

CLIENT INFORMATION

Limited liability partnerships - overview of legal issues

Introduction

A limited liability partnership (LLP) has many of the features of a normal partnership but it also offers reduced personal responsibility for business debts. Unlike an ordinary partnership, the LLP itself is responsible for any debts that it runs up, not the individual partners.

These notes aim to give you a quick overview of what is involved. They cover:

- answers to frequently-asked questions
- guidance on some of the matters that should be covered in an LLP agreement
- a conversion checklist.

This information is by no means exhaustive. We will be happy to provide detailed advice tailored to your specific circumstances and needs.

What is an LLP?

An LLP is a relatively new form of legal entity, introduced in 2001 under the Limited Liability Partnerships Act 2000.

The key features of an LLP are that it offers limited liability for members; is a separate legal entity; is taxed as a partnership and has the organisational flexibility of a partnership. Accounting and filing requirements are broadly the same as those of a company. In other respects it is very similar to a company.

Who can form an LLP?

Two or more people associated, and carrying on a lawful business with a view to profits, may form an LLP. It is worth noting that some regulatory bodies may prevent their members from operating as LLPs.

Limited liability

The limit of liability for any individual member* is the sum which he has agreed with the other members or with the LLP that he will be liable for. This sum may be nominal only.

** subject to the requirements of any professional body*

How many members must the LLP have?

An LLP must have at least two members. If membership falls to only one member and the LLP continues to trade for more than 6 months, the benefits of limited liability are lost.

At least two members of an LLP must be appointed as 'designated members'. They have the same rights and duties towards the LLP as any other member but with extra responsibilities. These include duties such as signing and delivering the accounts and annual returns and notifying Companies House of any changes in membership, registered office address or name. Designated members are accountable in law for failing to carry out these legal responsibilities.

Can I choose any name I want for my LLP?

There are certain restrictions on the choice of name: it could be rejected if, for example, it is the same as a name already on the index, it is offensive or its use would be a criminal offence.

There are also restrictions on names that contain words prescribed by regulations and names which suggest a connection with central or local government. Detailed guidance is given on Companies House website and we can advise further if this is likely to be an issue.

Importantly, all LLPs must end with the words 'Limited Liability Partnership' or their abbreviations 'LLP' or 'llp' (or Welsh equivalents).

What about ownership of assets and security for borrowing?

An LLP is able to own property and assets, and has the same capacity to enter into transactions as a private individual. There is no limitation on borrowing. An LLP is therefore able to charge its property as security for borrowing. It can issue debentures and grant a fixed and floating charge.

What are the issues if we are converting from an existing partnership?

They will be similar to those arising during a business transfer. There will be significant tax questions, on which an accountant's advice will be required. Thought should be given as to whether particular assets or liabilities ought to remain in the old partnership or whether all the business or assets of the partnership should be transferred to the LLP. You will also need to consider customer and client contracts, leases, banking arrangements, investments, employees and insurance. A useful checklist of conversion issues is attached.

LLP members' agreement

We strongly recommend the setting up an LLP agreement, which will govern the rights and duties of the members (the equivalent of articles of association for a company). Like a traditional partnership agreement, it is a private document that does not have to be disclosed to the outside world. The agreement can be tailored precisely to suit the requirements of the members (subject to statutory requirements).

In the absence of an LLP agreement, a set of default regulations would apply which, in many cases, are not appropriate.

Another important function of an LLP agreement is to determine the means of resolving any disputes that may arise between members. The Limited Liability Partnerships Act 2000 provides that partnership law is not appropriate. In the absence of a well-drafted agreement, there could be some uncertainty as to how disputes might be resolved.

Is a member deemed to be 'employed'?

No. The general position is that a member is self-employed. However, there is no requirement that a member is entitled to a share of the LLP profits. A member can therefore have a fixed remuneration rather than a profit share.

Disclosure requirements

Signage: Every LLP must paint or affix its name on the outside of every office or place of business (even if it is a member's home). The name must be both conspicuous and legible.

Documents: Whether in hard copy, electronic or any other form, the LLP must state its name, in legible lettering, on:

- business letters
- notices and other official publications
- invoices, receipts and letters of credit
- bills of exchange, promissory notes, endorsements, cheques and money or goods orders purporting to be signed by, or on behalf of, the LLP

Failure to comply with any of these statutory requirements will result in a fine for the LLP.

What issues should be covered in an LLP agreement?

Incorporation of an LLP creates legal obligations under the LLP and the members need to agree how these obligations are to be shared. These are some of the default provisions that would apply in the absence of an LLP agreement. They may act as a useful prompt as to matters that need to be included in your LLP agreement.

Equal shares: All members are entitled to share equally in the capital and profits of the LLP. There is no mention of losses because, unless specified otherwise, the LLP bears its own losses. The losses may or may not be allocated to members by the LLP agreement. Care should be taken to ensure that the members' limited liability is not jeopardised.

Indemnity for payments and personal liabilities: The LLP must indemnify each member for payments made by him and personal liabilities incurred by him in the ordinary and proper conduct of the business or anything necessarily done for the preservation of the business or property of the LLP.

Involvement in management: Every member may take part in the management of the LLP. Exclusion from management could result in a member bringing a claim for unfair prejudice.

No remuneration: No member is entitled to remuneration for acting in the business or management of the LLP.

Consent of members required for new members and assignments: No person may be introduced as a member or may voluntarily assign an interest in an LLP without the consent of all existing members.

Decision-making: Any difference arising on ordinary matters connected with the business may be decided by a majority of the members. Any proposed change to the nature of the business requires the consent of all members.

Access to books and records: Books and records must be made available for inspection. Every member may, when he thinks fit, have access to the books and records to inspect and copy them.

Duty to give true accounts and full information: Each member must give true accounts and full information of all things affecting the LLP to any other member or his legal representatives. It is arguable that this default provision creates a fiduciary relationship between the members themselves (see next point).

Duty of good faith: The Act does not indicate whether the members' relationships with each other and the LLP are of a fiduciary nature. As the members are agents of the LLP, it is likely they will be held to owe fiduciary duties to the LLP but it is not clear whether they owe any such duties to each other. Members may wish to provide for fiduciary duties in the LLP agreement.

Duty to account for profits from competing business: If, without the consent of the LLP, a member carries on any business of the same nature that competes with the business of the LLP, that member must account for and pay to the LLP all profits made by him in that other business.

Duty to account for benefits derived: A member must account to the LLP for any benefit derived by him, without the consent of the LLP, from:

- any transaction concerning the LLP
- any use of the property of the LLP
- any use of the name of the LLP
- any use of a business connection of the LLP.

Expulsion: A member cannot be expelled from the LLP by a majority of the members unless a power to do so has been conferred by express agreement between the members. (The default provisions on this issue are inappropriate for most LLPs so it is particularly important to displace or elaborate on them.)

Third parties and members' liability: The basic rule is that every member is an agent of the LLP and can therefore bind it. There are limits, however, where the member is not authorised to act, or has ceased to be a member.

Debentures: An LLP may issue debentures and give fixed charges and floating charges over its assets in the same way as a company. The applicable sections of the Companies Act 2006 apply in dealing with these matters.

Unfair prejudice: A member has the right to apply to court if the LLP or the other members are unfairly prejudicing his interests. The members can agree (unanimously in writing) to exclude this right in their LLP agreement for an agreed period of time. As this provision gives any disgruntled member the power to disrupt the LLP, many LLP agreements exclude this right.

Cessation of the LLP: Because the LLP has a separate existence from its members, unlike a partnership, it will not dissolve automatically if, for example the membership falls below a certain level. Instead, explicit steps must be taken to terminate an LLP.