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LAW SOCIETY
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From the President

Our Ref. : PRES/FA/737187-1

23 February 2012

Mr. Frank Poon,
Solicitor General,
Department of Justice,
4th Floor, High Block,
Queensway Government Offices,
66 Queensway, Hong Kong.

Dear Frank,

Re : Legal Practitioners (Amendment) Bill 2010

Thank you for taking the time to attend our Members' Forum on 13 February 2012. The purpose of the Forum was to update our members on the status of the proposed LLP legislation and to seek members' views on the way forward.

Members have been provided with background reading materials before the Forum as well as additional slides and materials on LLPs at the Forum. In addition to hearing from the Law Society's Working Party, our members have also had the opportunity to hear from you as representative of the Department of Justice and Ms. Margaret Ng of the Legislature on the key issues arising from the proposed legislation during the Forum.

As you are aware, a survey was conducted at the end of the Forum. The results of the survey show that about 95% of those who completed the survey do not support the LLP model as currently proposed by the Administration, but if the 6-year claw back is shortened, 71% are prepared to support it. In response to a question on the appropriate claw back period, 62% accept a 2-year period.

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From the President

23 February 2012

Mr. Frank Poon
Solicitor General
Department of Justice

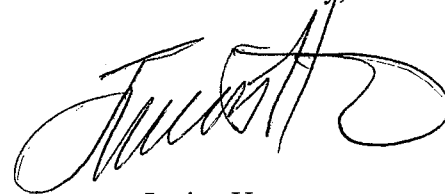
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Members' views illustrated in the findings of the survey are very clear. The overwhelming majority do not support the current LLP proposal unless the claw back is reduced to 2 years. The Law Society as a representative body of solicitors thus is not in a position to support the Bill as currently drafted and amended by the latest CSAs with respect to the claw back provisions. I will not repeat our submissions in relation to the impracticality and unfairness of the claw back provision, but by way of update, you may note that the Malaysian LLP Act has just been gazetted. There is a claw back provision in section 22, but it relates only to a winding up situation. The partner who receives a distribution when the LLP is insolvent is liable to return the distribution if it is received within two years before the commencement of winding up of the LLP. This adds to the long list of overseas LLP legislations that rely only on the general insolvency law to protect creditors (comparison chart attached).

At the Forum, you kindly explained the Administration's proposal on a notification requirement to replace the "designated partner" provisions. We await to see the incorporation of the proposal in the Bill before we can comment further on it.

Accordingly, we maintain the position as set out in our latest submission dated 29 June 2011 (copy attached) and I would be grateful if the Administration could reconsider the claw back provisions.

Yours sincerely,



Junius Ho
President

Encl.

c.c. Bills Committee on Legal Practitioners (Amendment) Bill 2010

Comparison on claw back provisions in LLP Legislation of overseas jurisdictions

	Jurisdiction	Provisions prohibiting distribution of partnership property	Partner is liable to the partnership for the wrongful distribution	Defence / objective bases for determining if distributions are prohibited	Limitation period applying specifically to LLPs
I. Canada					
1	Alberta (partial shield)	None	-	-	-
2.	British Columbia (full shield)	Yes	Yes	No	2 years from date of distribution
3	Manitoba (partial shield)	Yes	Yes	Yes	2 years from the date of distribution
4	Nova Scotia (partial shield)	Yes	Yes	Yes	2 years from the date of distribution
5	Ontario (full shield)	None	-	-	-
6	Saskatchewan (full shield)	Yes	Yes	Yes	-
II. United States Partnership statutes generally do not include restrictions on partnership distributions. Only the following states are excepted :					
7	Arizona	Yes (but to the extent that the distribution is a transfer fraudulent to creditors in breach of fraudulent transfer statute)	-	-	-
8.	California	Yes	Yes	No	4 years from the date of distribution
9.	Colorado	Yes	Yes but only if he knew at the time of distribution that it violated the relevant section	No	3 years from the date of distribution
10	Delaware	Yes	Yes but only if he knew at the time of distribution that it violated the relevant section	No	3 years from the date of distribution
11	North Dakota	Yes	Yes	Yes	2 years from the date of distribution
12	Oregon	Yes	Yes	Yes	2 years from the date of distribution

Note: There is no provision restricting partnership distributions in the New York LLP legislation. UK, Singapore and Malaysia adopt the corporate LLP model which apply the general company law on insolvency and winding up.

Submission on the Legal Practitioners (Amendment) Bill 2010 and the Committee Stage Amendments to the Bill

The Law Society is not in a position to support the Legal Practitioners (Amendment) Bill 2010 (“Bill”) as amended by the currently drafted Committee Stage Amendments.

Objectives

1. The Law Society’s aim in proposing the introduction of limited liability partnerships (“LLPs”) for solicitors is to make available to its members an additional choice of a mode of practice that:
 - (a) allows Hong Kong to catch up with the global trend as most jurisdictions including international financial centres like New York, London and Singapore have all adopted LLPs;
 - (b) addresses the unfairness to law firm partners who have to shoulder personal liability even in cases where they are not at fault;
 - (c) combines the features of limited liability to be offered by solicitor corporations and the culture of operating in a partnership that has traditionally been treasured by the profession;
 - (d) offers an attractive form of business organisation to those solicitors who wish to expand their operation by forming a larger partnership with partners who possess expertise in different practice areas thereby:
 - (i) facilitating a diversification of the scope of practice areas and legal services on offer in the same firm to meet the different needs of a client;
 - (ii) cultivating the concept of a one-stop shop making available a wide range of services for consumers’ convenience;
 - (iii) expanding the scale of operation leading to an economy of scale that benefits both the law firms and the consumers; and
 - (e) is simple and straightforward to implement.
2. LLPs are not intended to create new “privileges” to solicitors. Being a common mode of operation around the world, the introduction of LLPs is intended as a minor innovation to ensure that Hong Kong, being an international financial centre, is keeping itself abreast with the global modernisation of the law and the legal infrastructure.

Pace

3. The Law Society completed the LLP proposal in 2004. The issue was brought to the attention of the Panel on Administration of Justice and Legal Services of the Legislative Council in June 2004.
4. Meetings were held among stakeholders and research studies were carried out. In June 2005, the Law Society was given assurances by the then Solicitor General that the Administration had given priority to the preparation of a paper for the Policy Group to consider the LLP proposal. Suddenly, in March 2006, the Administration informed the Law Society that no further work would be carried out in respect of LLPs for the remaining term of the Chief Executive (until the end of June 2007).
5. The Law Society raised the LLP issue at its meeting with the Secretary for Justice in April 2007. The Administration resumed discussion with the Law Society in August 2008.
6. Since 2008, there were numerous exchanges between the Law Society with the Administration.
7. Finally, the Administration gazetted the Legal Practitioners (Amendment) Bill 2010 in June 2010.
8. Seven years have elapsed since the Law Society submitted its proposal in 2004. Nearly a decade of precious time has been lost for the legal profession in Hong Kong to catch up with the global development and the process is still not completed.

Major Modifications

Initial proposal - 2004

9. The salient features of the Law Society's initial LLP proposal were as follows:
 - (a) It operates in the form of a partnership.
 - (b) It is a full shield model, that is, all partners of an LLP are protected from all personal liability subject to the proviso that a partner is responsible for his own negligence.
 - (c) A partner is not required to indemnify the firm or other partners in respect of debts or obligations of the LLP for which a partner is not liable under the full shield model.
 - (d) The name of an LLP must include "LLP" or "Limited Liability Partnership".

- (e) This new form of practice should apply to everyone by way of a new Limited Liability Partnership Ordinance, a draft of which was prepared by the Law Society.

No stand alone Ordinance

- 10. In November 2008, the then Solicitor General proposed to implement the proposal by amending the Legal Practitioners Ordinance as it was the Administration's proposal to restrict the application to solicitors' firms only.
- 11. To avoid further delay, the Law Society agreed and urged the Administration to proceed with the drafting work quickly.

No full shield

- 12. A major modification by the Administration of the Law Society's initial proposal is to change it from a full shield model to a partial shield model, that is, partners are only protected from personal liability in relation to liabilities arising from negligent or wrongful acts or omissions only. This effectively means that the partners of an LLP will still be jointly and severally liable for the operational cost of the business of a law firm.
- 13. For ease of reference, the following major jurisdictions do offer a full shield model:
 - (a) New York, US;
 - (b) Ontario and British Columbia, Canada;
 - (c) UK (corporate model);
 - (d) Singapore (corporate model) ;
 - (e) India (corporate model).
- 14. Limited liability of solicitor partners on the operational cost of the business of a law firm has never been a cause of concern as law firms may carry out the necessary administrative functions in connection with the running of the practice through service companies.
- 15. The introduction of LLPs is a convenient opportunity to simplify the artificial structure of routing the engagement of administrative services through service companies. No useful purpose is served by requiring LLPs to artificially complicate their structure at additional cost to form service companies to achieve the same result.
- 16. It complicates the operation of law firms by forcing them to incur extra cost and administrative work, and yet the extra burden imposed on law firms does not result in any added protection to consumers. The Law Society finds the absurdity of insisting on such a lose-lose outcome incomprehensible.

17. The Law Society has spent considerable time in explaining its viewpoints to the Administration. It has also made previous submissions to the Panel on Administration of Justice and Legal Services on this issue. However, as currently drafted, the Bill only affords LLP protection to liabilities arising from negligent or wrongful acts or omission.

Allocation of liability to innocent partners

18. One of the objectives of the introduction of LLPs is to address the unfairness to law firm partners who have to shoulder personal liability even in cases where they are not at fault.
19. The issue of supervision was discussed back in 2008. The Administration was concerned that partners would avoid supervision in order to escape personal liability. It then proposed a default rule whereby all partners were required to share liability equally if no partner was found to be negligent.
20. The Law Society took the view that the proposed default rule distorted the basic objective of the law of tort which was to identify the responsible party and allocate responsibility accordingly. It created a perverse disincentive against seeking to identify the partner who was properly responsible.
21. In response, the Law Society objected to the proposed default rule and made its position clear - whether a partner is negligent in a case is a matter for the court to decide based on the particular facts of the case and any default rule attempting to allocate responsibility automatically in the absence of any proof of negligence is not acceptable.
22. The Administration subsequently proposed to include a constructive knowledge provision whereby a partner would lose LLP protection if he ought reasonably to have known of the default at the time of its occurrence and failed to exercise reasonable diligence to prevent its occurrence.
23. Such a proposal sparked off another lengthy discussion between the Law Society and the Administration.
24. The Law Society has explained at length that there was absolutely no cause for concern that partners in an LLP would abandon proper supervision. Even if there was such a concern, which the Law Society submitted was an unnecessary concern, expressly legislating on the attachment of liability to constructive knowledge would not resolve the issue.
25. It would simply invite claimants to adopt a catch-all approach by easily relying on such an express provision to include all partners as defendants on the basis that being partners in the same firm, they all ought to have known of the default. This defeated the purpose of the introduction of limited liability partnerships. Innocent partners would unreasonably and unnecessarily be dragged into negligence claims.

26. To address the Administration's concern that partners might deliberately avoid personal liability by not getting involved in the supervision at all, the Law Society proposed that LLPs be required in the Conduct Guide to inform their clients of the name and status of the person responsible for the conduct of the matter on a day-to-day basis; the partner responsible for the overall supervision of the matter and any subsequent changes.
27. The Administration insisted on imposing the notice requirement in the legislation providing for the loss of LLP protection for the firm in respect of that matter should the LLP fail to issue the written notice, unless the client knew who the responsible partner was prior to the default and within 30 days from the firm's acceptance of instructions in respect of that matter.
28. The Law Society objected to the suggested sanction. Providing for the stripping of a firm's LLP status (albeit only in respect of a particular matter) on the basis of a failure to comply with a mere formality of issuing a written notice renders the LLP status a sham.
29. In late May 2011, to the surprise of the Law Society, the Administration introduced by way of committee stage amendments, one further drastic distortion of the LLP model.
30. A new section was included to provide that the limitation on liability does not apply to the partner designated in the notice. This means that the supervising partner will automatically lose the entitlement to LLP protection even though he may be innocent and in the absence of any proof of negligence on his part. If so, it would have the unintended consequence of creating a general partnership between the designated partner and the negligent partner within the LLP. This is conceptually problematic.
31. This is akin to a regime imposing a "scapegoat" partner for each client matter with unlimited legal liability. This harsh approach is unprecedented as it is tantamount to imposing strict liability on the designated partner concerned.

Clawback of a distribution of partnership property

32. The Law Society understands the concern that consumers will be exposed to the risk of not being sufficiently compensated in a claim as a result of the exclusion of the personal assets of the innocent partners in an LLP.
33. However, this concern is greatly exaggerated. As stated in a previous submission, from 1994/95 indemnity year to July 2009, only 1.6% of the claims on the Fund have sought HK\$10 million or more and out of these claims, only one claim was brought by an individual who was paid HK\$10 million (including defence cost but less the indemnified's deductible).
34. Rarely does a claimant have to resort to the personal assets of the culpable partner, let alone the partnership assets because the statutory indemnity limit of HK\$10 million is already sufficient to settle the claim amount of an individual claimant.

35. On the basis of the claims history, the operation in the form of an LLP or a general partnership does not make much real practical difference with respect to the sufficiency of indemnity protection to consumers.
36. Looking at LLP provisions around the world, claw back provisions are uncommon.
37. Most other major jurisdictions like UK, Singapore or New York simply rely on the general insolvency or fraudulent transfers provisions that apply to all business organisations including LLPs.
38. The Law Society has submitted before and it reiterates its position that on the premise that consumers will not be disadvantaged, Hong Kong should be in line with most other jurisdictions in designing its LLP legislation so that it can truly achieve the objective of enhancing Hong Kong's competitiveness through a modernisation of its legal infrastructure that is comparable to other jurisdictions. Consumers will not be disadvantaged without clawback because:
 - (a) the mandatory Professional Indemnity Scheme has proven to be sufficient protection based on past claims experience;
 - (b) the Bankruptcy Ordinance will apply to claw back assets that should not have been transferred out in the event that the firm becomes insolvent and the partners are bankrupt;
 - (c) the general remedy of Mareva injunction will apply should there be any risk of dissipation of the firm's assets.
39. The committee stage amendments proposing to include a 6-year limit for a claimant to enforce a liability for a claw back and a defence to a partner who received a distribution based on a "reasonable assessment" that the distribution would not result in the distribution being "wrongful" did not address the Law Society's concern over uncertainty and unpredictability at all.
40. The Law Society's suggestion of adopting more specific objective criteria as in some Canadian provisions were not adopted. As currently drafted, neither practitioners nor the public will be able to know for certain what will be accepted as having satisfied the "reasonable assessment" test. The question of uncertainty and unpredictability still remains unresolved. As such, the "reasonable assessment" test is unworkable in the absence of defined criteria and would unnecessarily complicate even the routine distributions in the form of partnership drawings.

Sufficient safeguards

41. The Law Society is fully conscious of the importance of consumer protection. It takes the view that the existing safeguards in the proposed LLP framework are already sufficient:

- (a) The name of an LLP must include the words “Limited Liability Partnerships” or abbreviation “LLP” or “L.L.P.” so that the public know that the firm operates with limited liability;
 - (b) The name must be displayed visibly and legibly at or outside its offices and on its office documents;
 - (c) An LLP must notify its existing clients in writing within 30 days of the fact that it has become an LLP;
 - (d) The written notice to its existing clients by an LLP, the form of which is to be specified by the Law Society, must include a statement stating how liabilities of partners of a law firm are affected by the law firm becoming an LLP;
 - (e) An LLP must give 7-day advance notice of its particulars to the Law Society;
 - (f) The Law Society must keep a list of LLPs for public inspection free of charge.
42. On top of the above requirements, consumers are effectively protected with a statutory professional indemnity scheme which provides indemnity cover of a limit of HK\$10 million per claim as well as any top up indemnity insurance taken up by individual law firms.
43. In a negligence claim, a claimant will normally first sue against the firm and at this level, the claimant is already covered by the statutory professional indemnity limit of \$10 million plus top up insurance cover, if any.
44. The Law Society is of the strong view that all these safeguards have balanced the need to give adequate protection to consumers and to allow the modernisation of the legal infrastructure which has been moving at a snail pace to proceed at the speed it deserves to catch up with the global trend.
45. The LLP status of a firm and the effect on the liabilities of partners are made fully transparent to consumers to ensure that they can make an informed choice as to whether to engage the services of an LLP.

Final product unacceptable

46. However, the series of imposed modifications to the LLP model has distorted the Law Society’s initial LLP proposal to a point where the LLP structure no longer achieves the objectives for which it was initially introduced. This alternative mode of practice no longer serves as an additional choice because it has become wholly unattractive to the legal profession.

47. Unless the Committee Stage Amendments are revised as set out in paragraph 48, the Law Society will not render its support for the Bill and it will advise its members of its position accordingly.

48. The Law Society takes the view that with respect to the Committee Stage Amendments, the following should be revised:

- (a) Take out all proposed amendments in relation to the regulation of liability of the “designated partner”.

This will translate into the deletion of new section 7AC (2A) and new section 7AGA(1) in their entirety and of the proposed amendment to sections 7AC(2) and 7AL(2).

- (b) Take out all proposed amendments in relation to the notice requirement of the “designated partner” which is tied in with the regulation of liability of such a partner.

This will translate into the deletion of new section 7AGA(2) to (10). As a consequential amendment to the deletion, the reference to section 7AGA in section 7AH should also be deleted.

- (c) Redraft a simple provision requiring an LLP to notify clients of the name of the supervising partner for every matter and any subsequent change.

- (d) Delete the proposed amendment to section 7AC(2B) as it is a restatement of the law and wholly unnecessary.

- (e) Delete section 7AI in its entirety unless the following amendments are made:

- (i) Delete “will be” in section 7AI(1)(a) because the assessment of the ability of the partnership to repay its partnership obligations as they become due should be current and hence only present tense “is” should be used.

- (ii) Amend section 7AI(1A) by deleting the last four words in the preamble “the person proves that” and by amending subsection (a) as follows:

“immediately before making the distribution, the limited liability partnership made an assessment that the financial position of the partnership would not be as described in subsection (1) immediately after the distribution on the basis of:

- (a) financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;*
- (b) a fair valuation; or*

- (c) *any other method that is reasonable in the circumstances.”*
- (iii) Delete section 7AI(1A)(b) and (c) as they will not be necessary if section 7AI(1A)(a) is amended as above.
- (iv) Change “6 years” to “2 years” in section 7AI(6).

The Law Society of Hong Kong
29 June 2011