

## **LIMITED LIABILITY PARTNERSHIP**

### **Report of the Working Party on Limited Liability Partnership (the "Working Party") of the Law Society**

#### **TERMS OF REFERENCE OF THE WORKING PARTY:**

- (1) to consider the desirability and feasibility of permitting Hong Kong solicitors to practise as limited liability partnerships;
- (2) to consider the relevance of the Limited Partnerships Ordinance (Cap 37 of the Laws of Hong Kong) to the mode of operation of solicitors' practice in Hong Kong;
- (3) if appropriate, to formulate in draft for approval of the Council, new rules and/or amendments to existing legislation to provide a framework for the operation of limited liability partnerships.

#### **1. INTRODUCTION**

- 1.1 A limited liability partnership offers an attractive form of business organisation for businesses that thrive as partnerships but which are concerned about the risk of partners having unlimited liability for the consequences of another partner's negligence.
- 1.2 This report considers the case for legislation that would allow Hong Kong solicitors and others to practise through LLPs. The report examines the issues relevant to the formulation of legislation and appraises different models of LLP. We believe that the case for LLPs is met and suggest the legislation that we consider appropriate for Hong Kong.

#### **2. WHY HONG KONG SHOULD CONSIDER LLPS**

##### **2.1 Partnerships: a successful business model**

The partnership has offered professional firms a mode of practice uniquely suited to the requirements of clients and the partners.

##### **2.2 LLPs can perpetuate partnership culture**

LLPs allow different forms of partnership models to exist without affecting other forms of partnership models. The expression partnership culture lauds the benefits of a successful partnership:

- the trust that comes from partners' duty of good faith towards each other
- willingness to share clients and resources
- common investment in developing the firm's business and its people
- sharing financial rewards.

Clients benefit from the bonds that come from a firm with strong partnership culture. LLPs can perpetuate partnership culture.

## 2.3 Consumer interests

One should not advocate the abrogation of partners' joint and several liability without thorough consideration of whether this is in the interests of consumers. We consider consumer protection in paragraph 5.

Numerous other jurisdictions have adopted legislation that allows LLPs, notably most states of the United States of America, Great Britain and Germany.

The LLPs in these jurisdictions take widely different forms. The common denominator of LLP legislation is that a lawyer who practises as a partner in an LLP is not personally liable for the consequences of the negligence of a fellow partner although he remains fully liable for his own negligence. As some other jurisdictions have already adopted this common denominator, Hong Kong is not unique in adopting it. Later we consider the extent to which it is reasonable and consistent with consumers' interests for the Hong Kong LLP to confer a broader shield against liability. We also offer views on whether it is reasonable and consistent with consumer interests for any business - professional or non-professional - to be able to operate through a Hong Kong LLP.

## 2.4 Competitive threat

For more than a decade Hong Kong law firms produced in excess of HK\$6 billion of GDP per annum (Annex 1). It is in Hong Kong's economic interests to keep professional partnerships on-shore and, if consumers' interests are adequately protected, facilitate their practice through LLPs. Professionals who can practise free of personal liability for the negligence of their partners are more likely to invest in the development and expansion of their businesses.

The Jersey LLP provides a cautionary tale. In the 1990s British accountants lobbied hard for LLPs, alarmed at their increasing exposure to negligence claims against auditors. The British government was slow to respond so the accountants offered Jersey the proposition that they might move their headquarters to Jersey if Jersey enacted LLP legislation. Jersey duly did so in 1996, seeing the LLP as a way of attracting offshore professionals to the island and enhancing its reputation as a financial centre<sup>1</sup>.

Jersey's initiative prompted the British government to act. In its deliberations on the LLP bill, the House of Commons Select Committee on Trade and Industry commented on the presence of LLP legislation in other jurisdictions: "By mid-1996, it was plain that the option of registration as a Jersey LLP was being seriously considered by a number of the very large professional partnerships. It was this prospect, combined with the perceived possibility that a successful mega-claim could in due course precipitate the failure of a major firm, that led to the November 1996 decision ... to bring forward LLP legislation in the UK. Whether Parliament and Ministers like it or not, what is in no doubt is the real possibility of British firms registering offshore; if Jersey statute proves unattractive there may well be other offshore options on offer"<sup>2</sup>. In 2000, Parliament enacted the Limited Liability Partnerships Act (LLPA 2000).

The Singapore government proposes to legislate to allow LLPs, which may not be unconnected with its plan to make Singapore a tax haven for international law firms. See Annex 2. Malaysia is considering the adoption of LLP legislation.

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<sup>1</sup> The UK Inland Revenue frustrated the accountants' plans. The Jersey LLP, like the UK LLP, has legal personality. The Jersey legislation, like the UK legislation, provides that the LLP will nonetheless be treated as a partnership for tax purposes. It remains open to foreign tax authorities to treat an LLP with legal personality as a company for tax purposes, with the adverse consequence of double taxation. The UK Inland Revenue's determination that it would treat the Jersey LLP like a company ended the accountants' thoughts of relocating their headquarters. The Big 4 accountants now operate their UK businesses through English LLPs.

<sup>2</sup> As reported in Geoffrey Morse, Paul Davies, Ian F. Fletcher, David Milman, Richard Morris, David A Bennett Palmer's *Limited Liability Partnership Law* (London Sweet & Maxwell 2002) at 7.

It is important that Hong Kong react to these competitive threats. If Hong Kong-based international firms move their transactional practices to other financial centres in Asia, Hong Kong will cease to be the region's leading provider of legal services.

## **2.5 Demand**

The Enron collapse and the ensuing Arthur Andersen debacle have made partners more conscious of their business risks. The world has grown more litigious. Professional people are no longer content to be personally liable for claims against their firms that emanate from others' negligence. Hong Kong should modernise its law to allow LLPs.

## **3. WHY HONG KONG SOLICITORS NEED LLPs IN ADDITION TO SOLICITOR CORPORATIONS**

### **3.1 General**

It is true that solicitor corporations offer limitation on professionals' liability. However, the Solicitor Corporations Rules do not offer the right solution for Hong Kong law firms.

In England, law firms and audit firms were able to operate through limited companies before the LLPA 2000: law firms from 1988 and audit firms from 1991. However, few did so. It was generally agreed that the disadvantages of practising through a company outweighed the goal of limited liability. Not many Hong Kong audit firms have chosen to incorporate

As professional partnerships are owner-managed businesses, the partnership structure has - but for the liability exposure - been ideal for them. The partnership has no legal personality of its own: it is the relationship that subsists between the owner-managers who carry on the business with a view to profit. The corporate structure, by contrast, is ideal for investors who do not run the business. The company has a legal personality of its own, with rights and obligations distinct from those of its investors (whether they are shareholders or creditors) and its directors.

These fundamental differences are at the root of the disadvantages of a corporation for professional firms.

### **3.2 Legislative burden on companies**

The relationship between a company and other parties is regulated by extensive legislation intended to uphold the appropriate balance between their interests. By contrast, the law on partnerships is simple and allows partners a great deal of flexibility. The legislative burden of incorporation would be unattractive to professional partnerships.

### **3.3 Companies' financial reporting obligations**

A company is a vehicle designed for an infinite number of shareholders<sup>3</sup> who are free to sell their investment to others and are not expected to be intimate with the company's business. A company is also able to undertake liability without recourse to its shareholders. It follows that its shareholders and the public have statutory rights to certain information about the company, notably its accounts. Many professional partnerships would find the loss of privacy too high a price to pay for limiting their liability.

### **3.4 Companies do not engender a partnership culture**

While a company has extensive obligations to other parties, the shareholders' common interest in the company does not impose fiduciary duties among them nor require them to act in good faith towards each other<sup>4</sup>. Professional firms, whatever their size, value the ethos that is reinforced by partners' mutual duty of good faith. Partners who share knowledge, collaborate

<sup>3</sup> Section 29 of the Companies Ordinance provides that a company must be "public" if it has more than 50 shareholders.

<sup>4</sup> Subject to common law concerning the behaviour of a majority of shareholders.

on client work and pool their resulting profits feel that clients benefit from the partnership ethos. Professional partnerships would be deterred from incorporating for fear that they would lose the partnership culture inherent in partners' mutual duty of good faith.

Because of this partnership culture, it is important for a professional firm to be able to remove a partner with unsatisfactory performance from the legal firm. However, in case of a corporation, it is more difficult to remove a shareholder and director without his agreement.

Partners want to be "partners", not directors or employees, both in the sense of how they define their relationship with each other and so as to encourage a relationship of trust with their clients.

It has been argued that practising through a company offers protection to all lawyers, even the negligent lawyer. The English case law in this area<sup>5</sup> shows that a director of a company can be personally liable to a third party if he or she "assumes responsibility" towards the third party and the third party relied on the director's assumption of liability and was reasonable in doing so. The House of Lords said that these principles applied to determine the personal liability in tort of any agent acting on behalf of a principal with a separate legal identity, so they do not only apply to directors<sup>6</sup>. It may be that if these principles applied in Hong Kong, a lawyer practising as a partner of an LLP without separate legal identity might be more readily found to have assumed personal responsibility towards a client than a lawyer practising as a director or employee of a company<sup>7</sup>.

We suggest that such a conclusion would not cause a law firm to prefer a corporate structure to conversion to an LLP. Lawyers are accustomed to taking personal responsibility for their advice. The personal touch is an important element of the relationship of trust that they seek to establish with their clients. Lawyers are attracted to LLPs to shield them from liability for the negligence of their partners, not from the consequences of their own negligence.

### 3.5 **Company: no continuity**

The "conversion" of a law firm to a corporate structure requires a transfer of its assets and liabilities to a new company, typically newly incorporated by the partners. The transfer requires the assignment of leases, the negotiation of new bank facilities, the novation of other contracts and a time-consuming process. The new company would need a memorandum and articles of association instead of a partnership agreement. Partners would generally want the company's constitution to reflect the partnership agreement but because the company is a fundamentally different vehicle, a match will be impossible. The transfer would typically require partners to transfer their capital and current accounts to the company and be followed by the dissolution of the law firm.

By contrast, it would be a straightforward matter for a law firm to "convert" into the model of LLP that we recommend. Conversion would be effected by agreement among the partners. The law firm would preserve its continuity in every respect.

### 3.6 **Company: extra taxation**

It makes little difference to the tax treatment of domestic professional firms with no outside participation and which operate exclusively in Hong Kong if they practise through a company rather than an LLP. There is, however, a slightly higher rate of corporation tax than the corresponding income tax rate.

<sup>5</sup> *Williams v. Natural Life Health Foods Ltd.* [1998] 1 WLR 280.

<sup>6</sup> The *Williams* case was cited in and applied by Deputy High Court Judge Muttrie in *Yazhou Travel Investment Co. Ltd v. David Geoffrey Allan Bateson and Others* [2004] HKCU LEXIS 60; [2004] 103 HKCU 1.

<sup>7</sup> The discussion paper of the Standing Committee on Company Law Reform (document 174-1) suggests that a Hong Kong company offers total protection to a negligent lawyer: this is doubted.

If the company has shareholders (formally partners) resident outside Hong Kong this will generally be disadvantageous. Those partners will be subject to their own country's income tax liability on any undistributed profits, as well as suffering the economic cost of the Hong Kong profits tax paid by the company. They will be effectively subject to double taxation on the company's income<sup>8</sup>. The partnership's "conversion" into a company could trigger capital gains tax on the transfer of the foreign partners' interests in the partnership into shares in the company. The company could be liable to foreign corporation tax on its branch profits. Only Hong Kong resident partners, on becoming shareholders, would be largely unaffected: there is no Hong Kong capital gains tax charge, and any dividend they receive from a company paying Hong Kong profits tax is not chargeable to Hong Kong tax in the hands of the shareholders.

### 3.7 **LLP v. company: conclusion**

Solicitor corporations have a number of features which will lead law firms to eschew them as, in the UK, law firms eschewed limited companies. Solicitor corporations are therefore unlikely to assuage lawyers' interest in LLPs. Lawyers will seek a model of LLP that preserves the simplicity, flexibility and privacy of partnerships and with which professional firms, their clients and their creditors are familiar.

## 4. **MODELS OF LLP**

### 4.1 **Criteria for the perfect LLP**

#### 4.1.1 From a partner's point of view, the perfect LLP is one which:

- protects him from personal liability for the acts and omissions of other partners everywhere the firm operates
- is familiar, in the sense that the firm's partnership culture flourishes and the firm's legal structure, management structure and partnership agreement are not significantly disturbed
- preserves the privacy of a partnership
- is treated like a partnership for tax purposes everywhere the firm operates, with no tax costs on conversion
- makes conversion easy, not requiring the transfer of the partnership's business (and therefore its contracts) to a new entity.

Applying these criteria, there is no such thing as the perfect LLP.

#### 4.1.2 From a law-maker's perspective, the ideal LLP is one which:

- without jeopardising consumer interests, enables businesses that are important to the economic life of the jurisdiction to practise through an on-shore vehicle that meets their needs; and
- is simple to legislate for.

#### 4.1.3 Most law-makers have chosen a partnership model of LLP. We too advocate the partnership model of LLP for reasons stated later.

### 4.2 **Partnership model of LLP**

The partnership model of LLP is one which grafts on to existing partnership law. Partnership law in common law jurisdictions is generally codified on legislation based on the English

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<sup>8</sup> This is not just an "international law firm" issue: many Hong Kong firms have branches in the PRC, Bangkok, etc.

Partnership Act 1890. Legislation that creates a partnership model of LLP does so by amending the existing partnership legislation. The amending legislation covers:

- who may form an LLP
- how to form an LLP
- the requirement for public registration of an LLP
- the scope of a partner's liability shield.

The legislation may but need not include:

- the domestic legitimacy and registration of foreign LLPs
- the requirement that the LLP buy a certain level of insurance.

The relevant legislation can be concise (as in Ontario) or, despite the straightforwardness of the matters covered, wordy (as in New York).

LLP legislation in the United States and Canada is based on the partnership model<sup>9</sup>. Some of New York's major law firms have been slow to convert but most of them are now LLPs. Most of Ontario's law firms have become LLPs, including all the large firms.

#### 4.3 Corporate model of LLP

The corporate model of LLP is one which is grafted on to legislation on companies.

The English LLP is a body corporate established by the LLPA 2000. With only 25 pages the LLPA 2000 is easily read. This is because it relies on extensive statutory instruments. Most of the regulations are in Statutory Instrument 2001 No. 1090: the Limited Liability Partnership Regulations 2001 (LLPR 2001) <http://www.legislation.hmso.gov.uk/si/si2001/2011090.htm>. These regulations run to 118 pages.

The LLPR 2001 applies provisions of the Companies Act 1985, the Company Directors Disqualification Act 1986, the Insolvency Act 1986, and the Financial Services and Markets Act 2000 to LLPs with modifications specified in schedules. The regulations also make detailed amendments to 187 statutes so that they apply to LLPs, from the Bills of Sale Act (1877) Amendment Act 1882 to the Contracts (Rights of Third Parties) Act 1999.

The effect of the regulations' application of this legislation to LLPs cannot be understood without cross-reference to the legislation itself. Tolley's has published a book which, in 600 pages, shows how the Companies Act 1985, the Company Directors Disqualification Act 1986 and the Insolvency Act 1986 apply to LLPs<sup>10</sup>.

Additionally, the regulations apply to LLPs 24 statutory instruments made under the Companies Act 1985, the Insolvency Act 1986 and other legislation.

Other statutory instruments have been published since the LLPR 2001<sup>11</sup>.

<sup>9</sup> The Jersey LLP, which has legal personality, derives from discrete legislation, the Limited Liability Partnerships (Jersey Law) 1997. Jersey does not have legislation equivalent to the Partnerships Act 1890. The Jersey legislation draws on the customary law concerning *contrats de sociétés*. For this reason, we do not regard it as a helpful model for Hong Kong. Nor do we believe that civil law countries' LLPs, such as the German LLP, provide a helpful model.

<sup>10</sup> Tolley's Limited Liability Partnerships, The New Legislation by Douglas Armour, published by Tolley in 2001

<sup>11</sup> An uncontroversial fees order, SI2002 No. 503, and an order to apply to LLPs some 2002 company legislation allowing members of an LLP to apply to the Secretary of State for their residential address to be removed from the public register. The Secretary of State will only grant the application if satisfied that residents would otherwise be subject to violence or intimidation <http://www.hmso.gov.uk/si/si2002/20020913.htm>

Subsequent regulations on LLPs will arise on any amendment to the Companies Act 1985 and the Insolvency Act 1986 framework on which they depend.

The regulations are incomplete. There will, for instance, be further regulations on overseas LLPs.

No other common law jurisdiction has adopted the corporate model of LLP.

Only about 90, mostly smaller, UK law firms have become LLPs<sup>12</sup>. The other UK law firms have been deterred from conversion by the extensive requirements of the legislation as well as the features that make the English LLP so different from a partnership.

#### 4.4 Legal personality?

4.4.1 A corporate model of LLP has legal personality. It does not follow that a partnership model of LLP does not have legal personality. Some partnership models of LLP have aspects of legal personality.

4.4.2 The question of whether an LLP has legal personality may not matter domestically where there will be law about how to sue a partnership, who is liable for the firm's negligence and who pays tax on partnership profits. However the question of whether an LLP has legal personality can be important to a court or tax authority from another jurisdiction. For example:

- a foreign court considering whether a claim against a New York LLP under the foreign law is properly made against the LLP or its partners might disregard the New York law limitation on the partners' liability if it concludes that the New York LLP is not an entity
- a foreign tax authority considering how to characterise the profits of a branch within its jurisdiction might treat them like company profits potentially giving rise to double tax (a risk for an English LLP because it is a body corporate).

4.4.3 We considered whether, if Hong Kong were to adopt a partnership-style LLP, there was a case for providing that the Hong Kong LLP have legal personality.

This might have the advantage of persuading a court considering a foreign law claim against the LLP that the LLP, having legal personality, is contractually responsible for the claim to the exclusion of its partners.

It might have the disadvantage that the LLP, having legal personality, would be taxed on its profits (like a company) as well as its partners (like shareholders). The Hong Kong legislature could provide that domestically the LLP is treated like a partnership for tax purposes (i.e. the partnership is taxed through its partners, so that the partners' income is taxed only once) but such legislation might be disregarded by a tax authority in a foreign jurisdiction where the LLP has a branch. In that case the LLP and its partners could be subject to all the tax disadvantages of a corporate structure as were mentioned in paragraph 3.6.

A further disadvantage of conferring legal personality on an LLP is that the legislation for LLPs would be much more complicated.

4.4.4 In coming to our conclusions we drew on the recently published report of the English and Scottish Law Commissions on the law on general partnerships<sup>13</sup>. The extensive report - it runs to 500 pages - included a bill comprehensively to replace the English Partnership Act 1890 and the Limited Partnership Act 1907. It should be noted that the report did not deal with the English LLP which, by virtue of the LLPA 2000, has legal personality.

<sup>12</sup> Limited Liability: A Question of Protection by Bob Sherwood in the Financial Times, 26 April 2004.

<sup>13</sup> Law Com No. 283 and Scot Law Com No. 192

One of the Law Commissions' most far-reaching proposals was that the English partnership have legal personality, as the Scottish partnership does. The Law Commissions thought this proposal would helpfully modernise partnership law. For example a partnership's legal personality would give legislators the chance to assert a partnership's continuity of existence on a change of partner<sup>14</sup>. Such a change would also enable a partnership to hold property and enter contracts.

The Law Commissions took the view that a partnership's legal personality was incompatible with each partner being the agent of each other, so their bill makes each partner an agent of the firm instead<sup>15</sup>. They said that a partnership's legal personality was consistent, however, with partners continuing to have joint and several liability for the partnership's debts and obligations, as they do in Scotland.

4.4.5 While it was tempting to suggest that the Hong Kong LLP have legal personality to help partners defend claims under foreign law, we concluded not to make such a recommendation for the following reasons.

- The Hong Kong legislature might want to consider such a proposal only in the context of a review of the law on general partnerships enshrined in the Partnership Ordinance.
- The Hong Kong legislature would note that the changes to the Partnership Act 1890 that the Law Commissions recommend are far-reaching (not least because of the proposal that the general partnership have legal personality) and may never be enacted.
- Amendments to the Partnership Ordinance to provide for an LLP with legal personality would be much more complicated.
- A Hong Kong LLP that might be taxed like a company on its foreign profits would be unattractive to Hong Kong businesses with significant branches outside the jurisdiction.

#### 4.5 Partnership model v. corporate model

We recommend a partnership model of LLP for Hong Kong. Here we draw our reasoning together by measuring each of the partnership model and the corporate model against our criteria for the perfect LLP.

4.5.1 ***First criterion: protection of partners from personal liability for the acts and omissions of other partners.***

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<sup>14</sup> There is some doubt about the continuity of a Scottish partnership on a change of partner, despite it having legal personality. In England, partnership, seen as a relationship between individuals or as a contract between individuals, ceases when the identity of the partners changes. The same is true in Hong Kong. Even an agreement in advance that partners will continue to practise in partnership on the retirement of one of their number does not prevent the partnership which practises the day after retirement from being a different partnership from that in business on the previous day: *Hadlee v. Commissioners of Inland Revenue* [1989] 2 NZLR 447, 455 per Eichelbaum J.

<sup>15</sup> The UK Inland Revenue suggested that the partners' mutual agency was the justification for taxing partners on their partnership income and to the exclusion of taxing the partnership. The Law Commissions therefore accepted the UK Inland Revenue's offer to support the introduction of tax legislation to provide that a general partnership with legal personality be treated for tax purposes in the same way as English and Scottish partnerships are currently treated. The LLPA 2000 similarly provides that an English LLP, despite being a body corporate, is treated for tax purposes like an English general partnership. The Law Commissions' report indirectly recognised that such legislation could not determine a foreign tax authority's treatment of an English partnership with legal personality. As mentioned, one of the problems with the English LLP is that foreign tax authorities may tax it as if it were a company.



### *Hong Kong law*

A Hong Kong LLP based on the partnership model and without legal personality would, through an amendment to the Partnership Ordinance, shield a partner from personal liability for the consequences of another partner's negligence. A Hong Kong LLP based on the corporate model would mean that the LLP, as a legal person, was contractually responsible for its negligence to the exclusion of the partners. The law might leave the claimant able to establish that the negligent partner is liable for his negligence in tort<sup>16</sup>.

Under Hong Kong law, the non-negligent partner would be free of personal liability whether or not the LLP follows the partnership or corporate model. This might not be so if the law governing the LLP's breach of contract is foreign.

### *Foreign law*

If an LLP faces a claim under foreign law, the liability of the LLP and its partners will be determined by reference to the foreign law's doctrines on conflicts and these vary from jurisdiction to jurisdiction. In some jurisdictions the court will never have considered the liability of an LLP established elsewhere. Accordingly there may be uncertainty about the doctrine that the court would apply to a Hong Kong LLP sued under foreign law.

- Some jurisdictions that have adopted the partnership model of LLP - New York and Ontario for example - provide in their statutes that under certain conditions, the local court will apply the law of the jurisdiction in which the LLP was established to determine whether one of its partners should be liable to the claimant.
- Some jurisdictions will take the same approach on the basis of their own doctrines on conflicts of law, rather than because of statutory provision on foreign LLPs.
- Some jurisdictions will determine the question by assimilating the Hong Kong LLP to a local entity.
- Other jurisdictions, as mentioned in paragraph 4.4, might disregard Hong Kong law's limitation on partners' liability if the court determines that the Hong Kong LLP is not an entity under Hong Kong law. In that case the foreign law governing the LLP's contract with the client would attach responsibility for the breach to all the partners, whether they were negligent or not.

Overall, the corporate model of LLP is a surer shield for non-negligent Hong Kong partners facing claims under foreign law.

There remains a question, though, of whether the Hong Kong court would enforce a foreign court's judgment that the non-negligent partners are liable for the Hong Kong LLP's breach of contract.

#### **4.5.2 *Second criterion: familiarity***

Our second criterion for the perfect LLP was whether it would allow the partnership culture to flourish; and would the LLP be a familiar form of business, in the sense that conversion would not significantly disturb the firm's legal structure, management structure or partnership agreement? Partnerships are a successful business model. It is better for Hong Kong if the chosen model of LLP preserves the ingredients of their success.

The corporate model of LLP is very different from a Hong Kong general partnership, not least because the Hong Kong LLP would be a new legal person defined by legislation based on company legislation. We have argued that companies, subject to sophisticated legislation, are ideal for investors who do not run the business in question. Company legislation would appear unduly demanding and complicated for an owner-managed partnership. Bob

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<sup>16</sup> See paragraph 3.4 for a discussion of the relevant law.

Sherwood, writing about the English LLP in the Financial Times recently, said: "Many solicitors have been wary that becoming a corporate-style LLP as the legislation demands, would mean a fundamental shift in the ethos of partnership that is central to law firms. Martin Ellis, director of Alexander Forbes, the professional indemnity insurer, believes many law firms are afraid the switch would damage the "family approach" of law firms where all partners are "in it together". Senior managers at law firms may also be wary that they will inherit a fiduciary duty similar to that of a corporate executive"<sup>17</sup>.

The corporate model of LLP creates a legal person with rights and obligations of its own in relation to third parties and partners. Partners would become agents of the LLP and not of each other, undermining the collegiality that flows from the partners' mutual fiduciary duties. The partnership agreement would have to accommodate the existence of the LLP and acknowledge the new legal relationships that it establishes.

The partnership model of LLP preserves the existing partnership and partner relationships and requires no changes to the firm's operation.

#### 4.5.3 *Third criterion: privacy*

Partnerships value the fact that they can keep the firm's affairs confidential. Law-makers would want to ensure that consumers know what they are dealing with by at least requiring the LLP to demonstrate to third parties that the partners' liability is limited. Law-makers will tend to have different requirements for a partnership model of LLP compared with a corporate model.

Laws constituting partnership models of LLP require the LLP to demonstrate that partners' liability is limited by using the suffix "limited liability partnership" or "LLP" with the firm name and through some form of registration.

The corporate model of LLP is subject to the same requirements but also to onerous filing obligations based on the law of companies. Commentators have suggested that one of the reasons UK firms have been slow to take up limited liability is because the legislation on the UK LLP - a body corporate - requires the LLP and its partners to file the partners' names and addresses and annual accounts, including the total remuneration paid to the partners and the remuneration of the highest paid partner.

#### 4.5.4 *Fourth criterion: tax treatment*

Partners will want the LLP to be treated like a partnership for tax purposes.

The partnership model of LLP should not change partners' tax treatment.

The corporate model of Hong Kong LLP would create an entity which, but for specific legislation, would prima facie be taxable in its own right with partners being liable to tax on their profits as well. We assume that the Hong Kong legislature would follow the precedent set by the UK and say that notwithstanding the LLP's structure as a body corporate, its partners are to be taxed as if the body corporate were a partnership. This would mean the corporate model of Hong Kong LLP would not change partners' Hong Kong tax treatment.

The tax treatment of an LLP in a foreign jurisdiction depends upon the rules in that foreign jurisdiction, but foreign tax authorities are more likely to treat an LLP which is a body corporate as a company in contrast to a partnership model, with all the possible adverse consequences for partners resident outside Hong Kong as were discussed in paragraph 3.6:

- double tax
- capital gains tax on conversion

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<sup>17</sup> Limited Liability: A Question of Protection, Financial Times of 26 April 2004

- foreign corporation tax on branch profits.

The corporate model of LLP is therefore unlikely to be attractive to partnerships with operations outside Hong Kong.

#### 4.5.5 *Fifth criterion: easy conversion*

The partnership model of LLP perpetuates the partnership. The partnership achieves limited liability simply by agreement amongst the partners or registering as an LLP. The regulators of law firms would typically require the firm to tell clients that the firm has become an LLP. Conversion is therefore straightforward.

If the LLP is a body corporate, conversion requires partners to establish the new LLP, transfer the partnership business, assets and liabilities to the new LLP and wind up the operations conducted through the former partnership. The process will be time consuming and require a careful examination of the firm's contracts to see whether they may be assigned and whether novation should be sought.

#### 4.5.6 *Sixth criterion: simple legislation*

It is in the public interest that the LLP legislation be as simple as is consistent with public interest.

In paragraphs 4.2 and 4.3 we describe the legislation that creates partnership and corporate models of LLP, using the English LLP as our example of the latter. The partnership model of LLP is simple to legislate for; the corporate model of LLP requires complex legislation.

Also, it is simpler to adopt a LLP model as compared to a limited liability corporate model.

#### 4.5.7 *Seventh criterion: preservation of consumer interests*

Law-makers will want to create a form of LLP that, without jeopardising consumer interests, enables businesses that are important to the economic life of Hong Kong to practise in a Hong Kong-based vehicle that meets their needs.

If the legislators are satisfied that consumer interests are appropriately addressed by either model of LLP, they are likely to sponsor a model that enjoys the most support from partnerships that would like to limit the liability of non-negligent partners.

We consider that, balancing the judgments on the criteria for a perfect LLP, partnerships will be more likely to support the partnership model than the corporate model.

All criteria

Judged by these criteria, the partnership model of LLP is the better model for Hong Kong. It prevails over the corporate model in all but one (i.e. the first) of the seven criteria.

#### 4.6 **Full or partial liability shield?**

The earlier statutes creating common law partnership models of LLP in the US generally only protect partners from liability for claims arising from other partners' negligence or other malpractice. All partners remain jointly and severally liable for other partnership debts, obligations and liabilities. The Ontario LLP follows this model.

More recent common law partnership models of US LLP protect partners from all personal liability, subject to the proviso that a partner is responsible for his or her own negligence or other malpractice or that of a person under his or her direct supervision and control. The New York LLP follows this model.

The corporate model of LLP offers a full liability shield but may leave a partner exposed to personal liability for his own negligence.

We suggest that the justification of a full or partial liability shield be tested by reference to whether consumers retain adequate remedies against the firm.

#### **4.7 Different models of LLP**

We conclude this analysis of different models of LLP with a reference to Annex 3. Annex 3 summarises the differences among two forms of partnership model - Ontario and New York - and the English corporate model, indicating with a plus and minus sign the pros and cons of each. Later we discuss fine-tuning a partnership model of LLP for Hong Kong by reference to New York and Ontario legislation.

### **5. CONSUMER INTERESTS**

#### **5.1 Balancing the interests**

Those who want to undertake business with joint and several liability for the acts and omissions of their partners cannot be allowed to limit their liability unless the interests of those with whom they do business are adequately protected.

Hitherto Hong Kong has required certain professionals to carry on business with unlimited liability.

New rules allowing solicitors to practise through solicitor corporations suggest that Hong Kong has satisfied itself that a limitation on liability of solicitors is consistent with consumer interests.

In this section, we state why we believe allowing professionals to practise through LLPs can give adequate protection to the interests of those with whom they do business. We then touch on whether non-professionals should be allowed to practise through LLPs.

#### **5.2 Motivation**

Professional people will be no less motivated to meet the standards their clients require of them if they practise through an LLP. A partner's negligence could result in the ruin of the firm and all partners losing their capital and goodwill in the firm. The negligent partner could be bankrupted by a personal suit and therefore unable to practise.

A partnership model of LLP would leave the negligent partner with contractual and tortious liability for his own negligence. Not only does it protect the clients but the innocent partners. A corporate model would protect the negligent partner from contractual liability but leave him exposed to a claim in tort.

#### **5.3 Insurance and capital**

A firm will therefore be no less motivated to sustain its business as a going concern and buy appropriate levels of insurance if it becomes an LLP.

Professional regulators may set their own requirements for a firm's professional indemnity insurance and there is no reason why such requirements should be any different for an LLP.

- Some of the earlier LLP statutes enacted in the United States required an LLP to have insurance or an escrow account to cover liabilities as to which partners do not have personal responsibility. More recent US LLP statutes typically do not mandate insurance, but instead leave insurance issues to the statutes governing the relevant practitioners<sup>18</sup>.
- The Ontario legislation on LLPs says the professional body governing the relevant LLP must establish minimum insurance requirements. The Law Society of Upper

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<sup>18</sup> Limited Liability Partnerships and Limited Liability Limited Partnerships by J. William Callison Esq.

Canada does not require a lawyer practising through an LLP to have more than the CAN\$1 million cover that is the minimum for all lawyers.

- Jersey requires that its LLPs maintain £5 million in escrow to meet debts arising on its dissolution.
- The English LLPA does not require an LLP to buy insurance, leaving such matters to those who regulate the partners of the LLP.

Caron Wishart of the Lawyers' Professional Indemnity Company in Ontario confirms that the company's claims portfolio has not changed since the introduction of LLPs, nor have LLPs had an impact on the types or size of claims.

It seems unnecessary for Hong Kong legislation on LLPs to require a certain level of asset backing, either through specifying levels of insurance cover or capital contributions from partners. Those who deal with an LLP - or a partnership - are at liberty to make enquiries about the adequacy of the firm's assets and, if they are not satisfied, to deal with competitors or require greater protection. An LLP could respond by buying more insurance or agreeing that partners will be personally responsible for a particular transaction, for example by guaranteeing the firm's bank borrowings.

#### 5.4 Professional regulation

Professional regulators would retain responsibility for setting standards of conduct, investigating allegations of misconduct and applying penalties for breach of their rules.

Professional regulators are likely to have to adapt their rules to accommodate LLPs. The Law Society of England and Wales has made detailed rules for this purpose, drawing from its rules for incorporated practice. The new rules are therefore somewhat complicated but do not change the substance of the regulations governing solicitors in general partnership. The Law Society of Upper Canada has made simple changes to its by-laws to accommodate Ontario's partnership model of LLPs. These are shown in Annex 4.

#### 5.5 Disclosure

Those who deal with the LLP will know that partners' liability is limited because of the LLP suffix to the firm's name.

Good business practice would lead a firm to publicise its conversion among those with whom it does business. Professional regulators may require that the firm inform its clients of its conversion<sup>19</sup>.

#### 5.6 Pre-conversion liability

A firm's conversion to an LLP will not affect partners' responsibility for the acts and omissions of the firm and its partners before conversion.

#### 5.7 Liquidation

A Hong Kong partnership model of LLP would be dissolved under the Partnership Ordinance (as appropriately amended). The current legislation gives third parties priority over partners' claims to the firm's assets. Partners may therefore have to forfeit their undistributed profits and capital if the firm's assets are insufficient to pay the firm's creditors<sup>20</sup>.

The UK's corporate model of LLP enables partners to claim amounts that the firm owes them alongside third parties' claims to be paid. The UK LLP is not subject to rules on maintenance of capital of the kind that applies to a company but partners can be subject to rules which

<sup>19</sup> As in Ontario. See Annex 4 for the Law Society of Upper Canada's sample disclosure letter.

<sup>20</sup> Section 46 of the Partnership Ordinance

allow the liquidator to claw back property, including partnership profits, which a partner has withdrawn from the LLP in the two years before an insolvent liquidation. These powers are additional to those that arise from UK company legislation relating to "wrongful trading", which are absent from Hong Kong company legislation.

#### **5.8 Negotiated protection**

Banks, landlords and other suppliers of an LLP are free to insist that partners concede individual liability to them by contract.

The extent to which suppliers do so will depend on the model of LLP. Some partnership models of LLP only shield partners from liability for the negligence of other partners, so partners would remain jointly and severally liable to their suppliers.

Suppliers to LLPs which confer a broader shield may seek recourse against individual partners in the form of guarantees of specific obligations.

The legislation on New York LLPs allows partners by at least a majority to agree that their liability shield will not apply to a specific obligation.

#### **5.9 Conclusions: professional LLPs**

Anecdotal evidence from law firms that have become LLPs suggest that their standards remain as high, clients have not objected and the firms remain robust. For the reasons set out above, we suggest that allowing professional LLPs in Hong Kong - either partnership model or the corporate model - is not inconsistent with consumer interests.

#### **5.10 Should LLPs be for professionals only?**

Some states only allow professionals to practise through LLPs. The United States are divided on the issue with more recent LLP statutes tending to allow any business to practise through an LLP.

Canadian LLPs are only available to professionals.

The UK LLP is available to any trade, profession or occupation. We suggest that if Hong Kong agrees to adopt LLPs, there is no reason why this should only be available to professionals but this is a public policy matter for government. The LLP could offer a useful model of practice for all businesses and entrepreneurs. In the UK the great majority of the 5,000 LLPs registered are for trading activities such as marketing, joint ventures, property development and agricultural cooperatives, rather than for professional partnerships<sup>21</sup>.

We see no reason to reserve the LLP to professionals. The public is accustomed to dealing with businesses with limited liability. Hong Kong law would give customers of non-professional LLPs remedies against the LLP in contract and against a partner culpable of negligence or otherwise. Regulators and trade associations might require and enforce special standards of conduct through, for example, industry regulation of an LLP that is an insurance broker or trade regulation of an LLP that fits gas appliances.

### **6. A NEW LLP FOR HONG KONG: THE ONTARIO CUM NEW YORK MODEL**

We believe that the model of LLP that would best suit Hong Kong would be the Ontario model with the full liability shield conferred by the New York model. We call this the Ontario cum New York model.

The Ontario cum New York model would fulfil our criteria in the following ways.

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<sup>21</sup> Per Legal Week, 11 December 2003.

**6.1 First criterion: protection of partners from personal liability for the acts and omissions of other partners**

The Ontario cum New York model would protect partners from all personal liability, subject to the proviso that a partner is responsible for his or her own negligence.

Some US jurisdictions, including New York, add a proviso that a partner is responsible for the negligence or other malpractice of the person under his or her direct supervision and control. The statutes do not define "direct supervision and control" and the expression creates uncertainty<sup>22</sup>. We do not believe this second proviso is necessary. Common law would generally attach fault to a partner with ostensible responsibility for negligent advice whether the partner actually gave the negligent advice or not, subject to the usual conditions that establish whether the partner is liable in tort.

The "cum New York" feature of the model we propose is that, subject to the proviso that a partner is responsible for his or her own negligence, partners are protected from all personal liability. This contrasts with the Ontario model, which only protects partners from the consequences of other partners' negligence.

The imperfection of the partnership model is that partners might be vulnerable to claims against their assets under non-Hong Kong law, as described in paragraph 4.5.1. In paragraph 4.4 we discussed whether we should propose a Hong Kong partnership model of LLP that would have legal personality in order to help partners resist such claims. We concluded that we should resist this temptation for the reasons set out in paragraph 4.4.5. The vulnerability of a Hong Kong partner's assets in these circumstances depends on whether the Hong Kong court would enforce the foreign court's judgment that he or she is liable in damages. We believe that, for most Hong Kong law firms, this shortcoming is worth living with.

- It is not a concern for law firms that advise only under Hong Kong law and the law of jurisdictions which would respect Hong Kong law's limitation on partners' liability.
- While the corporate model of LLP should provide a surer shield against claims under non-Hong Kong law, its disadvantages outweigh this advantage. As judged by the remaining criteria, the Ontario cum New York model is superior.

**6.2 Second criterion: familiarity**

The Ontario Partnerships Act is a close descendent of the English Partnership Act 1890 and therefore closely resembles the Partnership Ordinance.

An LLP based on the Ontario cum New York model would offer a familiar entity that would allow the partnership culture to flourish and need not significantly disturb the firm's legal structure, management structure or partnership agreement.

A converting firm would want to review its partnership agreement and, in the light of the partners' limited liability, amend provisions relating to:

- partners' liability for losses: it should follow from the LLP status that partners do not expect their liability to exceed their share of partnership assets, including capital
- a negligent partner's right to indemnity
- the obligation of other partners to contribute if a partner has a right to indemnity.

<sup>22</sup> As discussed, for example, in *Limited Liability Partnerships & Limited Liability Limited Partnership* by J. William Callison.

**6.3 Third criterion: privacy**

The Ontario cum New York LLP would have to register under the Business Registration Ordinance. The firm would be able to keep its affairs confidential.

**6.4 Fourth criterion: tax treatment**

The Ontario cum New York model of LLP should be treated like a partnership for tax purposes wherever the firm operates.

**6.5 Fifth criterion: straightforward conversion**

The Ontario cum New York model of LLP would achieve conversion by agreement among the partners.

**6.6 Sixth criterion: simple legislation**

The legislation for the Ontario cum New York model of LLP would require simple amendments to the Partnership Ordinance<sup>23</sup>. We suggest the amendments in Annex 5. The Law society might wish to make minor amendments to the rules of the Law Society<sup>24</sup>.

**6.7 Seventh criterion: preservation of consumer interests**

We suggest that the framework within which the Ontario cum New York model of LLP would operate in Hong Kong appropriately addresses consumer interests.

**7. CONCLUSIONS**

We conclude that it is in Hong Kong's interests to change the Partnership Ordinance to allow a new form of practice: the limited liability partnership.

We believe that the LLP should be available to all but leave government to judge whether only professionals should be able to practise through LLPs.

Having surveyed different legislative frameworks for the Hong Kong LLP, we recommend a framework which requires few changes to the existing law and leaves professional regulators able to set their own standards of conduct.

**Members of the Working Party on Limited Liability Partnership:**

Denis Brock (Chairman)  
David Hirsch  
Andrew Jeffries  
Allan Leung  
Joseph Li  
Janice Chan (Secretary) (Assistant Director, Regulation and Guidance)

This paper is not legal advice. It may therefore not be construed as legal advice of any member of the working party or of the firms they come from.

<sup>23</sup> The changes would be much less extensive than those required to allow solicitor corporations because the latter have to accommodate practice through a new type of entity with its own legal personality (as would those relating to a corporate model LLP).

<sup>24</sup> E.g. confirm that solicitors may practise through LLPs and to cover notification of LLP status to clients.



## LIMITED LIABILITY PARTNERSHIP

### Report of the Working Party on Limited Liability Partnership

#### List of Annexures

1. Contribution to Hong Kong's GDP by Solicitors' Firms and Barristers Chambers
2. Singapore's plans to attract international professional services firms
3. Comparison of Ontario, New York and English LLPs
4. Law Society of Upper Canada: by-law for Ontario LLPs
5. Limited Liability Partnerships Ordinance (Draft) for Hong Kong
6. Ontario cum New York model: additional questions for legislature
- \*  
7. Partnerships Act, R.S.O. 1990 (marked up with amended provisions on LLP)
8. Bill 6 1998 (Ontario)
9. Section 26, Article 3, New York State Consolidated Laws on Partnership
10. Article 8-B, Registered Limited Liability Partnerships, New York State Consolidated Laws on Partnership
11. Section 12, Partnership Act, Alberta
12. Partnership Ordinance in Hong Kong (Cap. 38)
13. Limited Partnerships Ordinance (Cap. 37)

\* *Remarks: Annexures 7 to 13 are available on request*

# **Annexure 1**

# Annexure 1

## Value added contribution by establishments\* engaged in the provision of legal services in Hong Kong

	<u>Value added</u> (HK\$ Mn)	<u>% change</u> <u>over a year earlier</u>	<u>% contribution</u> <u>to GDP</u>
1990	4,754	4.3	0.8
1991	5,887	23.8	0.9
1992	5,914	0.5	0.8
1993	6,301	6.5	0.7
1994	8,361	32.7	0.9
1995	6,507	-22.2	0.6
1996	8,015	23.2	0.7
1997	9,583	19.6	0.8
1998	7,286	-24.0	0.6
1999	6,446	-11.5	0.5
2000	6,978	8.3	0.6
2001	6,597	-5.5	0.5
2002	6,522	-1.1	0.5

Notes : (\*) Establishments include solicitors and barristers firms in Hong Kong.

Source : GDP by economic activity

## **Annexure 2**

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## Annexure 2

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## In the News

**Launch of Expansion Incentive for Partnership tax incentive scheme and refinements to Regional Headquarters Award to boost Singapore's attractiveness as a regional business location**

DATE 31 Mar 2004

*Seven new International Headquarters Award recipients from manufacturing to emerging sectors such as food services and non-profit sectors attest to vibrancy of HQ environment in Singapore*

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\* [Headquarters Service](#)

1. Seven companies from a variety of sectors were presented with the International Headquarters (IHQ) award by the Singapore Economic Development Board (EDB) today. Minister of State for Trade & Industry and National Development, Dr Vivian Balakrishnan presented the IHQ award at a combined HQ ceremony to the recipients. The seven companies were BreadTalk Pte Ltd, Cuno Filtration Asia Pte Ltd, Emerson Process Management Asia Pacific Pte Ltd, Helen Keller International Asia Pacific, Informatics Holdings Ltd, Integra Holdings Private Limited and Mercury Marine Singapore Pte Ltd (see Annex B for company details). Together, these companies will generate an additional total business spending of \$140 million annually and employ some 1,200 skilled and professional workers when their business projects are fully implemented.
2. A strong base of professional services companies is also needed to complement the business activities of a vibrant and growing community of HQs. As part of EDB's concerted efforts to develop this industry, a new Expansion Incentive for Partnerships (EIP) programme for audit, accounting and law firms has been launched. This programme allows such firms, typically constituted as partnerships, to enjoy a 50% tax exemption on the qualifying overseas income above a pre-determined base. Previously, tax incentives were only available to manufacturing and services corporations. The EIP programme aims to encourage audit, accounting and law firms to use Singapore as their central business hub to develop their business and proficiencies locally and service the regional market from here.
3. EDB remains committed to developing Singapore as the foremost global business location and has put in place new measures for this. In the recent Budget 2004, it was announced that the Regional Headquarters (RHQ) award programme given out to smaller niche companies will be enhanced. The maximum duration of the RHQ scheme will be extended from a period of 3 to 5 years, allowing companies to enjoy a preferential tax rate of 15% for a longer period. The RHQ award criteria have also been broadened to allow all companies operating in Singapore to be eligible. These changes, together with the IHQ award programme, which is a customised incentive package for companies with substantial level of headquarters activities in Singapore, will allow EDB to cater to the business needs of a wider spectrum of HQs, big and small, local and foreign, from across industries.
4. In highlighting these new initiatives, Dr Vivian Balakrishnan said, "The new EIP Programme and the enhancements to the RHQ programme will strengthen Singapore's position as an international hub for HQ activities. These programmes, together with our excellent global connectivity, strong IP protection, legal and financial infrastructure will enhance our ability to better engage and service the more than 7,000 international companies that are based here. Singapore is the ideal location for companies to base their nerve centres in order to tap into the region's resources and to interact with other international and local businesses."
5. The diverse nature of these new HQ investments, from traditional areas of manufacturing excellence to new emerging areas such as food and non-profit sectors affirms Singapore's universal appeal as an attractive HQ location across industries. These seven companies join a growing base of companies who have located their global and regional HQs in Singapore and have made Singapore their decision-making centre to manage their businesses in the Asia-Pacific region and beyond. To date, there are over 4,000 multinational corporations with HQ operations in Singapore. Of these, EDB has granted 280 headquarters awards since the programme's inception in 1986.

- END -

For media enquiries, pls call Ms Sharon Ang, Marketing Communications at Tel: 6832 6087 (DID) 9005 4818 (HP) or email: [sharon\\_ang@edb.gov.sg](mailto:sharon_ang@edb.gov.sg)
 [Annex A - Quotes from Award Recipients](#)
 [Annex B - Company Profiles of Award Recipients](#)

[www.sedb.com/edbcorp/sg/en/uk/index/in\\_the\\_news/press\\_releases/2004/launch\\_of\\_expansion.html](http://www.sedb.com/edbcorp/sg/en/uk/index/in_the_news/press_releases/2004/launch_of_expansion.html)

# **Annexure 3**

**Comparison of Ontario LLP, New York LLP and English LLP**

	<b>Ontario LLP</b>	<b>Pro + Con -</b>	<b>New York LLP</b>	<b>Pro + Con -</b>	<b>English LLP</b>	<b>Pro + Con -</b>
<b>Legal personality</b>	No		No, but some aspects of personality		Yes	
<b>Tax</b>	Generally treated like a partnership for tax purposes	+	Generally treated like a partnership for tax purposes	+	Might be taxed like a company outside UK (extra tax)	-
<b>Legislation</b>	Based on partnership law	+	Based on partnership law	+	Based on company legislation (complex)	-
<b>Conversion process</b>	Agreement among partners	+	Registration as LLP (continuity)	+	Partners transfer business to newly incorporated LLP (transfer of assets and liabilities: time-consuming process; taxable transfer outside UK?)	-
<b>Publicity requirements</b>	Registration under Business Names Act 1998 No requirement for personal details or accounts Firm must show it is LLP, not partnership	+	Registration renewable every five years No requirement for personal details or accounts Firm must show it is LLP, not partnership	+	File names and addresses of partners, annual accounts and information about partners' remuneration Firm must show it is LLP, not partnership	-
<b>Liability shield</b>	Narrow and may not be recognised outside jurisdiction Partners only shielded from liability for others' malpractice	-	Broad but may not be recognised outside jurisdiction Negligent partner is responsible for own malpractice Partners can elect to waive liability shield	-	Broad Negligent partner may be liable in tort	+

**Comparison of Ontario LLP, New York LLP and English LLP**

<b>Use</b>	<b>For authorised professionals only</b>		<b>For authorised professionals only</b>		<b>For any trade, profession or occupation</b>	
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# **Annexure 4**

## Practising in Ontario

### Limited Liability Partnerships

#### The Governance Scheme

Amendments to the *Partnerships Act* in force in July 1998 permit professions to practice in the form of limited liability partnerships. Unlike a general partnership, where the partners are liable for debts and liabilities arising from the negligent acts of all partners, the partners in a limited liability partnership are not personally liable for the negligent acts of another partner or an employee who is directly supervised by another partner. However, the partnership assets continue to be at risk for the negligence of the partners and employees.

The *Partnerships Act* establishes the following requirements for professions wishing to practice as LLPs:

- \* the act governing the profession must expressly permit practice as an LLP;
- \* the partnership must register its firm name under the *Business Names Act*; and
- \* the professional governing body must establish minimum liability insurance requirements for the LLP.

The *Partnerships Statute Law Amendment Act, 1998 (Bill 6)* which amends the *Partnerships Act* respecting LLPs may be found at The Legislative Assembly of Ontario website at [www.onla.on.ca](http://www.onla.on.ca).

The *Law Society Act* permits lawyers to practice as limited liability partnerships. The registration of the business name of the firm as "LLP" is a requirement of the *Partnerships Act*. The final requirement of the minimum level of insurance for LLPs is in By-Law 26. By-Law 26 also requires lawyers to disclose to the clients of the LLP the nature of the limitation on the liability of the partners. The text of By-law 26 appears below, with relevant commentary.

#### BY-LAW 26

##### LIMITED LIABILITY PARTNERSHIPS

##### PROFESSIONAL LIABILITY INSURANCE

###### *Insurance requirements*

1. A limited liability partnership shall maintain professional liability insurance coverage for each partner in accordance with By-Law 16.

This section of the by-law establishes the minimum insurance required by a law firm practising as an LLP to be the coverage now maintained individually by each member who is a partner of the firm. This is currently in the amount of \$1,000,000 per member. Accordingly, the requirements in s. 44.2(b) of the *Partnerships Act* would be met by requiring the LLP to maintain the coverage that members who are partners maintain pursuant to By-Law 16 on Professional Liability Levies. Section 1 of the by-law focuses on the fact that the partners are essentially the partnership and that it is the partnership's obligation, in the language of the *Partnerships Act*, to ensure that the insurance at the member level is maintained for each partner to satisfy the requirement. The reference to By-Law 16, which requires all members practising law to pay the insurance levy for professional liability coverage, effectively links the scheme to the level of insurance currently carried by members individually. This provision, notwithstanding that for LLPs it is the partnership that is required to maintain the coverage for the partners, in no way operates to derogate from the obligation of members individually to comply with the requirements of By-Law 16 to pay the insurance levy.

##### DISCLOSURE

###### *Partnership continued as limited liability partnership*

2. (1) When a partnership is continued as a limited liability partnership, as soon as is reasonably practical after the continuance of the partnership as a limited liability partnership, the limited liability partnership shall disclose to each person who was a client immediately before the continuance and who remains a client after the continuance the liability of the partners of the limited liability partnership under the *Partnerships Act*.

(2) A limited liability partnership satisfies the disclosure requirement under subsection (1) if it publishes in a local newspaper notice of the matters set out in subsection (1).

(3) In subsection (2), "local newspaper" means any newspaper distributed in the area in which the limited liability partnership carries on business.

While disclosure of the fact that a firm is an LLP and the effect of the limitation of partners' liability is not a legislative requirement that must be enacted by a profession, the Law Society believes it is appropriate as a matter of professional responsibility that at a minimum, clients be told of the nature of the limited liability of the partners resulting from the new practice structure. Although public notice is effectively accomplished through the registration as an LLP under the *Business Names Act*, clients, within the general public, maintain unique relationships with law firms. Accordingly the by-law obliges lawyers to make the appropriate disclosure to clients at the time a firm continues as a LLP.

If a written form of notice to clients is to be sent, law firms are encouraged to design their own communications respecting the disclosure requirement and customize them as they see fit for their particular clients. To the extent that lawyers may find it useful, a sample letter, appearing below, may be considered an example of a communication on disclosure.

#### Sample Disclosure Letter for LLPs

Dear Client

Effective (date), the firm of --- has become a limited liability partnership, as permitted by amendments to the *Partnerships Act* and the *Law Society Act*. The firm is now known as --- LLP.

As the name suggests, the partnership carries on the practice of law with a degree of limited liability. The partners in a limited liability partnership are not personally liable for the negligent acts of another partner or an employee who is directly supervised by another partner. Each partner is personally liable for his or her own actions and for the actions of those he or she directly supervises and controls. The partnership continues to be liable for the negligence of its partners, associates and employees, and accordingly there is no reduction or limitation on the liability of the partnership. All of the firm's assets remain at risk.

Liability insurance protection for the members of the partnership continues, and minimum insurance requirements, as required by the *Partnerships Act*, have been established for LLPs by the Law Society. The Law Society has determined that the liability insurance coverage for an LLP is that maintained individually by the partners.

The limitation on liability is the only change to the partnership resulting from the legislative amendments and this change will not affect our firm's relationship with you as a client. We would be happy to answer any questions you have about our limited liability partnership.

Firms may also choose to publish a notice in a local newspaper as provided in subsection 2(2) of the by-law. Such notices should be complete and clear enough for clients to understand the nature of the limitation on the liability of the firm.

#### Taxation Issues

Law firms should consult with their tax advisors with respect to any tax consequences that may flow from continuance of a general partnership as an LLP, or any other matters that may impact on the firm because of the new practice structure.

# **Annexure 5**

## LIMITED LIABILITY PARTNERSHIPS

To establish limited liability partnerships.

[ ]

### 1. Short title

This Ordinance may be cited as the Limited Liability Partnerships Ordinance.

### 2. Interpretation

- (1) "foreign limited liability partnership" means a limited liability partnership formed under the laws of another jurisdiction.<sup>1</sup>
- (2) "limited liability partnership" means a partnership, other than a limited partnership, that is formed or continued as a limited liability partnership under section 8 or 9.<sup>2</sup>

### 3. Application

This Ordinance shall apply to partnerships carrying on business in Hong Kong.<sup>3</sup>

### 4. Constitution of limited liability partnerships

Limited liability partnerships may be formed in the manner and subject to the conditions by this Ordinance provided.<sup>4</sup>

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<sup>1</sup> See article "Limited Liability Partnerships & Limited Liability Limited Partnerships", J. William Callison, p.3 II(e)

<sup>2</sup> Bill 6, para.1

<sup>3</sup> s2, Limited Partnerships Ordinance, Hong Kong

<sup>4</sup> s3(1), Limited Partnerships Ordinance

**5. Law as to private partnership to apply**

Subject to the provisions of this Ordinance, the Partnership Ordinance (Cap. 38), and rules of equity and of common law applicable to partnerships, except so far as they are inconsistent with the express provisions of the Partnership Ordinance, shall apply to limited liability partnerships that are not foreign limited liability partnerships.<sup>5 6</sup>

**6. Liability of partners**

- (1) Subject to subsection (2), a partner in a limited liability partnership is not liable, by means of indemnification, contribution, assessment or otherwise, for debts, obligations and liabilities of the partnership or any partner,<sup>7</sup> whether arising in tort, contract or otherwise, which are incurred, created or assumed by the partnership or any partner while the partnership is a limited liability partnership solely by reason of being a partner or acting (or omitting to act) in that capacity or rendering professional services or otherwise participating in the conduct of other business or activities of the limited liability partnership.<sup>8</sup>
- (2) Subsection (1) does not affect the liability of a partner in a limited liability partnership for the partner's own negligence<sup>9</sup> or any wrongful act or misconduct committed by him or her while rendering professional services on behalf of the limited liability partnership.<sup>10</sup>
- (3) A partner in a limited liability partnership is not a proper party to a proceeding by or against the limited liability partnership for the purpose of recovering damages or enforcing obligations<sup>11</sup> arising out of debts, obligations or liabilities for which, because of subsection (1), he is not liable.
- (4) The protection from liability given to a partner by subsection (1) shall not be construed as offering any protection from claims against the partner's interest in the partnership property<sup>12</sup>.
- (5) This section does not apply to a foreign limited liability partnership.

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<sup>5</sup> s.6, Limited Partnerships Ordinance;

<sup>6</sup> s.45, Partnerships Act, RSO 1990, Ontario

<sup>7</sup> Bill 6, para 2(2)

<sup>8</sup> s26(b), Article 3 of New York State Consolidated Laws on Partnership

<sup>9</sup> Bill 6, para 2(2)

<sup>10</sup> s26(c)(i), Article 3 of New York State Consolidated Laws on Partnership

<sup>11</sup> Bill 6, para 2(2)

<sup>12</sup> s.12, Partnership Act, Alberta

*Limited Liability Partnerships Ordinance (Draft)*

**7. Rules as to interests and duties of partners<sup>13</sup>**

- (1) Subject to any agreement, express or implied, between the partners, a partner in a limited liability partnership shall not be liable to pay or contribute toward losses arising from a liability for which the partner is not liable under section 6; and
- (2) a partner in a limited liability partnership is not required to indemnify the firm or other partners in respect of debts or obligations of the partnership for which a partner is not liable under section 6.

**8. Formation of Limited Liability Partnerships**

A limited liability partnership that is not a foreign limited liability partnership is formed when two or more persons enter into a written agreement that,

- (a) designates the partnership as a limited liability partnership; and
- (b) states that this Ordinance governs the agreement.<sup>14</sup>

**9. Continuance of Limited Liability Partnerships**

A partnership that is not a foreign limited liability partnership, may be continued as a limited liability partnership if all of the partners,

- (a) enter into an agreement that continues the partnership as a limited liability partnership and states that this Ordinance governs the agreement; or
- (b) if there is an existing agreement between the partners that forms the partnership, amend the agreement to designate the partnership as a limited liability partnership and to state that this Ordinance governs the agreement.<sup>15</sup>

**10. Effect of continuance**

Upon the continuance of a partnership as a limited liability partnership under section 9,

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<sup>13</sup> Bill 6, para 4; s24(1) and (2.1) of Partnerships Act, R.S.O. 1990

<sup>14</sup> Bill 6, para.6, 44.1(1)

<sup>15</sup> Bill 6, para.6, 44.1(2)

*Limited Liability Partnerships Ordinance (Draft)*

- (a) the limited liability partnership possesses all the property, rights and privileges and is subject to all liabilities, including civil and criminal and all contracts, disabilities and debts of the partnership which were in existence immediately before the continuance; and
- (b) all persons who were partners immediately before the continuance remain liable for all debts, obligations and liabilities of the partnership that arose before the continuance.<sup>16</sup>

**11. Registration of business name**

No limited liability partnership formed or continued by an agreement governed by this Ordinance shall carry on business unless it has registered its firm name in accordance with the Business Registration Ordinance (Cap 310).

**12. Name of limited liability partnerships**

The name of a limited liability partnership mentioned in section 11 shall contain the words "limited liability partnership" or the abbreviations "LLP" or "L.L.P." as the last words or letters of its name.<sup>17</sup>

**13. Foreign limited liability partnerships**

- (1) No foreign limited liability partnership shall carry on business in Hong Kong unless it has registered in accordance with the Business Registration Ordinance.
- (2) To amend or cancel a registration of its firm name, a foreign limited liability partnership shall register an amendment or cancellation of a registration in accordance with the Business Registration Ordinance.
- (3) The laws of the jurisdiction under which a foreign limited liability partnership is formed shall govern,
  - (a) its organisation and internal affairs; and
  - (b) the liability of its partners for debts, obligations and liabilities of or chargeable to the partnership or any of its partners.

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<sup>16</sup> Bill 6, para 6, 44.1 (3)

<sup>17</sup> Bill 6, para 6, 44.3 (3)



*Limited Liability Partnerships Ordinance (Draft)*

- (4) Subsection (3)(b) shall not limit the liability of a partner in a foreign limited liability partnership for tort under the law of Hong Kong.
- (5) Every foreign limited liability partnership shall,
  - (a) conspicuously exhibit on every place where it carries on business in Hong Kong the name of the foreign limited liability partnership and the country or territory in which it is formed; and
  - (b) cause the name of the foreign limited liability partnership and the country or territory in which it is formed to be stated in legible letters in all bill-heads and letter paper, and in all notices and other official publications of the foreign limited liability partnership.
- (6) A person may serve a notice or document on a foreign limited liability partnership at its Hong Kong place of business, if any, or its address required to be maintained under the laws of the jurisdiction of formation or its principal office address.
- (7) The name of a foreign limited liability partnership shall contain the words "limited liability partnership" or the abbreviations "LLP" or "L.L.P." as the last words or letters of its name.

## **Annexure 6**

## LIMITED LIABILITY PARTNERSHIP

### Report of the Working Party on Limited Liability Partnership

#### ONTARIO CUM NEW YORK MODEL: ADDITIONAL QUESTIONS FOR LEGISLATURE

In the previous annex we have proposed simple legislation for a Hong Kong LLP, believing its simplicity is one of its virtues.

In our paper we mention features of partnership models of LLP which, while not essential, might attract the legislature. This annex summaries alternative options.

1. The LLP legislation might allow majority of partners to agree that all or specified partners are liable for all or specified debts of the partnership, as in section 26(d) of the New York State Consolidated Laws on Partnership.

This provision could give the LLP valuable flexibility insofar as majority of partners could waive partners' protection from liability.

New York law requires the LLP's registration to state whether all or specified partners are liable as authorised section 26(d).

2. Our legislation follows the Ontario model insofar as it provides that:

- a foreign LLP must register under the Business Registration Ordinance before it can carry on business in Hong Kong
- the law of the foreign LLP governs its organization and internal affairs and the liability of its partners for debts, obligations and liabilities of the firm and its partners.

We thought Hong Kong would want foreign LLPs to register, and the recognition of their law is a *quid pro quo*. The legislature may wish to consider whether to rely on the Hong Kong doctrine of conflict of law rather than recognise the foreign law of the LLP. As there is uncertainty about the applicable doctrine, we thought that the clear recognition of the foreign law was helpful.

3. In the light of our conclusion in paragraph 5.10, we have departed from the precedent of Ontario and New York law by not limiting the Hong Kong LLP to professional practice.
4. We have disregarded the Ontario Partnerships Act by not requiring that the Hong Kong LLP have minimum levels of insurance cover. This is consistent with our conclusions that regulators or market forces will ensure the LLP is appropriately insured.