

**Bills Committee on
Legal Practitioners (Amendment) Bill 2010 (“Bill”)**

**Administration’s Response to Issues Raised by Members
at the Bills Committee Meeting held on 14 July 2010**

Purpose

This paper sets out the Administration’s view on whether the proposed sections 7AC(3) and (4) of the Bill have achieved the legislative intent of protecting innocent partners of an LLP against personal liability for the default of other members of the firm on the one hand and protecting consumer interests on the other.

Background

2. Under the Partnership Ordinance (Cap 38), every partner in a firm is liable jointly and severally for the wrongful acts or omissions of the firm. The Bill seeks, among others, to add a new section 7AC to vary this rule for law firms that are limited liability partnership (“LLP”). According to the proposed section 7AC(1), subject to certain exceptions, a person will not, solely by reason of being a partner, become jointly or severally liable for any partnership obligation if the firm is an LLP and the partnership obligation arises from a default of another partner, or of an employee, agent or representative of the firm.

3. The object of the proposed section 7AC(1) is to protect an innocent partner against personal liability for the default of other members of the firm. Further, section 7AC(6)(a) restricts a person who suffers loss as a result of the negligence, wrongful act or omission of an LLP from claiming against the innocent partners of the LLP. To confine the protection to an innocent partner, the proposed section 7AC(3) provides that the protection under the proposed section 7AC(1) is not available to an LLP partner if he knew or ought reasonably to have known of a default at the time of its occurrence, and failed to exercise reasonable diligence to prevent its occurrence. Furthermore, to protect consumer interests, the proposed section 7AC(4) of the Bill provides that a partner may be protected from the liability arising from a claim made by a client only if the partnership was an LLP at the time the cause of action for the claim accrued, and the client knew or ought reasonably to have known that the partnership was an LLP at that time.

The Administration's View

4. The Bill follows the general trend of many other common law jurisdictions of allowing law firms to operate as LLPs. A principal consideration for the Administration in preparing the Bill is to strike a proper balance between limiting professional liability on the one hand and protecting consumer interests on the other. To this end, the Administration has given due consideration to LLP statutes in other common law jurisdictions, and to the views of the stakeholders on the subject during the preparation of the Bill.

The Proposed Section 7AC(4)

5. The proposed section 7AC(4) provides as follows –

“Subsection (1) protects a partner from the liability arising from a claim made against the partnership by a client only if-

- (a) the partnership was a limited liability partnership at the time the cause of action for the claim accrued; and
- (b) the client knew or ought reasonably to have known that the partnership was a limited liability partnership at that time.”

6. In respect of the proposed section 7AC(4)(a), it is noted that many other jurisdictions (namely, Alberta, Ontario, British Columbia, and Manitoba in Canada, and New York and Texas in the USA) have a similar qualification of requiring the firm to be an LLP in their legislation¹. It goes without saying that an innocent partner should only be entitled to the protection of LLP if his firm was an LLP at the time when the cause of action for the claim accrued.

7. In respect of the proposed section 7AC(4)(b), our policy intent is that a person who makes an informed decision to engage an LLP firm should not be allowed to claim damages against innocent partners of

¹ See section 12(1) of the *Alberta Partnership Act*, “while the partnership is an Alberta LLP”; section 10(2) of the *Ontario Partnerships Act*, “while the partnership is a limited liability partnership”; s 104 of the *British Columbia Partnership Act*, “a partner in a limited liability partnership”; section 75(1) of the *Manitoba Partnership Act*, “while the partnership is a Manitoba limited liability partnership”; section 26(b) of the *New York Partnership Law*, “while such partnership is a registered limited liability partnership”; and s 152.801(a) of the *Texas Business Organisation Code*, “while the partnership is a limited liability partnership”.

the LLP. In this respect, there have been discussions on whether an informed decision of a client should encompass the situation where the client did not actually know but ought to have known the firm he engaged was an LLP. On this point, the Law Society expressed the following view –

“It appears that under the new mechanism, the loss of the LLP status is automatic as soon as the absence of client notice is established. This fails to take into account other relevant factors which remove any reasonable basis for a client to expect that the firm is not an LLP; for example, the disclosure of a firm’s LLP status through the printing of its name which includes “LLP” on its letterhead and the display of its firm name on its office premises”²

8. Having taken into account the Law Society’s view above, we have concluded that the proposed section 7AC(4)(b) should encompass both actual and constructive knowledge on the part of client. An innocent partner should be protected in the situation where the client claimant ought to have known that the firm he engaged was an LLP.

9. The effectiveness of the proposed section 7AC(4)(b) is enhanced by three provisions: first, the proposed section 7AE which requires the name of an LLP to contain the words “有限責任合夥” if it is in Chinese, and the words “Limited Liability Partnership (or the abbreviation) if it is in English; second, the proposed section 7AF which requires the LLP’s name be displayed at every place of business of the partnership and stated in its correspondence, publications, invoices, bills of costs, etc.; and, third, the proposed section 7AG which requires an existing law firm to notify all of its existing clients within 30 days after it becomes an LLP. In our view, the proposed section 7AC(4)(b), supported by the requirements of the proposed sections 7AE, 7AF and 7AG as mentioned, provides adequate safeguards for protecting consumers who might otherwise be unaware of engaging a firm that is an LLP.

The Proposed Section 7AC(3)

10. The proposed section 7AC(3) provides as follows –

“Subsection (1) does not protect a partner from liability if the partner-

² See item 3, page 2 of the Law Society’s letter to the Department of Justice of 9 February 2010.

(a) knew or ought reasonably to have known of the default at the time of its occurrence; and

(b) failed to exercise reasonable diligence to prevent its occurrence.”

Practices in Other Jurisdictions

11. We note that each of Alberta³, Ontario⁴, Texas⁵, British Columbia⁶ and Manitoba⁷ has a similar stipulation that removes LLP protection for a partner who has actual knowledge of the default but failed to exercise reasonable diligence to prevent it.

12. We note that each of Ontario⁸ and Texas⁹ has a similar provision to remove LLP protection for a partner who ought reasonably

³ Section 12(2) of the *Alberta Partnership Act*: “Subsection (1) does not operate to protect a partner from liability (a) where the partner knew of the negligence, wrongful act or omission, malpractice or misconduct at the time it was committed and failed to take reasonable steps to prevent its commission”. [emphasis added]

⁴ Section 10(3) of the *Ontario Partnerships Act*: “Subsection (2) does not relieve a partner in a limited liability partnership from liabilityif...the partner knew or ought to have known of the act or omission and did not take the actions that a reasonable person would have taken to prevent it”. [emphasis added]

⁵ Section 152.801(b) of the *Texas Business Organisation Code*: “A partner in a limited liability partnership is not personally liableunless [he]had notice or knowledge of the error, omission, negligence, incompetence or malfeasance by the other partner or representative at the time of the occurrence and then failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence, or malfeasance” [emphasis added]

⁶ Section 104(2) of the *British Columbia Partnership Act*: “Subsection (1) does not relieve a partner in a limited liability partnership from personal liability...if the partner seeking relief (i) knew of the act of omission, and (ii) did not take the actions that a reasonable person would take to prevent it” [emphasis added]

⁷ Section 75(2) of the *Manitoba Partnerships Act*: “Subsection (1) does not operate to protect a partner from liability (a) if the partner knew of the negligence, wrongful act or omission, malpractice or misconduct at the time it was committed and failed to take reasonable steps to prevent its commission” [emphasis added]

⁸ Section 10(3) of the *Ontario Partnerships Act*: “Subsection (2) does not relieve a partner in a limited liability partnership from liabilityif...the partner knew or ought to have known of the act or omission and did not take the actions that a reasonable person would have taken to prevent it”. [emphasis added]

⁹ Section 152.801(b) of the *Texas Business Organisation Code*: “A partner in a limited liability partnership is not personally liableunless [he]had notice or knowledge of the error, omission, negligence, incompetence or malfeasance by the other partner or representative at the time of the occurrence and then failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence, or malfeasance”. According to Article 6132b-102(b) of the Texas Revised Civil Statute, “[a] person has notice of a fact if the person.....reasonably should have concluded, from all facts known to that person at the time in question, that the fact exists”. [emphasis added]

to have known of the default but failed to exercise reasonable diligence to prevent it.

Law Society's Recent Proposal

13. While the Assistant Legal Advisor questioned at the 14 July meeting whether the Bill provides adequate protection for the consumer, the Law Society on the other hand considers that the constructive knowledge provision in the proposed section 7AC(3) casts the net too wide on partners¹⁰. We take this opportunity to respond to the Law Society's submissions in this connection.

14. The Law Society has proposed to replace the latter part of the proposed section 7AC(3) with the following –

“where

- (i) the default was committed by an employee, agent or representative of the partnership for whom the partner was directly responsible in a supervisory role, and
- (ii) the partner failed to provide such adequate and competent supervision as would normally be expected of a partner in those circumstances.”

15. Upon careful consideration, we do not consider it appropriate to adopt the Law Society's proposal. Our reasons are threefold.

16. First, in general, a partner is liable at common law for the negligence or wrongful act of a person under his direct supervision¹¹. In other words, the proposed provision by the Law Society above does not provide any additional safeguards for consumer protection that are not already provided by common law. As we mentioned in paragraph 8 of the Explanatory Memorandum of the Bill –

¹⁰ Submission to the Bills Committee on Legal Practitioners (Amendment) Bill 2010 by the Law Society dated 6 August 2010, at paragraph 19.

¹¹ See *Yazhou Travel Investment Company Limited v Bateson & Ors* [2004] 1 HKC 292 where the High Court held that a consultant who supervised a firm's conveyancing department was liable for negligence and could not “escape liability for failure to advise the client by delegating the work”. Also, see *A Solicitor v The Law Society of Hong Kong*, CACV 83/2008 where the Solicitors-Disciplinary Tribunal stated that “It is about time that Solicitors should be made to aware that any lack of supervision of staff which results in commission of fraud would not be tolerated” and on appeal the Court of Appeal stated that “What had occurred was a fraud on members of the public which would not have occurred had there been proper scrutiny and supervision”.

“The object of the proposed section 7AC(1) is to protect an innocent partner against personal liability for the default of other members of the firm. This provision is not intended to change the common law position with respect to the general principles of negligence (see the proposed section 7AM). For example, a partner in a limited liability partnership may still be held responsible under the common law for vicarious liability arising from a default of an employee, agent or representative who is under the supervision of the partner.”

17. Second, by singling out a partner’s liability arising from his direct supervisory role, the Law Society’s proposed provision may impliedly negate a partner’s potential liability for the firm’s collective failure to establish a proper system of staff supervision, thus deviating from the policy intent. In this connection, Secretary for Justice elaborated on the policy intent in paragraphs 13 to 15 of his speech on 30 June 2010 when introducing the Bill into the Legislative Council,

“...The Bill is not intended to change the common law position with respect to the general principles of negligence. A partner in an LLP may still be held responsible under the common law for vicarious liability arising from the default of an employee, agent or representative who is under the supervision of the partner. Also, a failure to establish a proper system of staff supervision by the partners can be the basis for a claim that all partners of an LLP are personally liable for the default of an employee, agent or representative. ”

“In this connection, the Law Society has acknowledged that under the legislative proposal, it would “remain possible for a plaintiff to assert, and for a Court to determine, based on the particular facts of a case, that a partner is responsible for liability arising out of the negligence of an employee because of the negligence of that partner, whether by committing the act himself or through the lack of action or supervision or otherwise.”

“The Law Society has further acknowledged that if the partners of an LLP fail to establish a proper system of supervision, that failure could be the basis for a claim that all partners of an LLP are negligent, and therefore should be liable. The allocation of liability would be a matter for the Court to decide based on the particular facts of each case and an application of the general principles of negligence.”

18. Third, by confining an LLP partner’s liability to matters that he knows or under his direct supervision may provide disincentive for LLP partners to monitor the activities of the firm for the benefit of the firm and its clients. On this point, the learned authors, Alan Bromberg and Larry Ribstein commented that –

“Partners’ liability for participating in or supervising misconduct, coupled with their limited liability for other partnership debts, may have perverse incentive effects. Even without vicarious liability, partners have incentives to monitor their co-partners in order to protect the firm’s reputation. But it is important to keep in mind that the partners’ personal liability for participating in misconduct would exceed their partners’ share of the firm’s liability. Thus, **partners may find that they can best reduce their liability risk if they avoid monitoring that might trigger liability for participating in misconduct under a negligence theory or under statutory language that focuses liability on direct supervisors or partners who have notice or knowledge of misconduct.** For example, specialists may refuse to learn about cases in which they are not directly involved, and firms may abolish opinion committees. **This may hurt both firms and their clients**”¹² [our emphasis]

19. For reasons as referred to in paragraphs 16, 17 and 18 above, we consider it more appropriate to rely on the proposed section 7AC(3) than the provision proposed by the Law Society for consumer protection.

Law Society’s Concern

20. We are also aware of the Law Society’s concern that the proposed section 7AC(3) may lead to “excessive litigation” and that it is unclear “whether the claimant or the innocent partner should bear the burden of proof with respect to the constructive knowledge element”.¹³

21. In our view, there is no shifting of the burden of proof of constructive knowledge from the claimant to the innocent partner. The burden of proof, as in any litigation, would lie on the plaintiff to plead and adduce evidence to prove that there was constructive knowledge on the part of any identified partner. The proposed section 7AC(6)(a) of the Bill provides that if a partner is protected from any liability under the proposed section 7AC(1), he is not a proper party to any proceedings brought against the partnership for the purpose of recovering damages or claiming other relief in respect of the liability. If an innocent partner is wrongly named in a writ alleging that he had constructive knowledge without any particulars, the innocent partner could apply to strike out his name from the writ and ask for costs against the plaintiff.

¹² Bromberg and Ribstein on Limited Liability Partnerships, The Revised Uniform Partnership Act, and The Uniform Limited Partnership Act (2001), Wolters Kluwer, 2009 Edition, at p.128.

¹³ See footnote 10 above.

22. Moreover, it should be noted that the proposed section 7AC(3) is no more than a “reasonableness” test. A two-limb reasonableness test is provided in paragraphs (a) and (b) respectively of that section—

- (a) “**ought reasonably to have known** of the default at the time of its occurrence”; and
- (b) “failed to exercise **reasonable diligence** to prevent its occurrence”. [emphasis in bold added]

A partner would be caught only if both of the conditions in the proposed section 7AC(3)(a) and (b) are satisfied, we therefore take the view that the risk of abuses by consumers in invoking the proposed section 7CA(3) frivolously is minimal, if any, in practice.

Conclusion

23. Many factors are relevant to the broader question of whether a proper balance between consumer protection and protection of innocent partners is achieved by the Bill. In so far the proposed sections 7AC(3) and 7AC(4) are concerned, we are of the view that they are in line with the practices of many other jurisdictions and they are instrumental to achieving the legislative intent of protecting innocent partners of an LLP against personal liability for the default of other members of the firm on the one hand and protecting consumer interests on the other.

Department of Justice
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