

Describe the Limited Liability Partnership and explain the emergence of this new legal form in the first few years of the 21st Century.

After 4 years of consultation by the Department of Trade and Industry with academics, partnerships and professional partnerships, the Limited Liability Partnership Act 2000 finally received Royal Assent in July 2000. The Chancellor of the Exchequer announced in his pre-budget report on the 8th November 2000 that it would commence from April 6th 2001.¹ The LLP has been described as the ‘1st major addition to the range of business entities available in UK law since the Joint Stock Companies Act in 1855.’² The Act was introduced mainly in response to auditors who claimed that operating as a partnership unfairly discriminated against them due to the doctrines of joint/several liability and unlimited liability. Under joint/several liability³, the negligence of one partner will mean that all partners are liable. As s10 of the partnership Act states ‘partners are liable for the torts of their partners acting in the ordinary course of business.’ Joint/several liability extends to the principle that negligent partnerships are called upon to provide 100% of the damages even if one partner is only 1% at fault.⁴ Unlimited liability⁵ is the idea that all partners are liable for the personal debts of the partnership. In order to pay these debts, all members’ personal assets will be made available. These doctrines have caused problems. There has been a steady increase in legal actions brought against auditors and professional firms in what has been described as the ‘deep-pocket syndrome’. Partner’s individual assets were being made available to settle claims and debts even though most partners were not involved in the action leading to the claim. An example can be shown by the case of BDO Binder Hamlyn⁶, who were found liable for negligence. Damages of £65m were awarded but professional insurance only covered £31m of this. The remainder had to be paid by the 150 partners, most of which were not involved in the negligence.⁷

Broadly a LLP has been described as ‘a half-way house of sorts between a partnership and a limited company.’⁸ What are the characteristics of an LLP that make it unique from these other legal forms and what characteristics do they share? One of the main differences is in its Legal form. An LLP, like a Limited company and unlike a partnership, is a separate legal entity with a legal personality separate from its members.⁹ This allows it to enter contracts, hold property, sue and to be sued in its own name. For incorporation to take place, then registration must occur at Companies House under s2 of the Act. Previously there was no requirement that partnerships registered. Member names must also be registered and notification must be given of

¹ “*Limited Liability Partnerships: Available at Last*” (2000) 22(3) *Co.Lawyer* 65

² “*LLP's in Great Britain.*” *Journal of Management Consulting* June 2002

³ Partnership Act 1890 s10

⁴ Payne, J “*Limiting the Liability of Partnerships: in search of this Holy Grail.*” (1997) 19 *Co.Lawyer* 82.”

⁵ Partnership Act 1890 s9

⁶ *ADT Ltd v BDO Binder Hamlyn* [1996] BCC 808

⁷ Payne, J “*Limiting the Liability of Professional Partnerships: in search of this Holy Grail*”(1997) 18 *Company Lawyer* 81

⁸ Davies, J “*The LLP: About to take off.*” *Institute of Credit Management* (March 2001)

⁹ Limited Liability Partnership Act 2000 s1 (2)

any member changes. In order to incorporate an LLP, ‘two or more persons associated for carrying on a lawful business... must have subscribed their names to an incorporation document.’¹⁰ Originally, in consultation, incorporation was only open to professional bodies. This was dropped on the view that LLPs should be open to any 2 or more people who wish to form an LLP. This is the same for a partnership, which requires at least 2 partners. A limited company only needs one to incorporate. Members of an LLP are described as agents of the LLP¹¹. Each can bind the company unless in certain circumstances such as no authority to do so¹². Departed members are able to bind the company unless the person with whom he is dealing knows he has left the LLP. There must also be at least 2 ‘designated members’¹³, who have responsibilities similar to a company secretary such as administration and filing duties. There was no such requirement in a partnership.

The main advantage of an LLP over a partnership is that it has limited liability. Each member’s liability is limited to an amount that each agrees to pay in the event of insolvency. Gray¹⁴ describes this as ‘a guarantee requiring him or her to contribute up to a maximum specified sum if the assets of the LLP become available to its liquidator.’ This is true of a limited company where the debts in liquidation are limited by share or guarantee. In the case of joint/several liability that existed under a partnership, the LLP, as a separate corporate body, is liable for acts committed by its members. This liability of the firm in negligence means that members are not liable for each other’s acts. However, under s6 (4) of the act, the wrongdoer is liable to the same extent as the firm. This follows the liability of a company in negligence where the company can be sued, as it is a separate legal entity.

One characteristic of an LLP that makes it quite different from a partnership is that partnership law and the Partnership Act 1890 are not applicable¹⁵. The applicable law will be the LLP Act, delegated legislation via the Limited Liability Regulations 2001 and to some extent the Companies Act 1985 and Insolvency Act 1986 which will apply if an LLP does become insolvent. An LLP will be treated legally as a partnership when it comes to taxation. This was to ensure that the decision to incorporate as an LLP wasn’t influenced by tax. Members will be treated as partners and not employees so will come under schedule E income tax and class 4 (and not 1) National Insurance. They will also be treated as a partnership when it comes to capital gains tax.¹⁶

¹⁰ LLP Act 2000 s2 (1a)

¹¹ LLP Act 2000 s6(1)

¹² LLP Act 2000 s6 (2a)(2b)

¹³ LLP Act 2000 s8

¹⁴ Gray, J “*DTI Consults on Limited-Liability Partnerships.*”
(1997) *Company Lawyer* 18(4) pp 119

¹⁵ LLP Act 2000 s 1(5)

¹⁶ “*Limited Liability Partnerships: Available at Last.*” *Company Lawyer* (2001) 22(3) pp 98

A final characteristic of the LLP act is that it doesn't deal with internal relations as a company does with its articles of association. It is assumed under s5 of the act that members will draft internal relations themselves. Payne¹⁷ suggests that the emphasis of partnership ethics and professional responsibility which partnerships are based on will allow this to work. The House of Lords however, were unsuccessful in their debates in applying partnership law and ethos to member relations. There will also be no need for LLPs to hold AGMs, as companies are required to do. The major difference, which may make partnerships think twice about becoming an LLP, is new disclosure requirements. LLPs are required to open up their accounts for public inspection and audited accounts will have to be filed with Companies House under the accounting standards of a 'true and fair' view. This aspect of an LLP was introduced to protect creditors who may lose out under limited liability.

The Limited Liability Partnership was brought into effect due to concerns amongst professional bodies (and especially auditors) over the rise in legal actions brought against them. This was due to the joint/several liability doctrine and unlimited liability their members had for the firms debts. Indeed these concerns were often described, as 'unrealistic expectations and/or deep pocket syndrome'¹⁸ which are references to the vast amounts of money partners were having to pay out in claims, as demonstrated by the BDO Binder Hamlyn case. Originally, the main audit firms campaigned for a change in the rules of unlimited liability and joint/several liability. It was felt by the Law Commission in 1996 that these reforms wouldn't stem the tide of litigation or protect non-negligent partners.¹⁹ It was thought that LLPs would provide the answer and this seems to suggest that LLP's have only originated in the last few years. This may be true for the UK but evidence suggests that this was no great invention by the British.

Limited Liability Partnerships have been in operation in the US since 1988 where Delaware became the first US state to introduce such an entity. This again was in response to concerns by the big 6 accounting and audit firms over legal actions. Much closer to home in the 1990s, Jersey introduced legislation, which was based on the LLP legislation in Delaware. Like British LLPs of today, the Jersey legislation for LLPs allows them to have a separate legal personality, while partners are not personally liable for losses except where losses were caused by themselves. Unlike British LLPs however, Jersey LLPs will not be required to disclose their accounts but will have to place a Corporate bond in a bank that is readily available for creditors.²⁰ In fact, Jersey LLPs are much closer to partnerships than corporations. This is not surprising as two of the largest audit firms; Pricewaterhouse and Ernst & Young drafted the legislation for Jersey LLPs. This was another reason why an English LLP arose, in order to prevent professional bodies from moving and incorporating in Jersey or other jurisdictions that offered LLPs. Whether English Courts would have recognised in this instance their Limited Liability status is another question.

¹⁷ Payne, J “ *Limiting the Liability of Professional Partnerships: In search of this Holy Grail.* ”
(1997) Company Lawyer 18 pp 82

¹⁸ Freedman, J “ *Limited Liability Partnerships in the UK-do they have a role for small firms.* ”
Journal of Corporation Law Summer 2001

¹⁹ Payne, J “ *Limiting the Liability of Professional Partnerships: In search of this Holy Grail.* ”
(1997) Company Lawyer 18 pp 84

²⁰ Payne, J “ *Limiting the Liability of Professional Partnerships: In Search of the Holy Grail.* ”
(1997) Company Lawyer 18 pp 87

Have UK LLPs just emerged in response to moves in the US, the influence of large audit firms, professional bodies and competition from Jersey and other jurisdictions. Attempts have been made in the past to limit the liability of members of a partnership. The limited liability act of 1907 introduced the concept into English Law of a limited partnership and the difference between active and ‘sleeping’ partners.²¹ I.e. those involved in the management of the business and those, which are not. The Act allowed members not involved in the management of a business to have unlimited liability. Comparisons can be made with the Limited Liability Partnerships of today. A limited partnership was required to registrar at Companies House (or the register office) in much the same way, as an LLP is required to do.²² It also required notification of changes in the partnership²³. The act also allowed limited partners to have access to the company’s books and in some way they acted as shareholders, providing capital to the business while waiting on the return with unlimited liability while being unable to bind the firm. Indeed shareholders in a corporation have no power to bind the company. However, the company’s accounts were not disclosed to the general public. The limited partnership has never taken off and has been described as ‘a commercial mongrel and dismal failure that sunk almost without a trace.’²⁴ It is estimated only 3000-4000 are still operating in England and Wales²⁵.

Although Limited partnerships are quite different to a limited liability partnership; many commentators have suggested that the Limited Partnership Act was the first step towards a limited liability partnership. An article²⁶ Stated ‘after almost 100 years, the English have just updated their limited liability partnership laws to, we hope, get it right the 2nd time.’ This suggests that the LLP act didn’t introduce a wholly new concept into English law. The same article agrees however that a limited liability partnership is separate from a limited partnership. Another commentator Payne²⁷ wrote ‘this was remedied by the Limited Partnership Act 1907, which introduced the concept of the limited liability partnership (the LLP)’ which was in response to comments made by Pollock in 1882 that the limited liability partnership was unknown in the United Kingdom. These comments seem to suggest that the Limited Liability partnerships we now have emerged from Limited Partnerships and the 1907 Act, although nothing in the act seems to suggest this. In response to Freedman²⁸ wrote that the LLP in Great Britain is ‘not the result of an evolutionary process directly related to those overseas legal forms. It is an artificial creation, a fusion of partnership and company law.’ This suggests that whatever form of LLP may have existed in British Law in the past (of which I can find no evidence), the LLP act 2000 brought into effect something new, which was required to calm the political pressure from audit and professional firms for a legal form that quelled the negligence for members actions for which every member would be held liable.

²¹ In the 1907 act they are referred to as General and Limited Partners respectively s4(1)

²² Limited Partnership Act 1907 s8

²³ Limited Partnership act 1907 s9

²⁴ “ *Limited Partnerships under Review.* ” (2002) *Company Lawyer* 23(6) pp165

²⁵ “ *Limited Partnerships under Review.* ” (2002) *Company Lawyer* 23(6) pp166

²⁶ “ *LLPs in Great Britain.* ” *Journal of Management Consulting* June 2002

²⁷ Payne, J “ *Limiting the Liability of Professional Partnerships: In search of this Holy Grail.* ” (1997) *Company Lawyer* 18 pp 86

²⁸ Freedman, J “ *Limited Liability Partnerships in the UK-do they have a role for small firms.* ” *Journal of Corporation Law* Summer 2001

To conclude, a limited liability partnership has characteristics of both a company and a partnership. The major advantages will be allowing LLPs to gain unlimited liability for its members and be able to minimise the effects of joint/several liability by having a separate legal personality from its members. In return for this, LLPs have had to disclose to the public more of their activities and finances. The internal set-up of LLPs will be based on the ethics of partnership law although the Partnership Act will no longer apply, with the relevant law being the Limited Liability Partnership Act and delegated legislation. LLPs will also be treated as partnerships for tax purposes so that the decision to incorporate as an LLP is tax transparent.

The introduction of the limited liability partnership act was well received by the professional bodies with all the major accountancy groups such as KPMG, Pricewaterhouse Coopers and Ernst & Young becoming LLP's. The LLP is not really a new innovation in Britain. They are common in the US, Jersey and other foreign jurisdictions. A major reason for introducing them was to prevent partnerships from going abroad to incorporate as an LLP. There have also been small glimpses in the past that the idea of a British LLP has been considered before but no action has been taken. Suggestions that the Limited Partnership act of 1907 was a first evolutionary step towards a Limited Liability Partnership may be incorrect but there is no doubt that with many partnerships starting to incorporate as LLPs, they truly are an innovation in themselves.

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