



RESEARCH PAPER 00/54
22 MAY 2000

Limited Liability Partnerships Bill [HL]

Bill 108 1999-2000

The Bill creates a new corporate form. A Limited Liability Partnership will be a legal entity which trades with limited liability for its members, unlike a partnership where liability is unlimited. Its internal arrangements will largely be a matter for its members, but safeguards to protect those who have dealings with the company will be introduced in the form of information requirements and insolvency provisions. The new form is likely to be of interest to many types of undertaking which are currently structured as partnerships but wish to reduce the exposure of individual partners (as distinct from the partnership itself) to financial liabilities.

The Bill was introduced in the Lords on 23 November 1999. It is due to have its Second Reading in the Commons on Tuesday 23 May 2000.

Christopher Blair

BUSINESS & TRANSPORT SECTION

HOUSE OF COMMONS LIBRARY

Recent Library Research Papers include:

List of 15 most recent RPs

00/39	The <i>Learning and Skills Bill</i> [HL] [Bill 96 of 1999-2000]	28.03.00
00/40	The <i>Nuclear Safeguards Bill</i> [HL] [Bill 59 of 1999-2000]	30.03.00
00/41	Economic Indicators	03.04.00
00/42	Advisers to Ministers	05.04.00
00/43	<i>Census (Amendment) Bill</i> [HL] [Bill 100 of 1999-2000]	05.04.00
00/44	The <i>Local Government Bill</i> [HL]: Local government leadership etc [Bill 87 of 1999-2000]	06.04.00
00/45	The <i>Local Government Bill</i> [HL]: Electoral Aspects [Bill 87 of 1999-2000]	06.04.00
00/46	The <i>Local Government Bill</i> [HL]: welfare services and social services functions [Bill 87 of 1999-2000]	06.04.00
00/47	The <i>Local Government Bill</i> [HL]: the 'Section 28' debate [Bill 87 of 1999-2000]	06.04.00
00/48	Unemployment by Constituency - March 2000	19.04.00
00/49	Intergovernmental Conference 2000: the main agenda	19.04.00
00/50	Part-time work	15.05.00
00/51	Unemployment by Constituency - April 2000	17.05.00
00/52	The <i>Care Standards Bill</i> [HL] [Bill 105 of 1999-2000]	16.05.00
00/53	The local elections and elections for a London Mayor and Assembly:	17.05.00

Research Papers are available as PDF files:

- *to members of the general public on the Parliamentary web site,
URL: <http://www.parliament.uk>*
- *within Parliament to users of the Parliamentary Intranet,
URL: <http://hcl1.hclibrary.parliament.uk>*

Library Research Papers are compiled for the benefit of Members of Parliament and their personal staff. Authors are available to discuss the contents of these papers with Members and their staff but cannot advise members of the general public. Any comments on Research Papers should be sent to the Research Publications Officer, Room 407, 1 Derby Gate, London, SW1A 2DG or e-mailed to PAPERS@parliament.uk

Summary of main points

- The Bill creates a new form of corporate entity, the limited liability partnership (LLP). It combines features of limited companies and partnerships, but it will not be a partnership. Adoption of the form will be voluntary.
- Interest in such an entity is often associated with the large professional partnerships (such as accountants and solicitors) which have argued that the unlimited personal liability faced by all partners is no longer appropriate in the modern business climate.
- Previous plans to limit its availability to firms which are subject to professional regulation by an approved regulator have been abandoned. The LLP form will be available to any undertaking consisting of at least two persons.
- The Bill enjoyed all party support in the Lords, although there are those who object on principle to extending the privilege of limited liability outside the format of a registered company, or to extending it to the professions, or to extending it to auditors in particular.
- LLPs will be subject to many of the basic protections which apply to companies, such as an obligation for partners to be registered and the investigation and disqualification regimes. Financial information about the LLP will have to be disclosed. As with partnerships, their internal structures will not be prescribed by statute.
- LLPs will in general be treated as partnerships for tax purposes. The conversion of existing partnerships into LLPs will normally be tax neutral.
- The proposal originates from the previous administration. The Bill and some associated regulations have been issued for consultation twice in draft form. It has also been subject to pre-legislative scrutiny by the Trade and Industry Committee. Its report, and the Government's response, are a key source of information on the Bill.
- The Bill extends chiefly to England, Wales and Scotland, although the taxation provisions also extend to Northern Ireland. Regulation-making functions under the Bill dealing with the winding up of Scottish LLPs will be exercised by Scottish ministers.

CONTENTS

I	Background	7
	A. General introduction	7
	B. Development of proposals	9
II	The Bill	12
III	General themes	15
	A. Limiting liability	15
	B. The nature of liabilities	18
	C. The structure of the Bill	20
IV	Parliamentary progress in the Lords	21
	1. Second Reading	21
	2. Committee	22
	3. Report stage	24
	4. Third Reading	26
V	Bibliography	27

I Background

A. General introduction

Some of the professions, especially the accountants, have been lobbying for some time to have the law on liability changed in the United Kingdom. In the UK most professional firms, including accountants, solicitors and surveyors, are structured as partnerships. Although the partnership form has been in use for a long time, and the law applying to partnerships was codified into statute more than one hundred years ago, features of the law on partnership can present serious drawbacks to their use today.

A partnership is defined in law as the relation which subsists between persons carrying on a business with a view of profit (s. 1, *Partnership Act 1890*). A key feature of partnerships is that they do not have a legal personality of their own. In the eyes of the law, the partnership is merely a way of describing the individual partners who make up the partnership. This has important implications for the way obligations which are incurred by the partnership are treated. Unlike in a company, where the members (shareholders) of the company are to a large extent insulated from the liabilities of the company, in a partnership, each partner is held responsible not just for the liabilities caused by his own actions, but also for liabilities incurred by each and every partner. Moreover, the liability is not limited by his involvement in the business: his personal assets are fully at risk from the partnership's liabilities if those liabilities cannot be covered by the assets held within the partnership, or where applicable, professional indemnity insurance.

It is argued that this degree of personal liability is hindering the development of the UK's professional businesses, and leading to a risk that some of those firms which are currently structured as partnerships may choose to incorporate in other jurisdictions where the choice of business entities is more favourable.

Concern about the partnership form comes against a background of the very substantial claims which can be made in the commercial sector, especially when companies become insolvent. Although the auditors of such companies may not necessarily be at fault, or may not be the only party at fault, auditors are often sued in such circumstances (perhaps by the liquidator of the company, which may in practice be another firm of accountants) because of the various parties associated with an insolvency they are often the only one which is both trading and solvent. This scenario is sometimes called the deep pockets problem: when claimants are looking for someone to sue, they sue the party which is likely to have the funds to pay any award.

During the mid to late 1990s, some accountancy firms were exploring plans to move offshore in order to take advantage of more favourable legislation in other jurisdictions. A case in point is Jersey, which now allows partnerships to operate with limited liability, thanks to an Act which was passed apparently with significant assistance from some

major partnerships. The major UK firms have not, as it happened, incorporated as Limited Liability Partnerships in Jersey, partly it seems because of suggestions that there would be unfavourable tax consequences for their operations within the UK if they did. Nevertheless, in this climate the Conservative Government was spurred into issuing a consultation document on the possibility of introducing limited liability partnerships in the UK in February 1997.¹ The Labour Government has proceeded with these plans, and consulted twice on its detailed proposals.

The Trade and Industry Committee, which carried out pre-legislative scrutiny of this Bill, was critical of the details provided by the Department on the background to the proposals:

There has however been no public document seeking to explain or justify the proposals in any detail; no account of the trends and events which produced the demand for such a new entity; no public analysis of the experience of other jurisdictions with LLPs; and no extensive discussion of alternative means of producing the desired results. There is no shortage of such documentation in the public domain, including a number of academic articles, conference proceedings and suchlike, some of which we have used in drawing up this Report. In the absence of any official account, it has been easy for sceptical or hostile observers to suggest that the Bill is in effect a favour being thrown to the big accountancy partnerships, in return for the profession's acceptance of a limited scheme of independent supervision; that as a result the professions, particularly accountants and lawyers, will be free to enjoy all the benefits of partnership without the usually associated liabilities; and that the Government was forced into action by the passage of the Jersey LLP Law, procured for that very purpose by the efforts of several large firms. We heard oral evidence from a principal proponent of this view, Profesor Sikka of the University of Essex. **In our view, DTI Ministers of both administrations have failed to set out a convincing and detailed case for the introduction, without evidence of much prior analysis, of potentially far-reaching legislation. While we believe that there is a good case to be made, it could and should have been more fully and openly exposed in departmental papers.**²

It is important to note that the *Limited Liability Partnerships Bill* is relevant to more than accountants. Indeed the Government has been keen to stress that the primary reason for establishing LLPs in the UK is because the concept has intrinsic merit, rather than because it is needed to respond to competition from other jurisdictions which already offer LLPs.³ Although the Bill has been seen as targeted primarily at accountants and solicitors – who are often organised into very large partnerships – other professionals, such as surveyors are expected to be interested in the new corporate form which it offers.

¹ *Limited Liability Partnership: A new form of business association for professions: A consultation paper*, Department of Trade and Industry, February 1997

² *Draft Limited Liability Partnership Bill*, Trade and Industry Select Committee, 10 February 1999, HC 59 1998-99, para 6

³ *Government Observations on the Fourth Report from the Trade and Industry Committee on the Draft Limited Liability Partnership Bill*, 14 June 1999, HC 529 1998-99, para 21

The original proposal had been that only members of a regulated profession should be able to form a limited liability partnership. The Bill has since been changed to allow any group of at least two people to form an LLP.

The Bill itself is relatively short, but it will apply substantial sections of the company and insolvency legislation (mainly from the *Companies Act 1985* and the *Insolvency Act 1986*) by regulations, with appropriate modifications. Those regulations have already been issued for consultation.

In general the Government has sought to create what it sees as a level playing field between the controls on LLPs and those which apply to companies which are registered under the *Companies Act 1985* ('registered companies'). In practice this means that it has been reluctant to impose additional burdens on LLPs beyond those which apply to registered companies. At the same time, it has been keen to ensure that the safeguards and disclosure requirements which are placed on registered companies are also placed on LLPs. The tension between those aims, that is, what the price of limited liability should be, has been a regular theme in the Parliamentary debates so far on the Bill. Another theme has been the extent to which the requirements and ethos of conventional partnerships will bite on the new entity, the Limited Liability Partnership, which as a corporate body (clause 1) is not a partnership.

In its Regulatory Impact Assessment (RIA), issued in November 1999, the DTI notes that there are approximately 600,000 partnerships in the UK (1997 figures).⁴ Of these, only a minority are expected to become an LLP, and those firms are expected to be drawn mainly from a variety of professional backgrounds (including architects, surveyors and engineers, rather than the retail or manufacturing sectors). The RIA includes an estimate (described as 'little more than an impression') that perhaps 90,000 partnerships might opt to become LLPs. The costs for firms of such a choice would it is said mainly be those of producing the annual accounts and paying for audit. Whilst the introduction of LLPs will require new systems at Companies House, those costs are expected to be recouped through fees (as is the case with registered companies).

B. Development of proposals

In November 1996, Ian Lang, President of the Board of Trade, announced that the Government would bring forward legislation to make limited liability partnerships available in the UK:

I am well aware of the concerns of many within the professions about the possible consequences of the unlimited liability of partners in the modern commercial environment. In a big modern partnership advising on large

⁴ *Limited Liability Partnerships Bill: Regulatory Impact Assessment*, Department of Trade and Industry, November 1999 [URN 99/1234]

commercial transactions it may be impossible for partners to know all other partners and their work – yet their personal assets can be put at risk by the actions of their partners. The Government is determined to maintain a competitive and up-to-date legal framework for business in the UK. We are aware of recent developments in partnership law in other jurisdictions such as the United States of America and Jersey, and responses to a recent consultation were strongly in favour of dealing with this issue.⁵

The Conservative Government then issued a consultation document in February 1997 setting out its proposals to make limited liability partnerships available in the UK.⁶ The incoming Labour Government first announced that it would consult on draft legislation on LLPs on 22 May 1997. A draft Bill was issued for consultation in September 1998, together with draft regulations covering the application of the reporting requirements and insolvency provisions to LLPs.⁷

The draft Bill was put before the Trade and Industry Committee, for pre-legislative scrutiny, putting into effect one of the proposals on scrutinising legislation put forward by the Modernisation Committee.⁸ The Committee held evidence sessions in December 1998, and also drew on the detailed responses made to the DTI's consultations. Its report, published in February 1999, endorsed the broad need for the Bill, but recommended a number of specific changes, and also sought more information on a number of points.

The *Limited Liability Partnership Bill* was then re-issued in draft form by the Department of Trade and Industry in July 1999, with revised versions of the regulations which are to be made under it.⁹ The Bill itself was finally published in November 1999, and had its Second Reading in the House of Lords on 9 December 1999.¹⁰ The Committee stage was taken on 24 January 2000, and was reported on 6 March 2000.¹¹ A short Third Reading debate took place on 6 April 2000.¹² It is due to have its Second Reading in the Commons on 23 May 2000.

⁵ 'Ian Lang announces government intention to legislate on limited liability partnerships', DTI press release 96/831, 7 November 1996

⁶ *Limited Liability Partnership: A new form of business association for professions*, A consultation paper, 2 vols, Department of Trade and Industry, February 1997 [URN 97/597]

⁷ *Limited Liability Partnerships: Draft Bill: A consultation document*, Department of Trade and Industry, September 1998 [URN 98/874]

⁸ *Draft Limited Liability Partnership Bill*, Trade and Industry Select Committee, 10 February 1999, HC 59 1998-99

⁹ *Limited Liability Partnerships Bill: Consultation Document*, DTI, 27 July 1999. Includes draft Bill, draft Regulations, and an analysis of responses to the previous draft Bill.

¹⁰ Second Reading: HL Deb 9 December 1999 cc 1419-45

¹¹ Committee: HL Deb 24 January 2000 cc 1352-1410; Report: HL Deb 6 March 2000 cc 846-877

¹² Third Reading: HL Deb 6 April 2000 cc 1420-7

While the Bill was in the Lords, the Government issued a further consultation paper which covers the relationships between the members of an LLP.¹³

¹³ *Limited Liability Partnerships: Regulatory provisions governing relations between members: A consultation paper*, Department of Trade and Industry, February 2000 [URN 00/617]

II The Bill

Clause 1. Creates a new legal entity, the limited liability partnership. It is a body corporate with its own legal personality, and able to enter into any commercial arrangement ('unlimited capacity'). It is its existence as a separate person from its members (unlike a partnership) that is the key to the separation of individual liability from the liability of the LLP. The Bill and its regulations provide for the extent of the liability of the members to contribute to the LLP's assets on winding up. Partnership law, generally, does not apply to an LLP – although the Bill contains important exceptions to that rule.

Clause 2. An LLP requires at least two persons engaged in lawful business with a view to a profit. A statement of compliance (c.2(1)(c)) with that requirement, and an incorporation document, which contains core information about the LLP and its members, must be provided to the registrar of companies. It is an offence to make a false statement in relation to the compliance requirement.

Clause 3. If the requirements of clause 2 are met, the registrar will register the incorporation document and issue a certificate of incorporation under the specified name. That certificate is conclusive evidence of incorporation.

Clause 4. Subscribers to the incorporation document become the members of the LLP. Members may join or leave the LLP by agreement with the other members (or on death, or dissolution for non-natural persons). Members can also leave the LLP on reasonable notice to the others in the absence of agreement (c.4(3)). Members of an LLP are not usually treated as employees.

Clause 5. Normally the relationship between the members of an LLP and each other, and with the LLP, are to be governed by agreement, unless legislation provides otherwise. Where no agreement exists, default arrangements are to be provided in regulations. Several speakers in the Lords argued that such a provision was key to preserving the so-called 'partnership ethos' among partnerships which opt to become LLPs.

Clause 6. Members of an LLP are treated as agents of the LLP: their actions normally bind the LLP, and liabilities which a member incurs are also liabilities of the LLP. However, the LLP is not bound where a member acts beyond his authority and the third party knows that he does so, or does not know or believe that the member is a member of an LLP. In the case of former members of an LLP, the LLP is not bound if the registrar has been given notice of the member's retirement.

Clause 7. Former members and their representatives are entitled to receive sums in accordance with their remaining financial interest in the LLP, but not to interfere in the management or affairs of the LLP.

Clause 8. Certain formal and administrative responsibilities are placed on ‘designated members’, a position somewhat analogous to a company secretary. An LLP will have at least two designated members, since if it does not, all members become ‘designated members’. An LLP may decide in any case that all its members will be designated members. The registrar at Companies House must be informed when the designated members change.

Clause 9. The registrar must be informed within fourteen days of the appointment or retirement of a member. A longer period of 28 days is allowed to notify the registrar of changes in the address or name of a member.

Clause 10. The tax provisions in the Bill are intended to make the decision of a conventional partnership to become an LLP broadly tax neutral. Tax liabilities will not normally arise unless the same transaction between two partnerships would have created a liability.

Members of an LLP will be treated for income and capital gains tax as if they were in a conventional partnership. The clause also contains provisions to prevent LLPs being used as a tax avoidance vehicle, and to make the treatment of chargeable gains and losses when an LLP is wound up rational.

Clause 11. Members of an LLP will be treated in the same way as partners for inheritance tax: for example, business relief will be available on the same basis.

Clause 12. Stamp duty will not normally be payable when a partnership becomes an LLP.

Clause 13. Members of an LLP will be liable for Class IV National Insurance contributions on their share of the partnership profits, as they would be in a partnership.

Clause 14. The Secretary of State can apply by regulations, with appropriate modifications, the insolvency procedures of the *Insolvency Act 1986*. He can also apply or disapply other statutory provisions on insolvency and winding up. The circumstances in which prior drawings from an LLP can be clawed back if the LLP later becomes insolvent were widely discussed during the consultations on the Bill.

Clause 15. Similar powers to apply company and partnership law by regulation to LLPs are also given. This and the previous clause, through the regulations made under them, will be the source of much of the applicable law for LLPs. These regulations have been issued for consultation with draft versions of the Bill. It is intended that the regime for LLPs will closely follow that which applies to companies.

Clause 16. There are powers to make consequential amendments and repeals in any other legislation.

Clause 17. Secondary legislation under the Bill will be able to create criminal offences for non-compliance and can impose fees. Regulations under clauses 14 and 15 which do more than apply or incorporate (with or without modifications) provisions from the main insolvency and company legislation will be subject to the affirmative procedure, as will the powers under clause 16.

Clause 18 includes definitions for some terms used in the Bill.

Clause 19 deals with commencement and extent. The Bill applies to England, Wales and Scotland, but Scottish Ministers are empowered to make regulations governing winding-up procedures in Scotland (c.19(3)).

Schedule. The name of every Limited Liability Partnership must include that term, or an abbreviation of it, at its end. They may not use names which are the same as those of a registered company, and the Secretary of State has powers to control the use of offensive and some potentially misleading names. The Schedule provides more detail on names, and registered offices.

III General themes

A. Limiting liability

Most accountants and lawyers are structured as partnerships and trade with unlimited liability. The professions have long argued that the law in the UK should be changed to limit the incidence of liabilities. There are two key elements which could be changed. The first concerns the principle of 'joint and several liability' which allows any one against whom a claim is made to be required to meet the full claim (if it is substantiated) and not merely the claim in proportion to his or her own liability. The second is the liability of partners for the acts of the partnership. In theory if a claim is made against a partnership, the individual assets of all the partners are at risk in addition to the partnership's own assets irrespective of a partner's negligence or lack of it. One possible solution to this second problem is to reform the law of partnership liability, and this is what the current Bill would do. The law on joint and several liability is not being changed by this Bill.

The issue of reforming joint and several liability - perhaps even more important in the face of large liability claims against professional firms - although not covered by the new Bill, was the subject of a recent review by the Law Commission.¹⁴ The conclusions of that Review were summarised by the Trade and Industry Committee:

20. In May 1995 the Common Law Team of the Law Commission were invited by DTI and the Lord Chancellors Department to undertake an initial investigation into whether a full scale project of reform of the law of joint and several liability would be worthwhile. In December 1995, it concluded that such a project would not be worthwhile, since it found fundamental objections to the introduction of either full or modified schemes of proportionate liability, primarily because such schemes would shift the burden of risk onto those who had suffered loss away from those who had caused it. The team considered other means of solving what it recognised as "the very real problems faced by many professional defendants in obtaining affordable insurance", including the possibility of limiting liability by contract, and reform of joint and several liability *within* partnerships, noting the efforts then being made to obtain a Jersey LLP statute.¹⁵

In September 1998, the Government indicated that the debate over whether professional liability should be reformed was not closed.¹⁶ There is a major review of company law

¹⁴ *Feasibility investigation of joint and several liability*, Common Law Team of the Law Commission and DTI, 1996. The Law Commission and the Scottish Law Commission are currently reviewing partnership law generally (Law Commission Projects 48/30 and 48/90). They are expected to publish consultation papers of partnership in general and on limited partnerships in 2000.

¹⁵ Trade and Industry Committee, *Draft Limited Liability Partnership Bill*, HC 59 1998-99, 10 February 1999, para 20

¹⁶ 'Accountancy reform: regulation and liability', DTI press release 98/699, 17 September 1998

(initiated in March 1998 by the DTI's consultation paper, *Modern Company Law: For a competitive economy*) under way. Joint and several liability is expected to be discussed again as part of this review. The Review is also consulting generally on whether access to limited liability should be controlled in some way.¹⁷

This Bill, then, addresses the allocation of liability within partnerships, rather than the extent of a partnership's liability to other parties. Again it is helpful to use the situation in registered companies as a comparison. Such companies are usually 'limited by shares'. This means in simple terms that the liability of a member of the company for the company's debts is limited to the extent of the value of the member's nominal share capital in the company (usually a very small sum in proportion to the company's assets). If the company is sued, its assets are available to meet such claims, but the shareholders are unlikely to be pursued (except in very specific circumstances).

As has already been noted, in a conventional partnership, the partnership itself is not recognised as a legal entity in the way that a registered company is. There is no wall separating the members of the partnership from the partnership's liabilities, and each and every partner is therefore fully, and personally liable for all the liabilities of the partnership.

The Government's Explanatory Notes to the Bill outline why unlimited liability amongst partnerships has become a source of concern:

- (a) a general increase in the incidence of litigation for professional negligence and in the size of claims;
- (b) the growth in the size of partnerships (since in a very large partnership not all the partners will be personally known to one other);
- (c) the increase in specialisation among partners and the coming together of different professions within a partnership; and
- (d) the risk to a partner's personal assets when a claim exceeds the sum of the assets and insurance cover of the partnership.¹⁸

The Trade and Industry Committee, a little wryly, accepted these reasons:

Much of the evidence is anecdotal; the tales may gain somewhat in the telling. We are however satisfied that there is a real problem which the legislation attempts to address.¹⁹

¹⁷ *Modern Company Law for a competitive economy: Developing the framework*, A consultation from the Company Law Review Steering Group, Department of Trade and Industry, March 2000 [URN 00/656]. paras 9.61-9

¹⁸ *Explanatory Notes*, 6 April 2000, Bill 108-EN, para 9

Not all parties have shared this belief. In the Lords, Lord Phillips of Sudbury (a solicitor by profession), said that he believed the Bill to be ‘wholly unnecessary’:

The big firms are driving this Bill. Although there has been consultation, and although the Law Commission did a good job, I have to say that very few of them have given considered response from the point of view of the consumer. The overwhelming advice tendered has come from those who have an interest in this Bill being passed. I should like to suggest that the big firms, earning as they do – no doubt fairly – big fees for their work, which can lead to large claims for negligence, have thrived in that environment. Where is the evidence to show that any of them needs the protection of this Bill in order for them to do their work effectively, competitively and profitably? There is no evidence. When did we ever hear of one of the big City solicitors losing his trousers?²⁰

The Trade and Industry Committee also heard evidence from Professor Prem Sikka, who has consistently criticised the regulation of the accountancy profession. In a written memorandum, he commented:

The proposed LLP legislation is part of a long line of concessions to the auditing industry. Successive governments have diluted auditor responsibility and the redress available to third parties against negligent auditors. The present LLP proposals give considerable concessions to ‘producers’ and do nothing for the benefit of audit consumers.²¹

The Trade and Industry Committee itself had been critical of the level of detail provided by the Government when setting out the case for the new entity. However, it endorsed the proposals:

29. We would not contemplate giving a clean bill of health to a legislative proposal intended to confer favours on one profession or groups of professionals, simply as a response to a threat that they would take their business elsewhere. But, whatever our misgivings as to some of the circumstances surrounding its conception and birth, we are satisfied that in broad terms, and subject to adequate measures of consumer protection, the proposal to introduce limited liability partnerships is well-founded.²²

The Committee reported in detail on a number of suggestions, some accepted, others not, which have been canvassed as part of the compensatory measures of consumer protection.

¹⁹ Trade and Industry Committee, *Draft Limited Liability Partnership Bill*, HC 59 1998-99, 10 February 1999, para 15

²⁰ HL Deb 9 December 1999 c 1434

²¹ Trade and Industry Committee, Supplementary memorandum submitted by Professor Prem Sikka, *Draft Limited Liability Partnership Bill*, HC 59 1998-99, 10 February 1999 p 47. Austin Mitchell MP has criticised the proposals in similar terms: see ‘View from the House’, *Accountancy Age*, 30 September 1999

²² Trade and Industry Committee, *Draft Limited Liability Partnership Bill*, HC 59 1998-99, 10 February 1999 para 29

These include the question of whether LLPs should have some form of capital requirement, the role of professional indemnity insurance in creditor protection, and the application of insolvency procedures. A number of these issues were also debated during the Bill's progress through the Lords. Readers are referred to those debates and to the Select Committee's report for more information. Another important source is the Government's response to the Committee.²³

B. The nature of liabilities

Whether a legal liability is incurred as a result of one's actions or omissions is a complex area of the law, but in very simple terms, part of the understanding on which this Act has been presented is that individual members of an LLP should retain personal liability for their own negligent acts, while no longer remaining liable for the negligent acts of other members. The LLP itself as a legal entity would also be liable for the negligent member's act or omission.

The Government has spoken in the Regulatory Impact Assessment which accompanies the Bill of the Bill involving a redistribution of risk within an undertaking which changes its form from a partnership to a limited liability partnership. With reference to the risk of individual partners who are not personally connected with a wrongful act being held liable for the consequences of that act, it notes that in an LLP, the members of the LLP will in effect shift that risk onto the LLP itself. In general terms, though, an individual member of an LLP who commits a negligent act or omission is expected to remain personally liable for his or her actions.

During the Lords debates, Lord Goldsmith questioned whether the description of how liability would be allocated had been adequately described in the version of the Explanatory Notes which was then circulating.²⁴ In essence he suggested that the implication of a personal liability should be stated with less confidence.

In correspondence with Lord Goldsmith (deposited in the Library), the Minister explained the position in more detail.²⁵ Liabilities are likely to occur primarily in contract or in tort (usually the tort of negligence). In an LLP, the contractual liability will be between the third party and the LLP, rather than the member of the LLP, since under the Bill the member will be treated as an agent of the LLP. The possibility of a liability for negligence where the loss is economic is more difficult to explain. The test for whether, for example, professional advice gives rise to a duty of care when it is relied on is

²³ See the Bibliography at the end of this paper for more details.

²⁴ HL Deb 24 January 2000 cc 1381-2

²⁵ 'Limited Liability Partnership Bill: Various correspondence', including letter from Lord McIntosh of Haringey to Lord Goldsmith QC, 14 February 2000, Deposited paper DEP 00/676

currently thought to depend on whether there has been an assumption of personal responsibility by the person giving the advice:

...should the case of a negligent member of an LLP come before the courts, they would consider whether there had been an assumption of responsibility sufficient to give rise to liability for economic loss flowing from that reliance. The ‘assumption of responsibility’ requirement has been recently considered in the *Williams v Natural Life Health Foods* case to which you refer. Clearly, the courts’ decision cannot be forecast with absolute certainty, since their decision in any case would depend, not only on the general nature of the relationship between the member of an LLP and his client, but also on the exact facts of the particular case before them.

As you say, *Williams v Natural Life Health Foods*, and *Caparo v Dickman* – are both generally pointed to as having narrowed the scope of an individual’s duty of care. In the *Caparo* case it was held that the auditor of a public company’s accounts owed no duty of care to a member of the public at large who relied on the accounts to buy shares in the company because the court would not deduce a relationship of proximity between the auditor and the member of the public, because to do so would give rise to indeterminate liability on the part of the auditor.²⁶

Lord McIntosh, however, argues that the *Williams* case is probably more useful in considering whether a personal liability had been incurred by a member of an LLP who has given negligent advice. The revised version of the Explanatory Notes, which sets out the Government’s considered opinion on how individual members of an LLP may be liable in tort, now reads:

Should the courts consider the case of a negligent member of an LLP whose conduct has resulted in economic loss for his client[, t]he courts’ decision cannot be forecast with certainty, but recent case law (*Williams & anor v (1) Natural Life Health Foods Ltd (2) Richard Mistlin* [1998] 1 WLR 830) suggests that in deciding whether such a member was potentially liable to a client, the courts would have regard to various factors including whether the member of the LLP assumed personal responsibility for the advice, whether the client relied on the assumption of responsibility and whether such reliance was reasonable.²⁷

The Bill does not change the threshold at which liabilities, for professionals or others, is incurred. The Government argues that this matter should be left to the courts, and that it would in any case be undesirable to alter the position for one sector of commercial activity in isolation.

²⁶ Ibid.

²⁷ *Explanatory Notes*, 6 April 2000, Bill 108-EN, para 9

C. The structure of the Bill

Outside parties and Members of both Houses have noted that because the volume of associated regulations (and the enactments to which they refer) are so much more extensive than the short-ish Bill, the devil is, more so than usual, in the detail. Many of the regulations deal with the extent to which other corporate legislation will apply to this new entity. The approach which has been adopted is to list in regulations those sections of other statutes which apply, or which are disapplied, to LLPs. Where necessary, modifications to those statutes are made. The drawback with this approach is that only those who are intimately familiar with company legislation will find the regulations in any way meaningful. The advantage, is that the Bill can be much shorter than it would otherwise have to be (the *Companies Act 1985* has over 700 clauses alone). Moreover, it will be easier to keep the LLP legislation up to date when changes are made to other legislation.

The Bill, moreover, is also sparing on Schedules (it has just one). The Trade and Industry Committee, when it considered the appropriateness of 'legislation by reference' in the Bill, came down in favour of incorporating the detailed secondary legislation within the Bill. The Government did not act on this recommendation:

While noting and, to a degree, sharing the Committee's sympathies about regulations by reference to other legislation, we find the arguments in paragraph 79 of the Committee's report to be the more persuasive in this respect, i.e. that the alternative would be regulations of some hundreds of pages; that commercial publishers are likely to provide [a] stand-alone "consolidated" LLP statute, should there be sufficient demand; and that legislation by reference has the advantage of clearly highlighting where changes to company and insolvency law have been made specifically to deal with LLPs. We do not, therefore, propose to change our approach.²⁸

The Government has also pointed to the consultations which have already taken place on regulations which are to be made under the Bill, and the requirement for those regulations to be approved by parliament using the affirmative procedure.²⁹

²⁸ Trade and Industry Committee, *Government observations on the fourth report from the Trade and Industry Committee on the Draft Limited Liability Partnership Bill*, HC 529 1998-99, 14 June 1999 para 7

²⁹ *Ibid.*, para 5

IV Parliamentary progress in the Lords

1. Second Reading

Introducing the Bill for the Government on 9 December 1999, Lord McIntosh of Haringey pointed to the lengthy consultations which the Bill had already had.³⁰ He noted that business organisations welcomed the new corporate form, but stressed that a balance had also been struck to protect the interests of potential suppliers and customers of LLPs (c 1419).

Baroness Buscombe (Conservative) was largely supportive of the Bill, but noted several areas on which she thought attention was needed. In particular she sought provisions on how the relations between members of an LLP would be governed, in order to protect what she described as the ‘partnership ethos’, a phrase which was heard repeatedly during the Lords stages. She questioned the need for a ‘designated member’ (clause 8), a position which the Government has compared to that of a company secretary or corporate officer (c 1424). She described the provisions for LLP members to contribute to the assets of the LLP on insolvency, in certain circumstances, through a new s.214A of the *Insolvency Act 1986*, as more onerous than the obligation on company directors, and called for it to be dropped. Regulations provide for aggregate disclosure of members’ remuneration; a disclosure provision which she thought served no useful purpose. More generally, she criticised the complexity of the language of the Bill.

Lord Sharman (Liberal Democrat), former chairman of a large accountancy partnership, welcomed the Bill, which he described as a recognition of changes in the business world. However, he pointed to the desirability of full disclosure as a counterpart to the conferral of limited liability. He suggested that disclosure of remuneration, for example, was not as daunting a prospect as some had suggested:

I can speak with some experience in that regard because some five years ago, the firm of which I was chairman went through that process voluntarily.....Our disclosure included full details of my income. All that really happened was that we attracted a few extra column inches and I had to buy a few more drinks in the pub.³¹

Lords Haskel and Goldsmith (Labour) expressed a number of concerns about the Bill, before welcoming it on balance. Lord Lucas hoped the corporate form would be available for use by venture capital partnerships. Lord Goodhart (Liberal Democrat) was among those who questioned whether it was appropriate that so much of the practical effect of

³⁰ HL Deb 9 December 1999 cc 1419-45

³¹ HL Deb 9 December 1999 c 1427

the Bill was left to secondary legislation: the application of the main company law and insolvency provisions fall into this category (c 1438). Among the issues which he wished to see dealt with on the face of the Bill were the clawback provisions on insolvency, and matters dealing with the internal relations between members of an LLP. In particular, he wished the duty of good faith which members of a partnership owe each other, to apply to an LLP.

Lord Phillips of Sudbury (Liberal Democrat), who was later to warn of the possibility that the new form would be a source of abuse by some small businesses, alone thought the Bill unnecessary. Speaking as a practising solicitor, part of a profession which is expected to take advantage of the new form, he thought joint and several unlimited liability was a powerful incentive to probity among professionals. He noted that most of the input into the Bill had come from the large firms which supported the measure, but that the consumer voice had been under represented. He also objected to an extension of limited liability to firms, such as solicitors, who were not providers of risk capital (cc 1432-34).

2. Committee

In the Committee stage debate on 24 January 2000, the Government repeatedly stressed that although the Bill sets up a new type of business vehicle, the aim is to alter other business legislation to a very limited degree.³² It sees the LLP as being subject to company law for the most part, except in relation to its tax position, which will be that of partnerships. Regulations made under this Bill will apply as appropriate company and insolvency law to LLPs. The Government, however, aims to amend corporate legislation as little as possible in order to allow for LLPs. Moreover, it is trying to retain equality of treatment in general between the way directors of companies and members of LLPs are treated:

... the principle on which we must insist all through the Bill is that we are changing as little other law as possible. We are responding to pressure, particularly from professionals, that there should be some way for them to achieve the goal of limited liability. We are considering the price at which that achievement should be made.....

We seek to achieve that by creating a new entity - the limited liability partnership - which falls under company law as far as possible and changes company law as little as possible except in respect of taxation. It falls under partnership law as little as possible and changes partnership law as little as possible except in respect of those matters which are the concern of company law.³³

³² HL Deb 24 January 2000 cc 1352-1410

³³ Lord McIntosh of Haringey, HL Deb 24 January 2000 c 1353

The internal organisation of an LLP, however, will not in general be the subject of prescriptive legislation. Several speakers, including Baroness Buscombe (Conservative), Lord Goodhart and Lord Phillips of Sudbury (Liberal Democrat), questioned how the ethos of partnership would fit into the new framework. The relationship of individual members of an LLP to other members and the LLP itself is a key aspect of this. The Government, in rejecting a Liberal Democrat amendment which would have given members a right to retire from an LLP with 28 days notice, outlined the likely content of default provisions (similar to those in section 24 of the *Partnership Act 1890*) which would govern the internal arrangements of LLPs in the absence of alternative arrangements made by an individual LLP.³⁴ Those proposals were then still the subject of consultation.

An attempt to apply partnership law generally to the relations between LLP members was also unsuccessful.³⁵ Whilst default provisions would be set out in Regulations, the Government argued that to give partnership law primacy would cause confusion and breach the principle of the Bill.

The extent to which members of an LLP are able to bind the LLP through their actions (which may give rise to liabilities) was discussed. At this stage of the Bill, clause 6 provided that a member of an LLP will normally bind the LLP even if he acts beyond his authority unless the third party with whom deals knows *or believes* that the member has no authority.³⁶ However, the actions of an ex-member of an LLP will not bind the LLP, since this could be a licence for mischief by ex-members. Some speakers questioned the standard of knowledge which is to be applied.³⁷

Lord Phillips of Sudbury, who alone had criticised the need for the new corporate form at Second Reading, remained suspicious of its effects. His amendments, for example, one which would have required members of LLPs to place both their home and business addresses on company register, were rejected by the Minister on the grounds that LLP members should not face more onerous obligations than those which apply to the corporate sector (cc 1356-9). Later he suggested that safeguards against ‘phoenix’ LLPs (i.e. against traders who shelter behind limited liability to escape business obligations, and then start trading again under a new name) should be included in the Bill. The Minister in response said that it was desirable to maintain parity of treatment with the corporate sector. If matters of company law needed to be altered, that could be addressed by the Department of Trade and Industry’s ongoing Company Law Review.

Lord Phillips, unconvinced, outlined his fears about the new corporate vehicle:

³⁴ HL Deb 24 January 2000 c 1363

³⁵ HL Deb 24 January 2000 cc 1370-76

³⁶ Author’s emphasis. Note that this standard of knowledge was revised at Report stage: see below.

³⁷ HL Deb 24 January 2000 cc 1376-79

Although there are statutory protections with regard to wrongful trading, phoenix company provisions and the rest of it, the Minister must accept that this area of law is singularly ineffective. It is honoured in the breach. One of my jobs is that of legal adviser on the "Jimmy Young Show". Over 25 years I have heard of hundreds of thousands of cases of abuse in relation to small, local companies that get nowhere near the attention of the DTI and get nowhere near being addressed by the various provisions to which the Minister refers.

It depresses me that in this House we are so far out of touch with public opinion, if I may put it this way, at the bottom end of the social spectrum. People are ripped off, day in, day out, by the easy availability of limited liability for off-the-shelf companies and the protections provided for them, and with no real remedies.³⁸

Assurances were sought as to whether individual members of the LLP would be liable for negligent acts, in the straightforward manner described in the Explanatory Notes. Referring to a test set by the House of Lords in *Williams v Natural Life Ltd*, the Minister distinguished between liabilities which might arise in contract and those which arise in tort. Where the question of tortious liability arose, the courts would have to consider whether an individual had assumed sufficient personal responsibility to create a personal liability. The Government did not want to adjust the position on such liability specifically for LLPs in isolation from the treatment of companies (cc 1381-87).³⁹

Other points made during the debate include:

- LLPs will not be suitable for use by charitable companies and not for profit organisations (cc 1354-5)
- Members of an LLP will not be treated as employees (in the context of employment rights) (cc 159-60)
- An attempt to place on the face of the Bill the arrangements under which members and ex-members might be liable to contribute to an LLP's assets where the LLP becomes insolvent was unsuccessful (cc 1396-1400)

3. Report stage

At Report stage on 6 March 2000, a Liberal Democrat amendment to place many of the statutory rules from the *Partnership Act 1890*, which govern the internal arrangements of partnerships, on the face of the Bill was rejected (cc 846-854).⁴⁰ A Government

³⁸ HL Deb 24 January 2000 cc 1352-1410

³⁹ This issue is discussed earlier in this paper in more detail: see 'The nature of liabilities' above.

⁴⁰ HL Deb 6 March 2000 cc 846-877

amendment to clause 5, however, provides that in the absence of provisions in the Bill (or other statutes) or agreement by members of an LLP, default provisions, to be set out in regulations, will take effect.⁴¹ Matters which are likely to be covered by the default provisions, which are modelled on section 24 of the *Partnership Act 1890*, include a right for members to share equally in the capital and profits of the business and a right to participate in the management of the LLP.

One element of an LLP's internal arrangements, a right to withdraw from an LLP on reasonable notice, has been written onto the face of the Bill (cc 858-9). The amendment, originally proposed by Lord Goodhart (Liberal Democrat) during the Committee stage, does not, however provide for the terms on which a member may withdraw, which the minister insisted would have to depend on agreement between the members. Another Liberal Democrat amendment, to place a duty of good faith on dealing between members and both the LLP and the other members, was not accepted (cc 863-67). The Government, reluctant to include more elements from partnership law than are strictly necessary, argued that the provision (which was one of the issues covered by the February 2000 consultation) was neither necessary or desirable.

The substance of Lord Phillips of Sudbury's proposal, that LLP's who used the abbreviated form would also have to state on their business stationery that the firm was a 'limited liability partnership', was, however, accepted. The Liberal Democrat peer remarked that the man and woman in the street was slow to apprehend the niceties of company law, and that the corporate status of the new entity should therefore be made explicit, in the public interest (cc 876-7).

Other elements covered by the debate include:

- The Secretary of State will be able to petition the court for the winding up of LLPs which are operating for unlawful purposes (c 857)
- Both express and implied agreements of LLP members will take precedence over the default provisions. This arguably reflects partnership law where even express agreements can be overridden by evidence of a divergent 'course of dealing' (c 863).
- The position of third parties who deal with LLPs was strengthened by a Government amendment to lower the threshold which applies to the ability of members of an LLP to bind the LLP. An LLP will be bound unless the third party knows that the member of the LLP is acting beyond his authority (formerly a 'belief' short of knowledge would have exculpated an LLP in these circumstances) (c 868).

⁴¹ HL Deb 6 March 2000 c 860. The Government issued a consultation paper on the nature and scope of default provisions in February 2000: *Limited Liability Partnerships: Regulatory provisions governing relations between members: A consultation paper*, Department of Trade and Industry, February 2000 [URN 00/617]

- The Government partly conceded a point made in Committee by Lord Goldsmith, and said that the description of when personal liability attaches to an LLP member in the Explanatory Notes to the Bill would be revised (c 868).
- Anti-avoidance measures to prevent LLPs being used as vehicles for tax avoidance (by claiming tax relief disproportionate to the level of capital contributions) were introduced. The *Finance Bill 2001* will also address, after consultation, the possibility of LLPs being adopted primarily for tax advantages (cc 869-73).

4. Third Reading

At Third Reading, taken on 6 April 2000, a single amendment, tabled by the Liberal Democrat peer Lord Goodhart, was debated.⁴² The amendment wanted to establish how the property rights of a former member of an LLP would be treated, say on the death or retirement of an LLP member. Lord Goodhart proposed that the rules which apply in partnership law should be applied, so that in the absence of explicit agreement by the partners, the outgoing partner would have the right to be bought out. He was less attracted by the treatment of the capital of former members of a company, where the interest can be locked into the company unless there is a market for the shares.

The Minister, Lord McIntosh of Haringey, and another speaker, Lord Goldsmith, questioned the practicality of setting a procedure for treating such interests. It was argued that permitting part of the capital to be removed might prejudice the survival of the business, and that prescribing how an interest should be valued would be complex. The Minister said that most LLPs would agree exit provisions in advance, or would be able to reach agreement when the need arose. Statutory provisions, if they could be framed, would therefore only apply to a small proportion of LLPs, in particular those which are less well run. Lord McIntosh also indicated that the Government was minded to apply the provisions of s.459 of the *Companies Act 1985* to LLP by regulation, which would allow members of an LLP who believed that the LLP was being run in a manner prejudicial to their interests to apply to the court for relief. Lord Goodhart withdrew the amendment, but was unable to see how a deceased person could remain a member of an LLP and so be in a position to use the s.459 provisions.

⁴² HL Deb 6 April 2000 cc 1420-7

V Bibliography

Limited Liability Partnership: A new form of business association for professions, A consultation paper, 2 volumes, Department of Trade and Industry, February 1997 [URN 97/597]

Limited Liability Partnerships: Draft Bill: A consultation document, Department of Trade and Industry, September 1998 [URN 98/874]

Trade and Industry Committee, *Draft Limited Liability Partnership Bill*, HC 59 1998-99, 10 February 1999

<http://pubs1.tso.parliament.uk/pa/cm199899/cmselect/cmtrdind/59/5902.htm>

Trade and Industry Committee, *Government observations on the fourth report from the Trade and Industry Committee on the Draft Limited Liability Partnership Bill*, HC 529 1998-99, 14 June 1999

<http://pubs1.tso.parliament.uk/pa/cm199899/cmselect/cmtrdind/529/52902.htm>

Limited Liability Partnerships: Draft Regulations: A consultation document, Department of Trade and Industry, July 1999 [URN 99/1025]

<http://www.dti.gov.uk/cld/llpbill/condoc99/index.htm>

Limited Liability Partnerships Bill: Regulatory Impact Assessment, Department of Trade and Industry, November 1999 [URN 99/1234]

<http://www.dti.gov.uk/cld/llpbill/RIA.htm>

Explanatory Notes, 6 April 2000, Bill 108-EN

<http://www.publications.parliament.uk/pa/ld199900/ldbills/006/2000006.htm>

Limited Liability Partnerships: Regulatory provisions governing relations between members: A consultation paper, Department of Trade and Industry, February 2000 [URN 00/617]

<http://www.dti.gov.uk/cld/llpbill/consdoc.htm>

Parliamentary debates

Second Reading (Lords): HL Deb 9 December 1999 cc 1419-45

http://pubs1.tso.parliament.uk/pa/ld199697/ldhansrd/pdvn/lds99/text/91209-10.htm#91209-10_head1

Committee (Lords): HL Deb 24 January 2000 cc 1352-1410

http://pubs1.tso.parliament.uk/pa/ld199697/ldhansrd/pdvn/lds00/text/00124-09.htm#00124-09_head0

Report (Lords): HL Deb 6 March 2000 cc 846-877

http://pubs1.tso.parliament.uk/pa/ld199697/ldhansrd/pdvn/lds00/text/00306-13.htm#00306-13_head0

Third Reading (Lords) HL Deb 6 April 2000 cc 1420-7

http://pubs1.tso.parliament.uk/pa/ld199697/ldhansrd/pdvn/lds00/text/00406-03.htm#00406-03_head0