1904] 1 Ch. 486; *M.M. Lewis & Ors. V. W.E. Balasingam* [1970] 1 MLJ 133; and *Clifford v Timms* [1908] A.C.12). In such situation, a mediator facilitates free communication between the partners by providing them the opportunity to express their concerns and needs in a confidential setting, thus reducing misunderstanding and tension, and communication issues (*Yenice Ceylan, 2023; Marcil, & Thornton, 2008*). Apart from that, the mediator helps the parties approach each other directly and craft decisions that benefit each other (*Katz, 2007*). According to *Yenice Ceylan (2023)*, mediation assists the parties to communicate effectively regarding the division of properties upon dissolution of a partnership, thus economically resolving issues.

Detects Underlying Problems and expedite the resolution process

Partners might not agree on issues during dissolution, especially on the division of assets and liabilities or the carrying out of business responsibilities. The division of assets can only be made after the settlement of joint debts and liabilities (*Garbett v Veale* [1843] 5 QB 408) and is based on the unanimous consent of all the partners (*Byrne v Reid* (1902) 2 Ch 735 and section 26(g), Partnership Act 1961) to avoid the risk of litigation (*Reinstein, & Johnson, 2004*). Under the Rules of Court 2012 (Malaysia), the court will dismiss a plain and obvious case if there is no prospect of success or if the claims are frivolous or vexatious or an abuse of the court process, or the defences are unarguable (see *Duta Arif Sdn Bhd v Chartered Development Corp* [2008] 6 MLJ 139, *Alliance Investment Bank Sdn Bhd v Good Quantum Sdn Bhd* [2011] MLJU 1679, *Nescajaya Sdn Bhd v Suairah bt Parigula* [2011] 9 MLJ 774). Besides, pleadings that are hopeless, baseless or without foundation in law can be struck out by the court (see *Sivakumar a/l Varathaju Naidu v Ganesan a/l Retanam* [2011] 6 MLJ 70, CA).

In the above scenario, a mediator can assist partners in avoiding litigation by identifying and clarifying the main issues that must be resolved outside the courtroom. This method allows the parties to collect necessary information and concentrate on the effective method to resolve their concerns. In addition, the mediator assists the parties in exploring various solutions for each problem by using solution-oriented questions to produce solutions (*Stokoe, & Sikveland, 2016*).

A mediator assists parties in resolving the underlying issues, thus securing mediated settlements (*Gartner, & Bercovitch, 2006*). The flexibility of the mediation process facilitates an expedited resolution of disputes. If parties show willingness to participate in settlement discussion at the earliest possible time, the resolution process can be expedited (*Cortés (2023), Voss (2022), and Koçoğlu, 2020*)

Reduces Psychological Conflict

The dissolution of a partnership can become psychologically charged, especially if the partnership has a long history of strained relationships. In disputed matters, any partner(s) may apply to the court for an order to dissolve the partnership in any of the following situations: the insanity of a partner (section 37(a), Partnership Act 1961; permanent incapacity of a partner that affects his ability to perform his duty(ies) under section 37(b), Partnership Act 1961; conduct calculated to prejudicially affect the carrying out of the business Section 37 (b), Partnership Act 1961). Cases have shown that the courts allowed dissolution of partnerships caused by dishonesty, gross misconduct and conduct that is prejudicial to the business (Carmichael v Evans [1904] 1 Ch. 486; M.M. Lewis & Ors. V. W.E. Balasingam [1970] 1 MLJ 133; and Clifford v Timms [1908] A.C.12. The mediator, unlike a judge in a court system, acts as a neutral third party and a therapist, helping to diffuse emotional tension and keep discussions professional (Stoica, 2011). This allows partners to make decisions based on rational considerations rather than emotions, leading to more effective problem-solving.

Ensures Legal Compliance

Partners must be familiar with the payment of taxes under various statutory acts, namely the Real Property Gains Tax Act 1976 (Malaysia), Income Tax Act 1967 (Malaysia) and the Stamp Duty Act 1949 (Malaysia). These tax obligations and regulatory compliance steps continue even after the dissolution of the partnership. Key financial complications arise when the parties disagree on the computation of the final taxable income of the partnership at the point of dissolution, or the division of profits and losses allocation as mentioned in the partnership agreement. The mediator will lead the parties to focus on their interests rather than legal positions, thus assisting them in crafting their solution based on their standard of fairness. In such a process, the mediator can involve the parties' legal advisors (if any) to ensure that the settlement terms are legally binding on the parties. Partners may also involve their legal advisors in the mediation process to ensure that the final agreement is legally sound and compliant with relevant laws.

Maintains Relationships

Partnerships are formed based on trust and professional relationships. However, the dissolution of a partnership can affect such a business relationship in the long run. A mediator focuses on problem-solving solutions and endeavours to maintain respect between two conflicting parties, thus assisting in preserving relationships in the long run (Kokoeva, et. al 2022), in addition to reducing personal dissatisfaction and in clarifying personal and joint interests for professional development (Plassmann, 2021).

Establishes a Binding Agreement

Sensitive issues relating to the decision of whether the Intellectual property (IP) will be sold, transferred, or retained by the partnership entity until its formal dissolution must be handled with care. In such a situation, mutually agreeable terms resulting from successful mediation can be reduced to a written binding agreement, thus resolving issues in managing ongoing contracts entered by the partnership.

5. Conclusion

In Malaysia, the dissolution of a partnership does not end the duties of the partners. This is because they need to discuss crucial matters, especially relating to duties, the distribution of assets and liabilities, and any issues that arise from the disposal of properties. The management

of these matters occasionally raises indifferences among the partners and thus requires the assistance of a neutral third party in resolving any dispute.

Concerning this, a mediator can assist the partners in resolving their issues and eventually reduce animosity and improve business relationships. The mediator can assist the partners in crafting an effective settlement plan to resolve their disputes. By encouraging active communication, and exploring creative solutions, the mediator will see that partners reach a mutually satisfactory agreement, often preserving long-term relationships and reducing the stress associated with the dissolution process.

6. Recommendations

Mediation provides a practical, cost-effective, and efficient way to resolve complex issues that can arise during the dissolution of a partnership. It is therefore recommended that partners should consider inserting a dispute resolution clause in the partnership agreement, covering the use of mediation (and other forms of dispute resolution mechanisms) as a prerequisite before initiating a civil claim. Thus, future research could focus on the practical implementation of such clauses in the partnership agreement and how a mediator can assist dissolved partnerships in navigating the dissolution process efficiently.

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Yong Ah Huat & Anor v Toshiba Corp [2018] MLJU 262, referring to Emirate Trading and United Group Rail among others,