

## VICTORY FOR GOVERNMENT IN HEYDAY CASE

Edward Wanambwa, Partner, CM Murray LLP

On 25 September 2009, the High Court gave its long awaited decision in respect of the challenge led by Age Concern and Help the Aged against the UK government's default retirement age of 65 (the "DRA") for employees and other provisions of the 2006 Age Regulations.

The challenge was dismissed by Mr Justice Blake: the default retirement age of 65 for employees will therefore stand, at least for the time being.

The judge indicated that the DRA was lawful back in 2006 when it was introduced, due to the prevailing circumstances and evidence available at the time. However, he commented that the DRA would not be likely to be lawful if it were introduced now because of the current economic conditions.

This eagerly awaited decision was important for both employers and employees alike.

For employers, there was a sigh of relief as the status quo of retirement at 65 for employees will, at least for the time being, continue as before. But this is only a temporary reprieve. The government will review in 2010 whether the DRA is still 'appropriate and necessary' for employees. The judge's view was that it is not.

The government's review may therefore result in the DRA for employees being increased, say to 70, or possibly - as is the case in the USA for employees and as is the case here for partners - even being removed altogether. Employers would then have to justify whether the forcible retirement of a particular older employee at any age was justifiable.

For the some 300 employees who had their age discrimination claims stayed pending this decision, however, this was a disappointing decision. But longer term, if as is likely, the judge's comments prompt the government to increase the DRA for employees or to remove it completely, this will give a large number of older employees the financial life line they need as they face erosion in the value of their pensions.

The Heyday case was heard in the summer of this year after the European Court of Justice sent the challenge back to home soil after determining that having a DRA for employees in itself is not incompatible with the Equal Treatment Framework Directive.

The charities have indicated that they will not appeal as they expect a change in the law following the 2010 government review.

The Heyday decision does not change the law relating to retirement of partners. It remains the case that there is no default retirement age for partners and that any provision in a partnership agreement that forces partners to retire at a certain age is potentially discriminatory, unless it can be objectively justified.

However, we can now expect a decision from the Court of Appeal in *Seldon v Clarkson Wright and Jakes* before too long. The appeal in this case (the first case to consider compulsory retirement from a partnership) was adjourned by the Court of Appeal pending the outcome in *Heyday*.

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## Editorial Note

This edition of A Propos Partnership includes reports on our first “double” workshop held in September in which, in one room, those unfamiliar with partnership law could hear from experts in that field whilst those needing to “brush up” on partnership accounting could learn about that in a different room. Comments received afterwards (including on the feedback sheets) confirmed the concept to be a great success and illustrated the appetite of the various professions to deepen their understanding of each other - a need in which APP will continue to play its part.

With the latest economic data confirming that the UK recession remains deeper than some commentators had suggested, the business management challenges highlighted in the July workshop have lost none of their topicality.

As ever, our thanks are due to all the speakers, chairs, rapporteurs and hosting organisations who enable the workshops to flourish as a core APP activity.

No less crucial are the efforts of those Members who - individually or through the various APP Working Parties - keep an eye on the legislative, regulatory and fiscal changes which will impact all of us who deal with partnerships. Jon Cheney and Nick Carter-Pegg have helpfully summarised the impact on LLPs of the Companies Act 2006 whilst Edward Wanambwa, Mark Blackett-Ord and (as ever) Elspeth Berry have covered the latest news from the Courts.

Taxation remains a “minefield” for partnerships and the APP is indeed fortunate in having eagle-eyed Members maintaining a “watching brief” - as shown by Jon Peache’s resume of recent developments in this edition.

The APP Arbitrators and Mediators Directory is now “up and running” and can be accessed through an icon on the homepage of the APP website. This new service will help both the public and practitioners to identify professionals experienced in partnership disputes. Whilst inclusion in the Directory is restricted to APP Members, it can be viewed by anyone free of charge. Members wishing to apply for inclusion in the Directory will find details on the website. Peter Garry, in particular, has put a huge amount of effort into making the Directory a reality and our thanks are due to him.

Finally, on behalf of the Committee and all the Members, I take this opportunity to express our sincere thanks to Jayne, Pat and Charlotte for all the “unsung” work they do to ensure the smooth running of APP events. I am delighted to include a photograph of them clearly enjoying the task!



**Simon Prideaux**  
Editor

## AGM And Dinner 2010 - Date for your diaries

As a reminder the AGM and Dinner for 2010 will take place on **Thursday, 25th March** at **6.00 p.m.** at Stationers' Hall and is being sponsored by **The Royal Bank of Scotland plc.**

We are delighted to announce the Guest Speaker for the Dinner will be **David Edmonds CBE, Chairman of The Legal Services Board.**

*Details of how to reserve a place at the event will follow shortly.*

## A Change of Honorary Secretary



The Committee would like to thank Colin Ives who has been the Honorary Secretary for the past five and a half years and who has worked tirelessly throughout his term of office in this role. Jayne (Ford) would also like to add a big personal thank you for all the invaluable support (and sense of humour) he has given to her in this role.

The Committee are grateful to Gavin Foggo who has kindly stepped into Colin's shoes and taken over as Honorary Secretary with effect from 1st October.

## Alternative Business Structures Working Party Update by Tony Williams, Jomati Consultants LLP

This summer the Legal Services Board and the Solicitors Regulation Authority issued consultation papers on the Alternative Business Structure regime. The APP working party comprising Tony Williams, Nick Carter-Pegg, Simon Prideaux and William Wastie prepared responses to both of these consultation papers. These are available on the members' side of the APP website at <http://www.app.org.uk/submissions.php>.

It is now clear that the LSB is determined to implement the ABS regime by mid 2011. The entry into the legal market of non-lawyer owners of law firms including large corporations is likely to have a dramatic effect on the provision of legal services. Although these changes are likely to have a most immediate impact at the retail level, the ability of existing law firms to obtain outside capital and the possibility of major users of legal services either buying existing law firms or establishing their own law firm to act as captive providers of legal services will ensure that the new regime affects all areas of the legal market. Indeed some publicly funded barristers chambers are already considering, given the pressure on funding in their area, the possibility of forming very close working relationships with one or two law firms or even an LDP with solicitors.

In 2010 a raft of detailed draft regulation on the ABS can be expected. The APP working party will monitor developments and make appropriate submissions. As always any comment from members on the developing ABS regime will be most welcome.

## Younger Member Event 2009

As a reminder the Younger Members' Event is due to be held on **Thursday, 3rd December at 6.00 p.m.** at BDO LLP's Baker Street offices. If you have not registered for this event and would like to, please be in touch with Jayne Ford.

## And Finally

....and finally a photo (left to right) of Pat Newman, Charlotte Ford and Jayne Ford without whom no APP event would be complete.



# THE APPLICATION OF THE COMPANIES ACT 2006 TO LLPS

Article by Jon Cheney, Addleshaw Goddard LLP  
with a specialist contribution on the Annual Accounts by Nick Carter-Pegg, BDO LLP

**The Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (2009 Regulations) came into force on 1 October 2009, representing the most significant change to the landscape of LLP legislation since its inception. Whilst the audit and accounting provisions of the Companies Act 2006 (CA06) have applied to LLPs since 1 October 2008, the 2009 Regulations apply large parts of the remainder of the CA06 to LLPs, with appropriate modifications, in a stand alone set of regulations which, unlike the Limited Liability Partnerships Regulations 2001, are intended to be read without requiring reference to the primary legislation. Some of the key changes introduced by the 2009 Regulations are set out below.**

## **Members' residential addresses and the Register of Members**

There continues to be a requirement to notify the Registrar of Companies each time the membership of an LLP changes, or the personal details of a member change. However, each member may now provide a service address, instead of their residential address, for inclusion on the public record.

Unfortunately, this will be of limited comfort to a member who does not have the benefit of a confidentiality order and whose current residential address is already on the public record, as there is presently no intention of removing residential addresses from the public files unless a member can prove that either they, or anyone living with them, could be at risk of intimidation or violence if these details remain on the public file.

There will however be some benefit in existing members filing a new service address with the Registrar since the electronic details held at Companies House, which are often used as a quick reference, will be updated, with any new service address replacing the existing residential address.

A residential address must still be notified to the Registrar and, whilst it will not be published on the public record, the Registrar may, unless the member has the benefit of a confidentiality order, disclose a residential address at the request of a public authority (such as the FSA, OFT or Takeover Panel), and also to a person exercising certain statutory powers (including an insolvency practitioner) or a credit reference agency.

A new requirement from 1 October is for an LLP to maintain both a publicly accessible register of members and a private register of members' residential addresses.



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The publicly accessible register of members will have to show for each individual member their name (and any former name), a service address (which can be the LLP's registered office), their country of usual residence, date of birth and whether or not they are a designated member.

The most recent address notified to the Registrar will be deemed to be the service address and can be entered onto a register of members without the need to notify the Registrar. Similarly, residential addresses will not need to be notified to the Registrar unless they have changed from the last one notified prior to 1 October. A simple statement that a member's residential address is the same as his service address on the register of members will suffice for the entry on the register of residential addresses.

Similar information will be required in respect of corporate members but will include the address of the member's registered or principal office, as well as information on its place of corporate registration.

The publicly accessible register must be kept available for inspection, either at the LLP's registered office or at its "alternative inspection location", and the Registrar must be notified of the place of inspection. Any member is entitled to inspect it free of charge, and any other person may do so upon payment of a fee.

### **Incorporation and Companies House filings**

There have been amendments to a number of the forms required for making filings at Companies House. In many cases the forms have simply been renamed – the following link to the Companies House website lists the existing and new names of the forms:

<http://www.companieshouse.gov.uk/forms/formsOnline.shtml>.

There are some more substantive changes, however. For example, the incorporation document for a new LLP needs to contain, in relation to the first members, both a service address and a residential address, although that part of the incorporation document containing residential addresses will not be open to public inspection at Companies House.

It was possible under the old regime for companies to take the name of registered LLPs but LLPs did not have the reciprocal ability to register in the name of registered companies. This anomaly has been addressed and from 1 October 2009 a company can no longer use the registered name of an LLP.

Changes have also been made to the Annual Return, which no longer needs to be signed by a designated member. The information required is broadly the same but has been slightly expanded. It is now necessary to report the "alternative inspection location" where the LLP keeps "LLP records" if this is not the registered office. "LLP records" includes the register of members, register of debenture holders and other records that must be kept available for inspection.

### **Annual accounts**

There are also some important changes to the filing of annual accounts at Companies House which came into effect on 1 October 2009.

In order that documents are accepted by Companies House they must be in black ink only (including signatures) and not contain any logos or graphics. The name and registered number of the LLP must be included on one of

the balance sheet, directors' report, directors' remuneration report (if required) or audit report. Any current practice of including this elsewhere (such as the cover sheet) will need to be updated to comply with these rules. Otherwise, accounts are likely to be rejected by the Registrar and will need to be re-filed. Firms should note that the previous concession by which LLPs and companies had 14 days to re-file rejected documents is no longer available, which could mean that penalties are incurred if accounts are filed close to the deadline and then rejected.

In respect of audit reports, there is now no requirement for the copy filed at Companies House to have the auditor's signature. This version of the audit report only requires the names of the senior statutory auditor and the auditor (although it is possible voluntarily to include the signature of either the audit firm or the senior statutory auditor). All other copies of the audit report of LLPs for accounting periods beginning on or after 1 October 2008 should be signed by the senior statutory auditor and state the name of the senior statutory auditor and the name of the auditor.

### **Trading disclosures**

The Business Names Act 1985 has been repealed and LLPs have become subject to the same trading disclosure requirements as companies. There is a continuing requirement for LLPs to include their full registered name, address and number on letterheads and websites. However, other than in the narrow circumstances prescribed in the legislation, and subject to the obligations set out above in respect of the duty to maintain a Register of Members, it is no longer necessary to keep a list of members' names open to inspection in the reception of each

place of business and at the registered office.

The LLP will have to disclose to any person who it deals with in the ordinary course of business, and who submits a written request for such information, the location of its registered office, if applicable an alternative location where it keeps its records open to inspection, and the type of records which are open to inspection. The LLP must provide a written response within five days of receipt of the request.

### Execution of documents

The execution of deeds and documents has changed under the new regime to align LLPs with the rules governing companies. The most significant change is the ability of a single member in the presence of a witness to execute a deed on behalf of an LLP, as an alternative to the requirement for the signatures of two members.

### Debentures and charges

Those LLPs who have raised, or are considering raising, additional finance during the current economic climate should be aware that there are some changes to the provisions dealing with the creation and registration of debentures and charges. The changes primarily address points of detail and clarification rather than making substantive amendments to the legislation, however.

### Arrangements, reconstructions and cross-border mergers

The process for creditors' and members' compromise arrangements has not changed under the new regime. However, the Companies

(Cross-border Mergers) Regulations 2007 have been applied (with modifications) to LLPs to facilitate cross-border mergers within the EU, where there are at least two corporate bodies in two different EEA Member States. The Regulations prescribe a process for structuring certain types of merger. This is likely to result in a lengthy process for those transactions covered by the Regulations, and it is believed that a cross-border merger will not be the preferred structure in many cases.

### Dissolution and restoration to the register.

The rules for striking an LLP's name off the register have also changed. If an LLP wants to make such an application, it must be made by a majority of the members of the LLP. If there are only two members, the application must be made by both of them and if there is only one remaining member, the application must be made by that single member.

The application must now also contain a declaration from all the members making the application that certain matters apply to the LLP (including the absence of any pending court proceedings or insolvency proceedings.)

LLPs which have been struck off the register now have to comply with new rules in order to be restored to the register. An application may only be made by a former member of the LLP and the application must be submitted within six years of the date of the dissolution of the LLP.

An LLP which has been struck off by virtue of being defunct can be restored without an application to court (administrative restoration),

provided that the LLP was in operation at the time of its striking off and, if the LLP's property was vested in the Crown as bona vacantia, the Crown's representative must consent to the LLP's restoration to the register. The LLP must also deliver to the Registrar any such documents which will bring the Registrar's records up-to-date.

A statement of compliance must also accompany the application for administrative restoration to the register. This assures the Registrar that the person making the application has authority to apply. The applicant must also send notice of the application to all those who were members of the LLP at the time of its striking off. It is up to the former member making the application to decide how to notify the others.

If the Registrar decides that the LLP should be restored to the register, the LLP is deemed to have continued in existence as if it had not been struck off the register at all (even though potentially it could have been off the register for a period of up to six years).

### Conclusion

These are just some of the new statutory provisions applying to LLPs from 1 October 2009. The changes embody both points of detail, together with more substantive amendments.

Whilst aiming to take advantage of the "simplification and modernisation of company law", it is worth noting that the 2009 Regulations by no means achieve parity between LLPs and companies. Readers will therefore be comforted to know that providing accurate, professional advice in respect of LLPs remains the preserve of the specialist adviser!

# THE CHANGING TAX ENVIRONMENT

By Jon Peache, BDO LLP

In April, Alistair Darling announced as part of his Budget a number of proposals intended to ease the unprecedented level of public debt by raising revenues from top earners.

## The New Higher Tax Rate

Although an increase to the top rate of tax to 45% was anticipated in the 2008 Pre Budget Report (PBR), what was actually announced was a new higher rate of 50% to be brought in for the 2010/11 tax year, for those earning more than £150,000.

Anyone with net earnings of over £100,000 will see their tax rates increase

as a result of the stripping away of personal allowances. Income between £100,000 and approximately £113,000 will therefore be taxed at a marginal rate of taxation of 61.15%.

Even with headline tax rates of 50%, there is still a tax saving of operating through a partnership or LLP (approximately 5.5% compared to drawing salary). These margins decrease over the next couple of years. The table below illustrates the effective rate of tax on the extraction of salary and dividends from a company compared to profits from a partnership.

Individual taxpayer top tax rate 50%	Effective rate 2008/09 And 2009/10	Effective rate 2010/11	Effective rate 2011/12
<b>Dividend</b>			
Small company	40.75%	49.53%	49.53%
Marginal rate company	47.31%	55.12%	55.12%
Large company	46.00%	54.00%	54.00%
<b>Salary</b>			
	47.70%	56.57%	57.19%
<b>LLP or Partnership</b> (ignoring tax on disallowables)	41.00%	51.00%	51.50%

## Income v. Capital Growth

There is now an even greater differential between income tax rates and the rates applicable to capital gains – 50% compared to 18%. Traditionally, professional service firms have operated by allowing partners to draw out all

profits and thus on retirement partners have tended not to receive a capital distribution based on the increase in the value of the business over their term as partner.

To take advantage of the lower rates of tax on retained profits and capital gains



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we may see more businesses operating through structures that include both partnership and corporate entities.

### Timing Issues

One simple way of mitigating the increase in tax rates is to bring forward profits to the current tax year so that it may be taxed at 40%. Alternatively non urgent expenditure maybe delayed to future years, or tax relief deferred.

However, firms whose accounting year ends between 6 April and now will already be in the accounting year which will be subject to tax at the new higher rate (for example year end 30 April 2010 falls to be taxed in 2010/11).

Moving income between accounting periods may also have inequitable consequences on partners shares of profits (consider in particular retiring partners and new joiners), and the tax savings may not be to everyone's benefit.

Many firms with accounting year ends falling early in the 2010/11 tax year may have already considered a change to one later in the 2009/10 tax year in order to maximise profits being taxed before the 50 per cent tax rate is operational.

If a firm with a 30 April 2010 year end were to move this forward by 1 month to 31 March 2010, 11 months of profit which would have been taxed in 2010/11 will now fall to be taxed in 2009/10 at 40 per cent, rather than 50 per cent. This will also crystallise overlap relief. The funding cost, impact on cash flow, and future profitability need careful consideration and may negate any benefit.

### Service Companies In Vogue?

With the increase in the tax rate we are likely to see a resurgence of service companies as partnerships look to achieve tax savings on UK to UK transfer pricing adjustments.

Typically the company employs staff

and charges a fee to the partnership for supplying their services. The fee can be calculated in accordance with UK transfer pricing rules giving rise to a profit in the company, taxed at corporation tax rates (28%), and the partners claiming tax relief at 51%. The tax saving (assuming the top rates of corporation tax and income tax apply) is 23% of the transfer pricing adjustment.

### Pension Contributions

The 2009 Budget also announced changes to higher rate tax relief on pension contributions. From 6 April 2011 higher rate tax relief on pension contributions will be tapered away on incomes between £150,000 and £180,000 after which point tax relief will be at the basic rate of 20% only.

Transitional provisions prevent individuals from topping up their pension funds before the new regime comes into force. These provisions do not apply to those with relevant total income (i.e. income after deducting charitable donations and a maximum of £20,000 personal pension contributions) of less than £150,000 in the tax years from 2007/08 onwards. For others, the position is as follows:

If an individual had pension policies before 22 April and was making "regular" contributions (i.e. at least on a quarterly basis), then higher rate relief continues to be available for the contributions that continue at the same level to the same scheme.

In any case, higher rate relief is available on contributions up to £20,000. This £20,000 limit may be increased up to a maximum of £30,000 where the individual made irregular contributions during 2006/07, 2007/08 and 2008/09 tax years and the average contributions made during the three years exceeded £20,000.

Pension contributions which do not fall within either of the above limits will be subject to a 20% tax charge on the

"excess" contributions resulting in tax relief at the basic rate tax.

For individuals whose existing level of contributions falls below the £20,000 limit, there is an opportunity to increase contributions levels to £20,000 in both 2009/10 and 2010/11 (and potentially receive 50% tax relief in 2010/11).

For those who anticipate that their income in retirement will be taxable at higher rates (whatever that rate will actually be in the future), making pension contributions may be less attractive. Partners may only receive basic rate tax relief on pension contributions but pay higher rate tax when funds are withdrawn from the scheme. Alternatives to pensions should therefore be considered, such as:

- ISAs
- Enterprise Investment Schemes and Venture Capital Trusts
- Offshore investments
- Investments subject to CGT rather than Income Tax on realisation

Where investments outside of the pension regime are utilised, maintenance of the balance between investment assets is required. A diversified retirement investment portfolio requires greater discipline and management than, perhaps, one entirely generated through the conduit of pension accumulation.

### The Future

The past 18 months have been a difficult time for many businesses, and even those that have ridden out the storm, will be affected by the tax changes announced in the 2009 Budget.

With a general election on the horizon it is fair to say that the future of tax rates has never been more uncertain.

With such uncertainty ahead I would urge businesses and individuals to plan for the current known tax changes, but to keep their options open for the future.

# YOUR LIABILITY TO YOUR FIRM

(An earlier version of this article appeared in *Solicitors' Journal* for 23 June 2009)

Does a partner have a financial liability to his firm for his own mistakes? That depends upon the nature of his duty to his firm. He has a duty to be honest, obviously, and a duty to act in good faith. But is he liable for his own simple negligence in relation to the firm's affairs? The question is difficult.

It is not the practice in England<sup>1</sup> for a solicitors' firm to bill a partner with the cost of the firm's loss where that partner has been negligent to a client – for instance, the cost of the excess on the firm's insurance. But a partner owes a duty of care to the other partners because as their agent he has assumed responsibility for their affairs to the extent of the partnership relationship<sup>2</sup>. So a partner is liable to his partners whenever his own "gross" or "culpable" negligence caused loss to the firm. In *Re Webb*<sup>3</sup> a firm of carriers was held not to be liable to the owners after it lost a consignment of goods in

a warehouse fire. But one partner had mistakenly paid the owners for the value of the goods. Held he had paid them "in his own wrong" and could not recover from his partners. In *Thomas v Atherton*<sup>4</sup> the managing partner of a colliery had negligently run the mines too far, and the adjoining owner was held to be entitled to £6,000 damages for trespass, and the managing partner sued his partners for a contribution. The Court of Appeal held that he had acted with culpable negligence in causing the trespass, so he was alone liable. In *Bury v Allen*<sup>5</sup> Knight Bruce V-C ordered the return of a partnership premium and commented,

"Suppose the case of an act of fraud, or culpable negligence or wilful default, by a partner during the partnership, to the damage of its property or interests...he is certainly in equity compellable to compensate or indemnify the partnership in this respect".

<sup>1</sup>The practice in Hong Kong can be contrasted.

<sup>2</sup>*Thomas v Atherton* (1877) 10 Ch D 185, CA; *Re Webb* (1818) 8 Taunt 443; *McIlreath v Margaretson* (1785) 4 Doug KB 278 per Lord Mansfield; *Bury v Allen* (1845) 1 Coll 589. A partner was held not liable for loss on an injudicious sale of assets on winding up in *Cragg v Ford* (1842) 1 Y & C Ch Cas 280, probably because it did not amount to negligence.

<sup>3</sup>(1818) 8 Taunt 443; *Chapman v Great Western Railway Co* (1880) 5 QBD 278

<sup>4</sup>(1877) 10 Ch D 185, CA.

<sup>5</sup>(1845) Coll 589



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By contrast in *Re Protestant Assurance*<sup>6</sup> a partner arranged for his firm to take shares in a company which he had been told had limited liability which it proved not to have. The other partner refused to accept liability on the shares, saying that the whole liability should be that of the first partner. Kindersley V-C rejected this, “both being equally misled”.

The meaning of “gross” or “culpable” negligence is uncertain. Possibly it means no more than “negligence”<sup>7</sup>, or that the partner should not act “below the standards of a reasonable businessman”<sup>8</sup>. But the better view is that it means something more. So trustees’ “gross negligence” is recognised as something qualitatively different from the default of trustees “who have bona fide abstained from closely superintending the administration of a trust, or who have committed mere errors of judgement...”<sup>9</sup>

It can therefore be said that the duties of partners to one another are duties of honesty rather than care and so do not impose liability for simple negligence within the firm. In *Medforth v Blake*<sup>10</sup> Sir R Scott V-C said that “the concepts of negligence on the one hand and fraud or bad faith on the other ought in my view to be kept strictly apart”. Millett LJ said in *Armitage v Nurse*<sup>11</sup> that the duty of trustees is not one of skill and care, and *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295 shows that a mortgagee’s duty is not a general duty of care but only a duty to exercise his duty in good faith. Carnwath J at first instance in *Hurst v Bryk*<sup>12</sup> considered a claim by a partner against the firm’s management committee and said:

“I have serious doubts as to the nature of the duty of care...There is no doubt, of course, that partners owe each other duties of good faith...In addition, no doubt, a

partner may put himself in a position where he owes a higher duty of care...However...a partnership is a co-operative venture, whose success depends on a pooling of effort and responsibility. The mere fact that individual partners undertake particular tasks in the interest of the firm does not mean that they accept legal responsibility going beyond that which is expressed or implicit in the deed.”

In the Scottish striking-out case of *Ross Harper & Murphy v Banks*<sup>13</sup> Lord Hamilton expressed the view that a partner might be liable to the other partners for the excess on the professional insurance policy which was suffered as a result of his negligence, the issue being described as one of “reasonable care in all circumstances”. But his view was not warmly received at the hearing of the appeal and the case was settled. Nor was the same view taken on similar facts in *Lane v Bushby*<sup>14</sup> decided in the New South

<sup>6</sup>(1857) 26 LJ 455

<sup>7</sup>Rolfe B said in *Wilson v Brett* (1843) 11 M & W 113 (not a partnership case) that he “could see no difference between negligence and gross negligence – that it was the same thing, with the addition of a vituperative epithet”. Romer J in *Re City Equitable Fire Insurance Ltd* [1925] Ch 407 said at 427 that he found difficulty in understanding the difference and Millett LJ in *Armitage v Nurse* [1998] Ch 241, CA expressed a “healthy disrespect” for the distinction. The English and Scottish authorities are discussed in *Blackwood v Robertson* 1984 SLT (Sh Ct) 68 and the Commonwealth ones in *Lane v Bushby* (2000) 50 NSWLR 404, NSW SC.

<sup>8</sup>per Woolf J (without the benefit of the citation of authority) in *Winsor v Schroeder* (1979) 129 NLJ 1266; *Gallagher v Schul* (1988) NZBLC 103; *Mirco Bros Pty v Palermo Nominees* (2005) WASC 190.

<sup>9</sup>per Lord Watson in *Knox v Mackinnon* (1888) 13 App Cas 753, followed in *Robertson v Howden* (1892) 10 NZLR 609, as discussed in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services* (1996) PLR 179 (Jersey CA), itself approved by Millett LJ in *Armitage v Nurse* (1998) Ch 241

<sup>10</sup>[2000] Ch 86, CA

<sup>11</sup>(1998) Ch 241 at 253-4

<sup>12</sup>(11 April 1995, unreported), citing *Caparo plc v Dickman* [1990] 2 AC 605 and *White v Jones* [1995] 2 AC 207. See also *Lane v Bushby* (2000) 50 NSWLR 404; *Wisum & Cash v Cash* 837 P 2d 692 (1992); *Johnson v Weber* 803 P 2d 939 (1990); *Northern v Tatum* 51 So 17 (1909); *Snell v De Lane* 27 NE 183 (1891); *Thomas v Milfelt* 222 SW 2d 359 (1949)

<sup>13</sup>2000 SLT 699, followed in *Mirco Bros Pty v Palermo Nominees* (2005) WASC 190

<sup>14</sup>(2000) 50 NSWLR 404, NSW SC, followed in the Supreme Court of New Zealand: *Macalister Todd Phillip Bodkins v AMP General Insurance Ltd* [2007] 1 NZLR 485, where the firm’s practice on this was evidenced by its arrangements with its insurers

Wales Supreme Court the same year, nor by the Supreme Court of New Zealand in *Macalister Todd Phillips Bodkins v AMP General Assurance Ltd*<sup>15</sup> where the court remarked that

“partner negligence leading to a claim by a client is regarded as an unfortunate but accepted fact of life”.

Two cases have recently given the question detailed analysis to the question whether or not a partner must pick up the whole cost of his own negligence. In *Gallagher v Schulz*<sup>16</sup> Williamson J analysed the authorities and some Roman law and observed,

“ If the partner who causes loss has done so merely because of the lack of skill and experience, he is not answerable to the co-partner by reason of that lack alone...[but]...the duties of good faith and honesty... may be sufficient in themselves to impose upon a partner the duty to use his or her own skill in a reasonable manner.”

He held that the standard to be applied should be no more than the standard that the particular partner at fault might employ in the conduct of his own affairs, unless he had been taken into partnership because

of some special trust or particular confidence in him, in which case the level of duty would be set by that.

In *Tann v Herrington*<sup>17</sup> Bernard Livesey QC (sitting as a judge of the Chancery Division) considered a two-partner firm in which the insurance claims were dealt with by the defendant partner. A claim against the firm was made by a client which the defendant, did not refer to the insurers, and consequently when the claim matured the insurers declined to meet it and the partner had to meet it personally. He sought a contribution against the claimant. The Judge followed much of the reasoning in *Macalister Todd* (supra) but refused the claim saying

“where the default is by a partner entrusted with the responsibility of protecting the firm by complying with the insuring provisions...the firm entrusts such a partner with a responsibility...and expects him to perform the duty with all reasonable care and skill”.

This set an objective test which seems to be similar to that in an ordinary case of negligence. But the Judge accepted the possibility of alternative analysis,

“that the firm would expect each

partner to do his best...or to act to the standard he would apply in looking after his affairs”.

That would be a subjective test. The Judge held that the defendant failed in the circumstances to meet either test.

It seems that there are two strands of thought in the authorities. One is that the partner in default does not have a duty of care as such but only a duty of good faith which involves his obligation to do his best, like “a servant who loyally does his incompetent best for his master”<sup>18</sup>. The other is that he is liable in negligence under objective principles but only at the level where it can be said that his default is “gross”, the difference being not qualitative but one of degree. In either case it seems that the partner will not be liable to his partners for what might be termed merely his simple negligence.

### Mark Blackett-Ord

Mark Blackett-Ord appeared in *Tann v Herrington* and in several recent Court of Appeal decisions on partnership law. He is the author of *Partnership Law* (3rd ed 2007) (Tottell) and he practices from 5 Stone Buildings, Lincolns Inn.

<sup>15</sup>(2006) NZSC105

<sup>16</sup>(1988) 2 NZBLC pp 103,208-9

<sup>17</sup>2009 EWHC 445 (Ch)

<sup>18</sup>per Millett LJ in *Bristol & West Building Society v Mothew* (1998) 1 Ch 1 at 18

# INSOLVENCY ISSUES FOR PARTNERSHIPS

## - THE VIEWS FROM INSIDE & OUTSIDE

Workshop report prepared by Robert Budgen, The Royal Bank of Scotland plc.

**Chair:**

Simon Prideaux,  
The Royal Bank of Scotland plc.

**Speakers:**

Steve Billot,  
BDO LLP  
and  
Mark Feeny,  
Consergo Ltd.

**Date:**

Thursday, 2nd July, 2009

**Venue:**

Lawrence Graham LLP  
4 More London Riverside  
London SE1 2AU

### Introduction by Simon Prideaux

Simon opened by highlighting the impact of recent economic conditions on the clients of partnerships in all the professions and, hence, on the partnerships themselves. It was because these effects are being felt so widely that the topic had been added to the workshop programme as a “late substitution” for the planned tax workshop (which will now take place in January 2010).

Whilst commentators seem undecided whether the recession is “bottoming out” or may yet worsen, it is clear that certain partnerships have been more severely affected than others. Some appear to have been better prepared in the first place, others have reacted more swiftly and decisively than their peers but a growing number have had to resort to an insolvency process of one sort or another.

The workshop would look at the factors which can lead to financial difficulties and the available solutions. Given the sheer number and diversity of partnerships of solicitors, the speakers would base their comments predominantly on their experience in that sector but the underlying issues are common to all professions.

Both speakers have had practical

experience of managing professional partnerships through challenging times and both now act as advisers to such firms.

### Steve Billot (BDO LLP) and Mark Feeny (Consergo Ltd)

#### Issues and challenges

Even before the onset of the current recession solicitors were already facing numerous challenges including:

- the tax and cashflow consequences of earlier recognition of unbilled income
- the changing attitude of banks and other creditors as firms transfer to limited liability structures
- the impact of the Carter review on the attractiveness of Legal Aid work
- the effects of the annual funding cycle on the Legal Services Commission’s payment timetable
- the rise of e-conveyancing
- structural changes in the professional indemnity insurance market
- the squeezing of profit margins on personal injury and other “commoditised” work (making “economies of scale” ever more crucial if such work is to remain viable)
- the threat of even greater competition as new providers take



**Robert Budgen**  
The Royal Bank of Scotland Plc

advantage of the opportunities created by the Legal Services Act to enter the market.

Superimposing onto that landscape the wider “credit crunch” (and, in particular, the demise of Key Business Finance in its historic guise) has brought a sharp rise in the number of law firms requiring professional help to resolve financial problems.

Structurally and culturally the solicitor sector found itself poorly prepared to meet these challenges.

- 85% of businesses in the sector comprise sole traders or firms of less than 5 partners
- such businesses often have little in the way of formal “practice management” in place
- whilst the owners of the business may be skilled lawyers, they are not always “businessmen” in the broader sense
- the small number of (often ageing) partners creates succession issues when a partner seeks to retire (and expects his/her capital to be repaid!)
- mergers – sometimes seen as a solution to such issues – are often badly conceived (with inadequate “due diligence”) and poorly implemented (a truly shared vision and operational economies not being achieved)
- many of those now running firms have had little or no previous experience of steering the business through an economic downturn
- expectation that the “good times” (including rising property prices) would continue may have led partners to follow their clients’ lead by investing in real estate (leaving them now with an illiquid asset – often of declining value)

- the “family atmosphere” within the firm may discourage the taking of hard decisions to address overcapacity at times of declining business volumes
- the annual billing/cashflow cycle and its seasonal “pinch points” – especially those relating to the payment of tax – are not always understood
- as a result, it is frequently not recognised that profit (in the profit and loss account) is not the same thing as cash (in the bank account).

### The need for change

Against that background, those seeking to manage a firm through the recession have rapidly found themselves in unfamiliar territory requiring a different approach to management.

- the traditional objective of maintaining stability is replaced by a need for (sometimes drastic) change
- foreseeable, longer-term challenges are eclipsed by a multiplicity of unpredictable, immediate (but inter-related) problems
- leisurely, consensual decision-making has to be replaced by making quick - partly intuitive - choices
- the scope to balance many competing priorities has been replaced by a need to focus on those which are crucial for survival

In guiding a firm out of financial difficulties, the partners/managers have had to

- share a realistic view of the business model and its potential
- plan capacity consistent with available business volumes
- stop incurring unjustified costs (not

just to delay in paying them)

- communicate with all stakeholders:
    - staff
    - clients
    - creditors (especially the bank and HMRC)
    - regulators
    - press
  - manage individual fee-earner performance dispassionately
  - overhaul financial controls (for many firms this means a major “step change” not just marginal “tinkering”)
- but, above all.....
- act speedily. Delay allows continuing cash outflow which only intensifies pressure and risks a “manageable problem” becoming a full-blown “life-or-death crisis”.

Mistakes can easily be made - often through not being sufficiently bold and radical -including:

- not cutting fee-earner and support headcount deeply enough at the outset (so the whole unsettling process has to be gone through a second - or even third - time)
- relying on the achievement of unrealistic forecasts
- continuing to spend but relying on taking longer to pay
- distraction with ill-conceived “solutions” (e.g. the merger of two troubled firms may just create a bigger firm with even bigger troubles)
- not engaging with employees and the press (risking destabilizing comments by disaffected or “maverick” staff or the media drawing their own conclusions).

Ironically, the post-recession recovery phase - whenever it comes - can carry similar risks. If balance sheets and funding models cannot digest

the increased business volumes then available, financial failure can just as easily ensue.

### Options if turnaround fails

It is generally in the best interests of all stakeholders (partners, clients, creditors etc.) to avoid a formal insolvency process. Merger or takeover of the entire business may be the answer. Alternatively, some form of "restructuring" may be desirable with only part of the existing business being transferred into other ownership.

Sometimes, however, a formal insolvency process is the only viable way forward. In considering the optimal route, due consideration must be given to all relevant factors including:

- the exposure of individual partners to partnership debts (through direct recourse, guarantees or other personal security given to lenders)
- the terms on which leasehold property is occupied (including partners personal guarantees to landlords)
- potential "clawback" of withdrawals from an insolvent LLP in the event of winding-up
- the quality and realisation potential of both work-in-progress and debtors
- retaining/maximising the value of "goodwill" and links with key clients
- relationships between the partners (e.g. "equity" vs. "fixed share"/ "salaried") and any actual or potential areas of dispute
- commitments to former partners
- the terms of the partnership deed (if there is one!).

The most frequently seen insolvency processes are:

- Partnership Voluntary Arrangements (PVAs) remain the most popular process for traditional unlimited partnerships - either as a "stand alone" procedure or supported by Individual Voluntary Arrangements (IVAs) of the partners - enabling the partners to continue to practice whilst repaying the firm's debts to the agreed extent. For LLPs, a Company Voluntary Arrangement (CVA) achieves the same result.
- Winding-up/Liquidation - for unlimited partnerships this is often accompanied by bankruptcy orders against the individual partners. Since this is generally the least likely to maximise the return to creditors, it is less frequently used.
- Administration. This is an increasingly popular solution as it helps the underlying business to be saved - potentially through a "pre packaged" sale negotiated prior to the Administrator's appointment.

Whilst an Administration has obvious attractions - to partners, staff and clients - in enabling the business to continue, there are various practical and regulatory issues which have to be borne in mind including:

- the ease of access to historic files
- the responsibilities of being the "successor practice" (including maintenance of professional indemnity insurance)
- "TUPE" regulations in respect of staff transferring to the new entity
- the control of client funds
- the potential to inherit liability for past regulatory breaches
- the requirements of Statement of

Insolvency Practice 16 ("SIP 16").

SIP 16 lays down clear guidelines on the handling of "pre packaged" sales (so reducing the scope for the "phoenix" transactions seen in previous times). In particular, SIP 16 requires the Insolvency Practitioners involved to disclose to creditors:

- how they came to be involved and the extent of that involvement prior to formal appointment
- the steps taken to market the business and any valuations obtained
- the alternatives considered and why they were not pursued
- any consultations with key creditors and/or working capital funders
- relationships between the purchaser and the owners/ managers/secured creditors of the failed business.

As shown by the case of Alexander Samuels LLP (in which an Administrator was ousted by the court having failed to keep creditors properly advised), there is a determination to see these processes enacted professionally.

Even though LLPs have been with us for some years, there have - until now - been relatively few failures amongst professional practice LLPs but seven of the examples mentioned by the speakers were LLPs (with returns to creditors under CVAs ranging from 25p to 75p in the £).

*A copy of the slides used at the workshop can be found on the members' side of the APP website under "workshops".*

# THE ROUGH GUIDE TO PARTNERSHIP & LLP ACCOUNTING

**Chair:**

Colin Ives  
BDO LLP

**Speaker:**

Peter Saunders  
Deloitte

**Date:**

Thursday, 24th September, 2009

**Venue:**

Deloitte,  
2 New Street Square,  
London EC4A 3BZ

Workshop report prepared by Alan Hodgson, Field Fisher Waterhouse LLP

**A double workshop was held at Deloitte's offices in September with two "rough guides" given to members.**

**Colin Ives chaired the Rough Guide to Partnership and LLP Accounting and began by introducing the speaker, Peter Saunders. The aim of the session was to provide a high level summary of why accounts are prepared, what their purpose is, some of the pitfalls to watch out for, and what may happen to the format of accounts in the future.**

## Why accounts are prepared

Peter explained that partnership accounts are primarily prepared in order to determine the results (and tax) of a period, however they can also be produced in order to ascertain the final position of a firm that is closing or merging with another firm.

Historically, the main driver behind accounts' preparation was to strike the profit and divide it amongst partners. Now, as many firms are LLPs, the shift has moved more to a regulatory requirement to produce and report publicly the results of a firm.

The basis of accounting is one of the fundamental decisions when preparing accounts. Does the firm account for transactions on a:

- cash basis (e.g. only recognise income when the cash is received – i.e. a slower recognition basis); or

- accruals basis (e.g. recognise income when it is "earned" at the point of performing the work – i.e. an accelerated recognition basis)?

The requirements of LLP reporting, and the need to conform to UK Generally Accepted Accounting Principles ("UK GAAP") means that firms must account on an accruals basis.

## What is their purpose?

Partnership accounts are used by a variety of different people for a variety of different purposes, and those users have changed over the past few years.

Former private partnerships' key users would have been the partners themselves, the tax authorities, the bank manager and prospective lateral partners.

Now, with the public reporting of LLP accounts, key users remain the above groups of people, but also include staff,



**Alan Hodgson,**  
Field Fisher Waterhouse LLP

clients, suppliers, competitors and the press, who seem to have an insatiable appetite for gossip on firms' results.

### Common issues

One of the most difficult issues for partnerships to contend with is balancing the need to conform to UK GAAP (in the case of an LLP) with the need to ensure equity amongst different generations of partners. This leads to firms having one set of accounts which need to be completed for regulatory purposes, and a separate set in order to divide the profits between partners.

Some of the different issues that arise in this context are:

**- provisioning:** where a firm may have a vacant floor or vacant property, for example, UK GAAP requires the full cost of that space to be calculated up to the first break clause of the lease, and to charge it to the profit and loss account in the year that the lease becomes onerous. This may not be considered equitable amongst different generations of partners, resulting in firms taking a slightly different approach when it accounts for the cost of that lease.

**- rent free periods:** we are increasingly seeing greater incentives being offered to take on new property, often in the form of rent-free periods. Whilst this is excellent news from a cashflow perspective, UK GAAP states that the benefit of this period should be spread over the lease. This may be one area where UK GAAP provides equity amongst partners, but some firms may choose to take the benefit of the rent-free period at the point it arises in cash, as it may offset the additional costs incurred in moving premises.

**- pension schemes:** UK GAAP states that a firm must recognise the full deficit of a pension scheme immediately, whereas it may be more equitable for partnerships to spread this charge over several years so that it does not adversely affect one set of partners.

Peter explained that to ensure the accounting remains relatively simple and easy for the partners to understand, any adjustments between the statutory accounts and the accounts used to divide profits should be saved for the larger items otherwise reconciling between the two sets can become a very cumbersome and long-winded exercise.

Other areas of accounting that lead to issues for partnerships are:

**- work in progress ("WIP"):** UK GAAP requires firms to value WIP on a "right to consideration" basis. That is, when a firm has earned the right to receive the revenue, it should account for that benefit immediately. There are a variety of specific rules governing this area of accounting (e.g. contingent fee and fixed fee arrangements) which can make the calculation complex for some firms.

**- consolidation:** firms have set up separate partnerships overseas for regulatory or tax reasons. When pulling together the global accounts of the partnership, various criteria need to be considered to determine which entities get consolidated into which set of accounts.

**- members' balances:** for LLP's, members' capital and current accounts will usually be determined as a debt to the members and should therefore not form part of the assets of the LLP. This can change the whole appearance of a partnership's balance sheet at the year end, particularly when considering the impact this may have on bank covenants.

**- dividing profits:** the point of when profits are actually divided amongst partners can become a significant issue. Prior to division, those profits are "owned" by the LLP and are therefore shown as an asset of the LLP. After division, they become a debt of the LLP, representing the fact that the LLP owes that money to its members.

### The future

Peter ended by explaining that in the next 2-3 years it is likely that UK GAAP will disappear in favour of International Financial Reporting Standards applicable to small and medium sized entities.

This will lead to more complexity from an accounting perspective, but will require partnerships to disclose less to the wider public audience.

### Questions & Answers

The following provides a summary of the questions that were raised following Peter's main presentation:

**- vacant property provisions:** Peter explained that it may be fairer for partnerships to ignore UK GAAP in calculating the profit to be divided each year, and to account on the basis of the actual cash that is being paid to the landlord.

**- division of profit:** the LLP earns the profit and it is not until that profit is divided, that it becomes owned by the members. Many firms talk about "sharing" profits, however this may well mean nothing in an insolvency situation: formal agreements must be in place and the decision to distribute / divide the profit must be formally documented. In the current climate, one particularly difficult issue for firms is dealing with the fact that fixed share partners could be better off than those sharing in the, now possibly lower, profits of the firm.

**- valuation of WIP:** the last question posed was in relation to what a typical valuation would be for non-contingent WIP. Peter explained that in his experience, WIP is valued anywhere between 55% and 80% of the gross value. There is no specific standard answer however, and he would favour firms taking a comprehensive approach to this valuation rather than a broad brush methodology.

*A copy of the slides together with an audio file of the workshop can be downloaded from the members' side of the APP website under "workshops".*

# THE ROUGH GUIDE TO PARTNERSHIP AND LLP LAW

## Chair:

Jeremy Callman  
10 Old Square

## Speakers:

Fergus Payne  
Lewis Silkin LLP  
and  
Gavin Foggo  
Fox Williams LLP

## Date:

Thursday, 24th September, 2009

## Venue:

Deloitte,  
2 New Street Square,  
London EC4A 3BZ

Workshop report prepared by Miguel Pereira, Lewis Silkin LLP

A double workshop was held at Deloitte's offices in September with two "rough guides" given to members.

After introducing the speakers, Jeremy gave a brief summary of the type of partnerships in England and Wales:

- (i) a general partnership,
- (ii) a limited liability partnership; and
- (iii) a limited partnership.

The first consists of individuals coming together in business with a view to making a profit and their relationship is governed by The Partnership Act 1890. The second exists by virtue of incorporation at Companies House and is governed by The Limited Liability Partnerships Act 2000 and the third is less common, mainly used in the financial sector, and is formed by a general partner (who effectively manages the partnership and has unlimited liability) and limited partners and is governed by The Limited Partnership Act 1907.

Jeremy explained that the speakers would be focusing on general partnerships and limited liability partnerships ("LLPs").

Fergus started off by highlighting that The Partnership Act 1890 and significant case law are the sources of law for partnerships but that partnership law does not apply to LLPs. The principal governing piece of legislation for LLPs is The Limited Liability Partnerships Act 2000. Subsequent regulations introduced under such Act have applied significant parts of The Insolvency Act 1986 and the Companies Act 1985 and 2006 to LLPs. There has been little case law to date on LLPs, most likely a product of the

relatively short time they have been in existence and the desire of professional firms to keep disputes out of the court arena.

Whether a partnership or an LLP, it is essential to have a written partnership agreement. In the absence of an agreement, the provisions of The Partnership Act 1890 (for partnerships) and the default regime set out in the LLP Regulations 2001 (for LLPs) will apply but they are both wholly unsatisfactory. In the absence of a written agreement:

- (i) partners/members will share equally in the capital and profits of the partnerships or LLPs (and in partnerships contributing equally to losses);
- (ii) the admission of a new partner or member can only be carried out with unanimous consent;
- (iii) a majority cannot expel a partner or member unless the power is conferred by express agreement;
- (iv) in relation to decision making, ordinary matters can be approved by a majority but a change to the nature of the business requires unanimity;
- (v) a partner cannot retire without consent unless in a "partnership at will"; and
- (vi) LLP members may retire after giving reasonable notice.

There is potentially a nasty trap for retiring LLP members in that although there is a statutory right to retire on reasonable notice, the legislation does not give a retired member a default right to repayment of his capital or profit



Miguel Pereira,  
Lewis Silkin LLP

share.

The absence of a written agreement in the case of a partnership could give rise to the unpleasant consequence of a partnership at will. In a partnership at will, any partner may dissolve the partnership by giving notice to the others. This is a potential time bomb should any partnership dispute arise given that a disgruntled partner can threaten dissolution along with the unwanted consequences that brings.

Next, Fergus looked at LLP conversions and noted:

- there is no conversion as such, the process involves the incorporation of the LLP to which the business and assets of the existing partnership transfers;
- careful thought should be given to the consent required internally for conversion, for example what majority is required to vote in favour of conversion;
- externally, the position with regard to landlords and banks should be considered carefully as their consent is often required to transfer the business and assets to a LLP;
- a comprehensive and up to date partnership agreement can form the basis of a new members agreement, but the new agreement should address:-
  - the disapplication of the default regime;
  - the appointment and duties of the designated members;
  - the duty of good faith and who owes it and to whom;
  - duty of care of indemnities from the LLP; and
  - accounting provisions and insolvency.

Fergus highlighted that there is an interesting conundrum in relation to LLPs in that the LLP Act recognises that LLP members can be employees while the current HMRC practice is to treat all members as being self employed.

The area of age discrimination which has provoked the most debate in

partnership circles, is the enforceability of a mandatory retirement age. Unlike the position with employees where a mandatory retirement age of 65 is lawful, a mandatory retirement age in a partnership or LLP member's agreement is potentially discriminatory and will need to be justified as proportionate means of achieving a legitimate aim. The law has got some clarity as a result of the much reported case of *Seldon v Clarkson Wright & Jakes* which indicated that reasons associated with succession planning and motivating junior professionals may represent legitimate objectives to having a mandatory retirement age. The case itself has been referred for further consideration and we watch this space.

As for personal liability, Fergus highlighted that partners of a partnership have joint and several liability for the debts and obligations of their firm. This has been the primary driver for converting partnerships into LLPs. An LLP, however, has a separate legal personality and therefore it will be liable for its own debts and obligations. However, there is potential for personal liability on the part of a member. First, in the discharge of his responsibilities as a designated member. Secondly, for any contractual liability under guarantees given to a bank or landlord (although in each case one would expect the LLP to indemnify the member). Third, on an insolvency in the same way as company directors, an LLP member can be liable for fraudulent or wrongful trading and there is additional potential liability under Section 214(a) of the Insolvency Act (the so called "clawback" provision) which essentially means that if wrongful trading is proved, a member can be required to repay monies taken out in the two years prior to the insolvent liquidation. Finally, a member may be personally liable for any negligent act if he has assumed a personal duty of care but LLPs can take steps to protect its members ensuring that the professional indemnity cover extends to members and other risk management steps are taken.

Gavin then looked at the relationship between partners in a partnership and the duties owed to each other. There are a number of common law duties known as fiduciary duties which are owed by partners in a partnership; these are as follows:

- overarching duty of utmost good faith (this is the highest duty at common law);
- duty of loyalty;
- duty not to put oneself in position of conflict;
- duty not to make profit from position (ie. secret profit); and
- duty of confidentiality.

Gavin also noted that there are a number of statutory duties set out in the Partnership Act 1890, for instance:

- the full disclosure duty under Section 28 which provides that each partner is obliged to render true accounts and full information (which is a powerful tool in a dispute between partners);
- the non-profit duty at Section 29 whereby a partner is under a duty to account for the personal benefits derived from the use of assets or connections with the partnership; and
- a duty not to compete under Section 30 whereby a partner is under a duty to account for profits from a competing business in which he or she is involved with.

A subjective standard is used to measure the above duties.

Gavin then turned to the duties owed by the members to the LLP. As agents of the LLP, a member will owe a number of fiduciary duties and statutory duties. The fiduciary duties are as follows:

- duty of loyalty;
- duty not to put self in position of conflict;
- duty not to make profit from position; and
- duty of confidentiality.

In addition, contractual duties can be included in the member's agreement and these can also include duties as

between the members themselves.

These duties will be measured objectively rather than subjectively. This means that the standard will be that of a reasonable diligent person having general knowledge, skill and experience reasonably expected of a member carrying out those functions. This is very similar to the standard of duties owed by a director to a company.

Although there are no duties as between members of an LLP unless expressly set out in the members agreement, Gavin warned that there is no case law governing this and therefore it is possible that a duty of care could be established between members of an LLP in circumstances where:

- a member provides specialist assistance to another member's client;
- a member is entrusted by others to carry out a specific regulatory function.

The LLP itself may owe a duty to its members. Again, there is no case law on this point but Gavin suggested that such duties could be expressed in the members' agreement and that LLPs are obliged to comply with certain rights members have by virtue of the Companies Act. For instance:

- a right to inspect account records and receive accounts;
- a right to serve notice on LLP to file documents at Companies House; and
- a right for a 1/5th of members to request the Secretary of State to investigate the LLP.

Gavin then looked at issues relating to partners or members leaving partnerships or LLPs. Except for a partnership at will (which any partner can dissolve on written notice) partners in a partnership can only retire from a partnership if they have a right to retire under the partnership agreement and they can be expelled if an express power is also set out in the partnership agreement. The effect of a partner leaving does lead to the technical dissolution of the partnership but the partnership will survive as long as there is a provision that the partnership does not dissolve in the event of a partner retiring.

As for LLPs, there are some minor differences. The main difference is that the default provisions under the LLP Regulations 2001 give a member the right to retire on reasonable notice. The length of such notice will depend on the circumstances. The status of the LLP remains unaffected if a member leaves, it is very much like an employee leaving a company.

Gavin then looked at the terms of departure for partners and members. In partnerships, a retiring partner has a right to have his capital returned to him and to receive his outstanding profit share. Except for an implied duty not to solicit the business of the partnership's clients there will be no implied restrictive covenants; these must be set out in writing and courts may be willing to enforce more onerous covenants than in the context of an employment relationship. For instance, a restrictive covenant of 5 years duration was upheld in the leading case of *Bridge v Deacons*.

There is no automatic right for members of an LLP to receive their capital on departure, this will have to be expressly provided in the members' agreement. There is at present no case law in relation to the application of restrictive covenants to LLPs and their enforcement but it is likely that these will be the same as for outgoing partners in partnerships.

Gavin then turned to the dissolution of partnerships and LLPs. Dissolution of a partnership can occur technically upon the death or bankruptcy of a partner unless the partnership agreement expressly provides otherwise. Partnerships can also be dissolved by agreement or by notice, particularly when dealing with partnerships at will. The court, by virtue of Section 35 of the Partnership Act 1890, also has the power to dissolve partnerships. Once a partnership is dissolved, its business needs to be wound up. It is preferable for partners to wind up the partnerships business but sometimes a receiver is appointed

to do so and he is required to act in the best interest of partners. This is a much slower and more expensive process. During the winding up process, the partnership cannot take on new business but has to complete existing client work. It then has to realise its assets in order to pay off its debts and draw up a final account. If the debts of the partnership exceeds the assets, the partners will be personally liable for the shortfall.

As for LLPs, an LLP can be struck off the register at Companies House if it has not been trading. A trading LLP can be voluntarily wound up if the members so agree. If the LLP is insolvent, a liquidator will be appointed to wind up the business of the LLP and realise its assets and pay off the LLPs creditors. The members' powers including any express powers in an LLP agreement will cease on appointment of the liquidator.

The court also has powers to wind up an LLP, usually in the following circumstances:

- failure to begin business within a year of incorporation;
- if it has fewer than 2 members;
- if the LLP is unable to pay debts; and
- if it is just and equitable to wind up the LLP.

Gavin closed by setting out the common disputes between members of LLPs and partnerships. These are as follows:

- the withholding of information or documents;
- the amendment or withholding of profit shares or drawings;
- depriving a member or partner from participating in management;
- depriving a member or partner of access to premises or IT systems;
- terms for the retirement of a member or partner and the application of restrictive covenants; and
- threats of dissolution or winding up.

*A copy of the slides used at the workshop can be found on the members' side of the APP website under "workshops".*

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## Berry v Laytons and another [2009] EWHC 1591 (QB), judgment of 3 July 2009, not yet reported.

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The claimant, Berry, was the main partner in Electronic Interconnection Services Associates (EIS), which was a client of the defendant firm of solicitors, Laytons. Berry alleged that Laytons gave confused and inadequate advice to EIS on its rights under the Commercial Agents (Council Directive) Regulations 1993 (the Agency Regulations). The parties agreed that Laytons owed Berry duties in contract and in tort to give advice with reasonable care. Since they held themselves out as having a particular expertise in the law concerning commercial agents, and they were consulted on that basis, they were required to meet the standard of skill and care reasonable to be expected of solicitors with such standing and expertise. They were also obliged to convey their advice with proper clarity so that a reasonable recipient could understand the message that was being conveyed. They were not liable for errors of judgement, but only errors which no reasonably well informed and competent member of their profession with the requisite skill and care reasonably to be expected of them as

specialists in their field could have made at the time they advised.

The court held that negligent advice had been given, to the effect that it was not worth taking the risk of litigation based on the Agency Regulations to obtain more compensation than was set out in EIS's agency agreement with a third party. Causation should be considered by reference to the most likely advice that would have been given had proper care been exercised, which was that he had a reasonable prospect of defeating the claim that he was restricted to the compensation fixed by the agency agreement and that he would have had a strong claim for substantial compensation under the Agency Regulations. It was for Berry to prove on the balance of probabilities that he acted on the negligent advice to his detriment and that he would have acted on the likely advice, had it been given. The court concluded that if the hypothetical likely advice had been given, Berry would not have settled on the terms that he did and would have pursued the claim under the Regulations, if necessary



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by litigation. Damages were therefore awarded on a loss of chance basis, based on the value of the claim and the probabilities of success.

### Comment

This judgment provides a detailed analysis of the standard of skill and care to be expected of a professional partnership,

making explicit reference to the judgment of Henderson J in *Hicks v Russell Jones & Walker* [2007] EWHC 940 (Ch), unreported, at para 138.

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## Julienne Rowlands v Paul Simon Graham Hodson [2009] EWCA Civ 1025, judgment of 16 October 2009, not yet reported

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This judgment was given in an appeal against an order dated 12 March 2009 made by Arnold J and discussed in the APP Newsletter Issue 26 - July 2009.

Paul Hodson was the personal representative of Ruby Hodson deceased. He took over her claim against the defendants including, inter alia, a claim against Mr Cloutman and his firm Tudor Rose for professional negligence and breach of fiduciary duty. In 2006, judgment was given in favour of Paul Hodson against all the defendants, and the defendants ordered to pay compensation and costs. Permission was granted to Paul Hodson to join in Mrs Rowlands as a defendant, and to enforce the order against her. This appeal dealt with the preliminary issue of whether Mrs Rowlands had been a partner with Mr Cloutman.

The Court of Appeal held that Arnold J was right, for the reasons he gave, to hold that

Mrs Rowlands was a partner during the period 1 August 2000 to 31 July 2003. The partnership deed entered into by Mrs Rowlands and Mr Cloutman clearly established a partnership between them because it purported to do so and satisfied the conditions laid down in s1 of the Partnership Act 1890. First, the business was that of a solicitors' firm. Second, it was to be carried on by two or more persons, namely Mr Cloutman and Mrs Rowlands. Third, it was clearly with a view of profit. Although it appeared that Mrs Rowlands had waived her claim to her small share of profits earned in the two accounting periods ended 31 July 2002 and 2003, she remained entitled under the partnership agreement to 1% of the profits, and in any event the receipt of a share of partnership profits was not an essential element of the definition.

The purpose of the partnership arrangement was to ensure that Mrs Rowlands could

supervise Mr Cloutman, because he was not sufficiently experienced to practice on his own. However, while she stopped supervising in December 2001 following Law Society dispensation, she continued doing occasional work for the firm for which it charged, using its bank account, assuming a liability for its overdraft, taking the benefit of its insurance cover, being described on its notepaper and elsewhere as a partner, and continuing to be bound by the terms of the partnership agreement. The only change throughout the period of partnership was the dispensation of the need for Mrs Rowlands to supervise, and this could not, of itself, have operated to dissolve the partnership any more than could a partner's failure to attend the partnership office and carry on the partnership business, whether through willfulness, idleness or illness. In either event, dissolution could only be effected by an agreement by the two partners to dissolve the partnership.

# PROGRAMME OF EVENTS

Date	Workshop
Tuesday, 19th January, 2010	<p><b>LLPs, LPs and Tax Developments</b> to be held at Addleshaw Goddard LLP, Milton Gate, 60 Chiswell Street London EC1Y 4AG at 5.45 p.m. for 6.00 p.m. Chair: Colin Ives (BDO LLP) Speakers: Louis Baker (Horwath Clark Whitehill LLP) and Andrew Disley (Allen &amp; Overy LLP)</p>
Wednesday, 10th March, 2010	<p><b>Opening-up the legal profession - the risk and regulatory consequences</b> to be held at The Royal Bank of Scotland plc, 280 Bishopsgate, London EC2M 4RB at 5.45 p.m. for 6.00 p.m. Chair: William Wastie (Addleshaw Goddard LLP) Speakers: Terry Caden (Willis Ltd.) and Heather McCallum (Allen &amp; Overy LLP)</p>
Thursday, 25th March, 2010	<p><b>Annual General Meeting and Dinner</b> sponsored by The Royal Bank of Scotland plc to be held at Stationers' Hall, Ave Maria Lane, London EC4M 7DD at 6.00 p.m. Guest speaker at the dinner: David Edmonds CBE, Chairman of The Legal Services Board</p>
Tuesday, 25th May, 2010	<p><b>Moving out - transforming an in-house team into an out-sourced provider</b> to be held at Lawrence Graham LLP, 4 More London Riverside, London SE1 2AU at 5.45 p.m. for 6.00 p.m. Chair: Simon Prideaux (The Royal Bank of Scotland plc) Speakers: Richard Turnor (Maurice Turnor Gardner LLP) and (Details to follow)</p>
Thursday, 1st July, 2010	<p><b>Alternative uses for Partnership Structures</b> to be held at: Macfarlanes LLP, 20 Cursitor Street, London EC4A 1LT at 5.45 p.m. for 6.00 p.m. Chair: Bridget Barker (Macfarlanes LLP) Speakers: Robin Vos (Macfarlanes LLP) and (Details to follow)</p>
Wednesday, 22nd September, 2010	<p><b>Partnership Disputes: Arbitration and Mediation</b> to be held at: Allen &amp; Overy LLP, One Bishops Square, London E1 6AO at 5.45 for 6.00 p.m. Chair: Simon Bevan (BDO LLP) Speakers: Peter Garry (Cripps Harries Hall LLP) and (Details to follow)</p>
Tuesday, 2nd November, 2010	<p><b>Legal Services Board: The story so far</b> to be held at Deloitte, 2 New Street Square, London EC4A 3BZ at 5.45 for 6.00 p.m. Chair: Tony Williams (Jomati Consultants LLP) Speakers: (Details to follow)</p>

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### Disclaimer

Except where otherwise stated, the views and opinions recorded in this newsletter are the personal views of individual APP members and do not reflect the views of the Association as a whole. The information contained in this newsletter is not intended to be an exhaustive statement of the law.

### Contributions

Any member who wishes to contribute in any way to the APP by, for example organising, speaking at or suggesting topics for workshops, contributing to the newsletter, participating in the Working Parties, providing a venue for APP events, or suggesting other APP initiatives, should contact the Administrator.

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