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Legislative Council

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LC Paper No. CB(2)2680/11-12
(These minutes have been seen
by the Administration)

Bills Committee on Legal Practitioners (Amendment) Bill 2010

Minutes of meeting
held on Monday, 19 March 2012, at 8:30 am
in Conference Room 3 of the Legislative Council Complex

Members present : Dr Hon Margaret NG (Chairman)
Hon LAU Kong-wah, JP
Hon Audrey EU Yuet-mee, SC, JP
Hon Paul TSE Wai-chun, JP

Members absent : Hon Albert HO Chun-yan
Hon Miriam LAU Kin-yee, GBS, JP
Hon Ronny TONG Ka-wah, SC

Public Officers attending : Ms Adeline WAN
Senior Assistant Solicitor General
Department of Justice

Ms Betty CHEUNG
Senior Assistant Law Draftsman
Department of Justice

Mr Christopher NG
Senior Government Counsel
Department of Justice

Ms Ida CHAN
Senior Government Counsel
Department of Justice

Ms Karmen KWOK
Senior Government Counsel
Department of Justice

Mr Bernard YUE
Government Counsel
Department of Justice

Attendance by invitation : The Law Society of Hong Kong

Mr David HIRSCH
Member of the Working Party on LLPs

Mr Allan LEUNG
Member of the Working Party on LLPs

Ms Heidi CHU
Secretary General

Clerk in attendance : Miss Mary SO
Chief Council Secretary (3) 3

Staff in attendance : Miss Winnie LO
Assistant Legal Adviser 7

Ms Maisie LAM
Senior Council Secretary (2) 5

Ms Sandy HAU
Legislative Assistant (2) 5

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I. Meeting with the Law Society of Hong Kong and the Administration
[LC Paper No. CB(2) 1417 /11-12(01)]

The Bills Committee deliberated (index of proceedings attached at **Annex**).

2. At the invitation of the Chairman, Senior Assistant Solicitor General ("SASG") briefed members on the professional indemnity insurance requirements on a limited liability partnership ("LLP") in 11 overseas jurisdictions, including, where available, information on the difference in the requirements as between an LLP and a general partnership, details of which were set out in the Administration's paper (LC Paper No. CB(2)1417/11-12(01)). Specifically, in Singapore, the professional

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indemnity insurance requirement is SG\$4 million per claim for an LLP and SG\$1 million per claim for a general partnership. In the United Kingdom, the professional indemnity insurance requirement is £3 million per claim for an LLP and £2 million per claim for a general partnership. Based on the information on the 11 jurisdictions studied, it appeared that specific or additional professional indemnity insurance requirements were generally imposed on LLPs over general partnerships.

3. Mr Allan LEUNG of The Law Society of Hong Kong ("LS") said that as confirmed with The Law Society of Manitoba, there was no difference in the professional indemnity insurance requirements between an LLP and a general partnership in Manitoba. While noting that there were specific requirements for LLPs in the seven jurisdictions studied, i.e. Alberta, California, Malaysia, Manitoba, Nova Scotia, Ontario and Texas, Mr LEUNG said that it was not clear from the Administration's paper whether there were lower professional indemnity insurance for general partnerships in these overseas jurisdictions.

4. SASG replied that the reason why the Administration did not mention about the professional indemnity insurance requirements for general partnerships in Alberta, California, Malaysia, Manitoba, Nova Scotia, Ontario and Texas in its paper to the Bills Committee was because there was no readily available information on such. Due to time constraint, the Administration was unable to verify with the authorities concerned in these seven overseas jurisdictions whether professional indemnity insurance requirements for general partnerships were different from those for LLPs.

5. The Chairman said that the reason for requesting the Administration to provide information on the professional insurance requirements on LLPs versus general partnerships in overseas jurisdictions was to facilitate the Bills Committee consideration on whether imposing an additional professional indemnity insurance requirements for LLPs was an option which could be pursued to protect consumer interests if the clawback period was less than six years.

6. The Chairman pointed out that the Administration considered it necessary to have a clawback provision in the Bill to protect consumer interest, as the proposed section 7AI did not prohibit distribution of partnership property and that it was entirely the LLP's decision and judgement whether or not it should make a distribution to its partners where it had (a) a remote obligation; (b) a frivolous and vexatious claim against it and/or (c) a claim, the amount that was out of proportion to the anticipated liability. To address the concern raised by LS that the clawback provision had an unlimited time period, the Administration proposed a clawback

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period of two years from the date the claimant discovered the distribution made or could with reasonable diligence have discovered it. LS disagreed with this proposal on the ground that the clawback provision would be uncertain. Hence, the Administration further proposed a clawback period of six years from the date of distribution. LS considered a six years' clawback period unreasonably burdensome and as such most solicitors' firms would choose not to operate as LLPs. LS also considered that the lack of a clawback period would not undermine consumer interest, as there was sufficient compensation for consumers under the Professional Indemnity Scheme of LS and there was sufficient protection against dissipation of the assets of LLPs under the Bankruptcy Ordinance (Cap. 6). Further, the general remedy of Mareva injunction would apply should there be any risk of dissipation of the assets of LLPs. Should a clawback provision be put in place, the clawback period should be set at two years from the date of distribution.

7. Mr David HIRSCH of LS said that although LS did not support the six years' clawback period proposed by the Administration, LS was considering the suggestion raised by the Bills Committee at its last meeting of increasing the existing statutory indemnity limit of HK\$10 million per claim or any other options to make the Bill workable from the standpoint of LS and acceptable to the Administration. Mr HIRSCH further said that although additional professional indemnity insurance requirements were imposed on LLPs over general partnerships in Singapore and the United Kingdom, it should be pointed out that the LLPs of these two jurisdictions run on a corporate model and had full liability shield, whereas the LLP proposed in the Bill was a partnership model and LLP partners would continue to be held liable for ordinary debts of the business, i.e. partial liability shield, such as rent and salaries.

8. SASG pointed out that different jurisdictions had different provisions in their LLP legislation in order to strike a proper balance between protection of innocent partners and consumers. For instance, although the LLPs in Canada were run on a partnership model, many of their LLP legislation prohibited distribution of partnership property in breach of the solvency tests (unlike the Bill which did not prohibit a distribution from being made), and in many cases, such as in the province of Manitoba, a partner who authorized the distribution in breach of the solvency tests would be held personally liable for the amount distributed if the amount could not be recovered from the partner who received the distribution. Under the Bill, only the recipient partner (but not the partners authorizing the distribution) would be held liable for a distribution made in breach of the solvency tests. SASG further said that as the Bill allowed LLPs to have the autonomy to distribute partnership property, it was necessary to provide appropriate checks and

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balances against irresponsible distribution for consumer protection purposes. Accordingly a clawback provision was proposed in the Bill. In arriving at a six years' clawback period, reference was made to the Limitation Ordinance (Cap. 347) where any actions to recover any sum recoverable by virtue of any Ordinance, other than a penalty or forfeiture or sum of penalty or forfeiture, should be made within six years from the date on which the cause of action accrued.

9. SASG further said that although the Administration considered a six years' clawback period appropriate to strike a proper balance between protection of innocent partners and consumers, it was open to any suggestion by the Bills Committee on this issue in order that the Bill could be passed by the Council before the expiry of the current legislative term. However, the Administration would not accept the LS' proposal of shortening the clawback period to two years from the date of distribution as it usually took more than two years for a client to obtain a first instance judgement on his/her claim for negligence against a law firm before he/she was in a position to enforce the judgement debt.

10. Mr LAU Kong-wah asked LS whether it would accept a clawback period longer than two years.

11. Mr David HIRSCH responded that the reason why the majority of members of LS would only accept a two years' clawback period was that most of the overseas jurisdictions which had clawback in their LLP legislation only had a two years' clawback period, and in one or two overseas jurisdictions the clawback period was three to four years. Moreover, many overseas jurisdictions did not have any clawback provision in their LLP legislation and none of the overseas jurisdictions had a six years' clawback provision in their LLP legislation. Mr HIRSCH further said that in consideration of what safeguard should be provided in the Bill to protect consumer interest, it should be noted that consumers in Hong Kong were no different from those in other places. Apart from safeguarding the interests of consumers, it was equally important to achieve the objective of the Bill which was to help legal profession to grow in Hong Kong for the benefits of Hong Kong.

12. The Chairman said that the six years' clawback period was illusionary, as partners of LLPs could avoid returning the distribution received if the partners could prove that they had exercised reasonable assessment when making the distribution as proposed by the Administration in its draft Committee Stage amendments ("CSAs") to the Bill (i.e. the proposed new section 7AI(1A)). The Chairman urged the Administration to consider LS' proposal of providing clear bases to determine whether a distribution could

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be made as set out in paragraph 12 of its submission to the Bills Committee (LC Paper No. CB(2)1311/11-12(01)).

13. SASG said that the new section 7AI(1A) proposed by the Administration stipulated that a person who received the distribution as described in subsection (1) was not liable for clawback "if the person proves that -

- (a) immediately before making the distribution, the LLP made a reasonable assessment that the financial position of the partnership would not be as described in subsection (1) immediately after the distribution;
- (b) the partnership arrived at the assessment after exercising reasonable diligence and based on information obtained for the purpose of the assessment or otherwise available at the time of the assessment; and
- (c) at the time of the distribution the person did not have, or (if the person is an assignee of a partner's share in the partnership) neither the person nor that partner had, any reason to doubt the correctness of that assessment."

In LS' submission to the Bills Committee dated 29 June 2011 (LC Paper No. 2263/10-11(01)), it asked to amend the proposed new section 7AI(1A) by -

- (a) deleting the words "the person proves that";
- (b) amending paragraph (a) to read "immediately before making the distribution, the LLP made an assessment that the financial position of the partnership would not be described as subsection (1) immediately after the distribution on the basis of the following criteria:
 - (i) financial statements prepared on the basis of accounting practices and principles that were reasonable in the circumstances; or
 - (ii) a fair valuation; or
 - (iii) any other method that was reasonable in the circumstances; and
- (c) deleting paragraphs (b) and (c).

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14. SASG further said that the reason why the Administration did not accept LS' proposed amendments to the proposed new section 7AI(1A) as set out in paragraph 13 above was because it would have the effect of stripping the courts of their ability to make a ruling based on the facts of the specific case concerned. In the Administration's view, the courts should be allowed to make a ruling based on all relevant circumstances of the specific case concerned.

15. Mr David HIRSCH clarified that it was not LS' intention to strip the courts of their ability to make a ruling of whether partners of an LLP should return the distribution received on a clawback action by a client. The reason for adding the criteria in justifying the distribution, which was modelled on the Manitoba LLP legislation, was to add certainty and predictability to the clawback provision so that an LLP would know how to ensure compliance with the provision.

16. SASG welcomed the LS' clarification. The Administration would consider adding, as examples of materials that an LLP might put forward to the court in justifying the distribution, the three criteria proposed by LS, referred to in paragraph 13 above, under the proposed new section 7AI(1A)(b). SASG stressed that the court must not be confined to those as the only materials that the court might consider.

17. Mr David HIRSCH said that although LS agreed that the courts should be the gatekeeper as to whether a distribution made was or was not in breach of the solvency tests, the courts should not second guess the partners of an LLP if these partners had based on one of the three criteria mentioned above in making the distribution.

18. The Chairman said that although the courts would be the gatekeeper on the defence provision under LS' proposal, the fact that the courts could not second guess the partners of an LLP if they had based on one of the criteria set out in the proposal to make a distribution would in effect limit the ability of the courts to make a ruling of the case concerned.

Conclusion

19. Mr LAU Kong-wah urged the Administration and LS to expeditiously come up with a mutually acceptable clawback period, lest the Bill could not be passed in the current legislative term. As members had indicated at its previous meetings that they did not support a two years' clawback period, Mr LAU said that LS must come up with new argument(s) to justify its proposal of a two years' clawback period if it wished the Bills Committee to change its mind to supporting a two years' clawback period.

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20. The Chairman said that as the Bills Committee had already spent a long time hearing all of the arguments from the Administration and LS on the Bill and as adequate time must be set aside to scrutinize the revised draft CSAs if a consensus could be reached between the two sides on the clawback and defence provisions, the Bills Committee should decide at its next meeting whether the Bills Committee should cease its work if no such consensus could be reached by then.

21. Mr LAU Kwong-wah said that although he would not insist on a six years' clawback period as this was not acceptable to LS, he would support the Chairman's suggestion for the Bills Committee to cease its scrutiny work if no consensus could be reached between the Administration and LS on the clawback and defence provisions at its next meeting.

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22. The Chairman requested the Administration to provide the following paper for the next meeting -

- (a) an overall description of the Administration's current proposal on clawing back distributions made by an LLP to its partners by reference to (i) prohibitions against distributions; (ii) the six-year clawback period; and (iii) the proposed defence under the proposed new section 7AI(1A) of the Administration's latest draft CSAs; and
- (b) comparison of the defence provision proposed by the Administration and LS and the defence provision adopted by the Manitoba LLP legislation.

LS

The Chairman further requested LS to respond to the above paper provided by the Administration prior to the next meeting.

II. Date of next meeting

23. The Chairman said that the next meeting had been scheduled for 27 March 2012 at 8:30 am.

24. There being no other business, the meeting ended at 10:00 am.

**Proceedings of the meeting of the
Bills Committee on Legal Practitioners (Amendment) Bill 2010
on Monday, 19 March 2012, at 8:30 am
in Conference Room 3 of the Legislative Council Complex**

Time marker	Speaker	Subject	Action required
000000 - 000621	Chairman	Opening remarks	
000622 - 001300	Admin Chairman	Briefing by the Administration on the professional indemnity insurance requirements on an limited liability partnership ("LLP") in 11 overseas jurisdictions, including, where available, information on the difference in the requirements as between an LLP and a general partnership (LC Paper No. CB(2)1417/11-12(01))	
001301 - 001639	Chairman The Law Society of Hong Kong ("LS") Admin	Whether there were lower professional indemnity insurance for general partnerships in the seven overseas jurisdictions studied where there were specific requirements for LLPs	
001640 - 002523	Chairman Mr LAU Kong-wah	Chairman's recap on the reason for requesting the Administration to provide information on the professional insurance requirements on LLPs versus general partnerships in overseas jurisdictions and the views of the Administration and LS on the issue of clawback period raised at previous meetings	
002524 - 002901	LS Chairman	LS's latest stances on the six years' clawback period proposed by the Administration and the suggestion raised by the Bills Committee at its last meeting of increasing the existing statutory indemnity limit of \$10 million per claim	
002902 - 003604	Mr LAU Kong-wah Admin Chairman	The Administration's stance on the LS's proposal of shortening the clawback period to two years from the date of distribution	
003605 - 004537	Chairman	The Chairman's recap on members' views on the issue of clawback period raised at previous meetings	
004538 - 005004	Mr LAU Kong-wah Chairman LS	Whether LS would accept a clawback period longer than two years	
005005 - 005408	Chairman	The Chairman's view that the six years' clawback period proposed by the Administration was illusionary and the Administration should consider LS's proposal of providing clear bases to determine whether a distribution could be made	
005409 - 010340	Admin Chairman	The Administration's explanation why it did not accept LS' proposed amendments to the proposed new section 7AI(1A)	
010341 - 010644	Chairman Admin	The defence provision adopted by the Manitoba LLP legislation	

Time marker	Speaker	Subject	Action required
010645 - 010904	Chairman LS Admin	Discussions on whether LS' proposal might strip the courts' ability to make a ruling of whether partners of an LLP should return a distribution received in a clawback action by the client	
010905 - 011058	Chairman	The Administration was requested to provide a comparison of the defence provisions proposed by the Administration and LS and the defence provision adopted by the Manitoba LLP legislation and LS was requested to respond to the paper prior to the next meeting	Admin (para. 22 of the minutes refers)
011059 - 011710	Chairman Admin Mr LAU Kong-wah LS	Discussion on LS's proposal of adding the criteria in justifying the distribution which was modelled on the Manitoba LLP legislation	
011711 - 011947	Chairman	The Administration was requested to provide an overall description of the Administration's current proposal on clawing back distributions made by an LLP to its partners by reference to (i) prohibitions against distributions; (ii) the 6 year clawback period; and (iii) the proposed defence under s 7AI(1A) of the Administration's latest draft CSAs	Admin (para. 22 of the minutes refers)
011948 - 012138	Mr LAU Kong-wah Chairman	Mr LAU Kong-wah's view that the Administration and LS should expeditiously come up with a mutually acceptable clawback period; and LS must come up with new argument(s) to justify its proposal of a two years' clawback period if it wished the Bills Committee to change its mind to supporting a two years' clawback period	
012139 - 012547	Chairman	The Chairman's suggestion that the Bills Committee should decide at its next meeting whether it should cease its scrutiny work if no consensus could be reached between the Administration and LS on the clawback and defence provisions by then	
012548 - 012823	Mr LAU Kong-wah Chairman	Mr LAU Kong-wah's concurrence to the suggestion of the Chairman, albeit that he would not insist on a six years' clawback period as this was not acceptable to LS	
012824 - 012938	Chairman Mr LAU Kong-wah Admin	Date of next meeting	