LIMITED LIABILITY PARTNERSHIP –
A NEW BUSINESS MODEL

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INTRODUCTION

The inclination to collaborate to accomplish certain commercial objectives has a long history. The commercial magnetism of such collaborations and a need to govern their business ultimately led to the codification of corporate and partnership laws.

GENESIS AND DEVELOPMENT OF PARTNERSHIP LAWS

Corporations and Partnerships have been a primary form of business structure for a long time now. For more than a century, partnership law has offered an all-embracing and lucid alternative to corporate law. Although, the two bodies of law have much in common, historically they differed sharply on the role of the contract and private ordering in structuring the firm.

Partnership law encourages private ordering through bargaining by providing an agreement amongst partners. In contrast, corporate law historically has provided a mandatory framework for firm structure highly resistant to shareholders’ attempts to define their relationships through bargaining1. Proponents of private ordering within firms prefer the freedoms of partnership law to the mandates of corporate law, and over time they have enjoyed success in extending the bargaining model from partnership law to corporate law.

However, certain inherent limitations of both these forms of business have made them unsuitable for certain businesses. This ultimately led to the evolution of certain hybrid forms of business structures such as limited partnerships, limited liability partnership, limited liability limited partnerships etc.

CONCEPT OF LLP

A limited liability partnership (LLP) is a hybrid corporate business vehicle that has a perpetual succession and separate legal entity. It not only provides the benefits of limited liability but also allows its partners the flexibility of organizing their internal structure as a general partnership.

The push for the creation of limited liability partnership grew from several factors, such as general increase in the incidence of litigation for professional’s negligence and the size of claims; the risk to a partner’s personal assets, when the claim exceeds the sum of the assets and insurance cover of the partnership; the growth in the size of partnerships; increase in specialization among partners and the coming together of different professions within a partnership.

However, the concerns centered on the fact that partners had unlimited personal liability irrespective of any fault or any degree of fault on the part of a particular partner and the partners generally. The level of protection that a limited liability partnership affords to its partners is an important factor that led to the proliferation of this form of business structure. Major professional and venture capital firms around the world prefer this model of business over the others.

The following paragraphs discuss the limited liability partnership laws around the world.

LLP LAWS IN UNITED STATES

The idea for the LLP has been credited to “a twenty-odd person law firm from Lubbock,” Texas2. Their idea, which led to the enactment of the first LLP statute in

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2 Hamilton 1995 at 1073.
Texas in 1991, was a reaction to the legal fallout from an economic calamity. The LLP was a direct outgrowth of the collapse of real estate and energy prices in the late 1980s, and the concomitant disaster that befell Texas’s banks and savings and loan associations.3

The enactment of Texas legislation allowed members of certain professions who were carrying on business as ordinary partnerships to register as LLPs. Once a firm was registered as an LLP, each partner was shielded from personal liability claims against the firm arising from any future malpractice of other members of the firm.

The “Texas model” for LLP legislation has two key characteristics. Firstly, its liability shield only covers professional malpractice claims. Secondly, the liability shield does not protect a professional for personal malpractice, that is, where they are personally involved in the wrongful conduct or have direct supervisory responsibility over those who are personally involved in the wrongful conduct.

After Texas passed its LLP legislation, most other states quickly followed and today all 51 states have passed laws that permit the formation of an LLP.4

A limited liability partnership is considered as a special type of partnership that requires a special filing with the State where the partners operate. This partnership form offers all partners the right to participate in the management and the operation of a partnership without subjecting themselves to unlimited personal liability as is the case in general partnerships.5

However, if the special laws governing it are not precisely followed, they can be held as general partnership in a court of law. Moreover, if the partners want, the old partnership agreement can continue to govern the newly formed LLP. A partnership, especially a limited liability partnership, transacting business in any state other than the state of domicile is required to register with the Secretary of the foreign state as a foreign partnership.6

LLP LAW IN JERSEY

The Channel Island of Jersey is a British Crown Dependency. In 1997, Jersey enacted the Limited Liability Partnership (Jersey) Law 1997. The driving force that led to the codification of the legislation was that the major Accountancy firms in UK were facing a number of high profile lawsuits arising out of real/alleged audit failures. But even after their long campaign, they could not secure liability concessions from the UK government. As a result they approached the Jersey Authorities in mid 1990s to enact similar legislation.9

The Jersey LLP Bill was drafted by Ernst & Young and Price Waterhouse (now part of PricewaterhouseCoopers), at a private cost of more than £1 million and was designed to dilute ‘joint and several’ liability and reduce the redress available to audit stakeholders.11

The Bill was “championed by the Island’s leading politicians” who also promised to “fast track” it, effectively displacing the previously agreed legislative programme persuading some to conclude that Jersey was offering its ‘legislature for hire’ to enable major accountancy firms (or international capital) to hold other nation-states (e.g. the UK) to ransom. The approach to Jersey was accompanied by a threat that if the British government failed to match the liability concessions,

3 Hamilton 1995 at 1069.
5 Margaret Bartschi, Foundations of Business Organizations for Paralegals, p. 3.
6 Angela Schneeman, The Laws of Corporations, and other Business Organizations, p. 42.
7 The Channel Islands consist of five island. These are Jersey, Guernsey, Sark, Herm and Alderney. Jersey is by the far the largest of these islands. Each island has its own government.
10 The Accountant, November 1996, p. 5.
11 Globalization and its discontents: Accounting firms buy limited liability partnership legislation in Jersey by Prem Sikka, University of Essex.
14 Hampton and Christensen, 1999a.
the firms would relocate their operations to Jersey\textsuperscript{15}. The threat was sufficient to discipline the UK government and it promised similar legislation "within a week"\textsuperscript{16}. The UK government eventually enacted the LLP legislation and the firms did not register in Jersey.

The externally drafted legislation was described by a member of Jersey parliament as "not offshore tax avoidance, on which our finance industry is built, but offshore liability avoidance"\textsuperscript{17}.

As per the Jersey Law, an LLP is required to pay a £10,000 as registration fee, which makes it affordable only to businesses of stature.

The Act classifies partners as 'partners' and 'designated partners'. Every LLP must also have a registered office in Jersey at which it must maintain those records specified in Article 8(4) of the law, which are available for inspection by partners. The names and addresses of all the partners of an LLP are also a matter of public record. Similarly, LLPs are not required to file partnership agreement, accounts or to have their accounts audited; they must, however, maintain proper accounting records.

On a closer look at the provisions of the law, one finds that the provisions are somewhat similar to legislation in the State of Delaware (US). The law allows partners to take an active part in the management of a partnership whilst retaining their own individual limited liability. Every LLP is required to make a £5 million provision for judgments against the partnership and to compensate creditors. This financial provision against debts and liabilities of the partnership are required to be maintained throughout the life of the partnership and are not permitted to be made the subject of a security or set-off\textsuperscript{18}.

Despite actually having a separate legal personality, the Jersey limited liability partnership is treated as a partnership for taxation purposes. It is rather fiscally transparent i.e. tax is levied on the individual partner’s share of profits rather than the overall partnership profit. In this respect the Jersey LLP is also similar to the Scottish general partnership structure.

LLP LAW IN UNITED KINGDOM

In early 1997 the UK Department of Trade and Industry ("DTI") circulated a consultation paper that begins with the statement that the UK government had announced its intention to bring forward legislation at the earliest opportunity to make limited liability partnership available to regulated professions in the UK. As already discussed in preceding paragraphs this was a result of the pressure exerted by the major UK accountancy and law firms which were expected to take advantage of the Jersey LLP.

The UK Limited Liability Partnerships Act 2000 came into force on 6 April 2001\textsuperscript{19} providing limited liability partnership the organisational flexibility and tax status of a partnership with limited liability for its members.

The Act classifies partners into two categories namely 'members' and 'designated members'. A limited liability partnership must have at least two, formally appointed, designated members at all times. Designated members are similar to executive or managing directors and the company secretary of a company. If there are fewer than two designated members then every member automatically becomes a designated member. By virtue of section 24 of the UK Companies Act 1985, where a limited liability partnership continues for more than six months with a single member, then that member becomes liable jointly and severally with the LLP for the debts of the firms contracted for during that period.

The management structure of a limited liability partnership is governed by its agreement among members and LLP and members inter se. The agreement should cover the sort of issues dealt within a normal partnership agreement. It is however not mandatory to file the same with the Registrar. The First Schedule of the Act provides for certain default provisions which are applicable if the members agreement is silent on a certain issue.

A limited liability partnership is also considered to be a ‘Legal Person’ in its own right, and can operate in the same way as a company in most respects. However one important difference between an LLP and a limited company is the way in which the profits are taxed, with

\textsuperscript{15} Cousins et al., 1998.
\textsuperscript{19} http://www.volaw.com/pg405.htm
each member of the partnership being taxed according to the share of the profits that they receive rather than the LLP paying tax directly on its profits.

A LLP is required to produce and publish financial accounts with a similar level of details to a similar sized limited company and to submit accounts and an annual return to the Registrar of Companies each year. This requirement is far more demanding than the position for normal partnerships and some specific accounting rules may lead to different profits from those of a normal partnership. Further, the Act applies the provisions of company law and insolvency law, with appropriate modifications, to LLPs.

LLP LAW IN SINGAPORE

In Singapore, a Study Team on Limited Partnerships ("LPs") and Limited Liability Partnerships ("LLPs") was set up by the Ministry of Finance in November 2002, to work out the details of the legal framework governing limited partnerships and limited liability partnerships. The Singapore Limited Liability Partnership Act, 2005 came into effect on April 11, 2005. By having a close look at the legislation, one can conclude that the Singapore LLP Act is broadly modelled on the Delaware Revised Uniform Partnership Act (the "Delaware Code").

A LLP is required at all times to have at least two partners, with the exception that if the LLP is left with only one partner, the remaining sole partner is given a grace period of up to two years to find a new partner. If the LLP continues with less than two partners for more than two years, the remaining sole partner assumes unlimited liability and is vulnerable to winding-up by the courts.

It is mandatory for a LLP to have a local manager who is a natural person aged twenty one years and above and does not have a questionable character and must also meet other requirements specified under the LLP Regulations, including those pertaining to solvency. One of the important characteristics of a manager is that he need not be a partner of the LLP.

Although the LLP structure is available to all types of businesses yet it is not subject to full financial reporting and disclosure requirements, for example, relating to its capital contributions and changes to capital, making this a suitable vehicle for small businesses and new start-ups. Further, it is also not mandatory to file the partnership agreement with the Registrar.

LLPs are required to ensure that the partnership name is followed by the words ‘limited liability partnership’ or the acronym ‘LLP’. Invoices and official correspondence are also required to carry the name, registration number and a statement that the partnership is registered with limited liability. Additionally, LLPs formed by conversion of existing unlimited partnerships are required to carry a statement regarding the conversion and the effective date on all official correspondence and invoices for 12 months commencing 14 days after the date of registration.

LLPs are also required to file a declaration of solvency or insolvency, which will be publicly available. Failure to file a declaration of solvency implies insolvency leaving the LLP vulnerable to winding-up action by creditors. As a measure of creditor protection, there is a claw-back mechanism, which allows LLPs to recover amounts distributed to its partners within a period of three years preceding the commencement of the winding up of an LLP.

INDIAN SCENARIO

In India, businesses mainly operate as companies, sole proprietorships and partnerships. Each of these business structures has its own advantages and shortcomings and is subject to different regulatory and tax regimes. The idea that there should be the opportunity in India to organize as an LLP emerged out of the Report of the Naresh Chandra Committee on Regulation of Private Companies and Partnership and Report of the Dr. J. J. Irani Expert Committee on Company Law. After studying the major LLP statutes around the World it is suggested that the Singapore LLP Act, 2005 along with the Indian Companies Act, 1956 with apposite adaptations and modifications may form a base to the Indian LLP statute.

ISSUES FOR CONSIDERATION

Some of the important issues that need in-depth analysis, debate, discussion and deliberations are as under:

1. Whether LLP form of business structure should be made available to Professionals only?
2. Whether LLP Agreement should be made mandatory to be filed with the Registrar?
3. What contents of the LLP agreement should be filed with the Registrar?
4. Whether foreign individuals should be allowed to be a partner or not?
5. Whether LLPs should be allowed to have one general partner with unlimited liability or not?
6. Whether manager should be a partner of LLP or not?
7. Whether LLP should have a limit on the number of partners it can have?
8. What should be the extent of liability of a partner?
9. How should the LLPs be taxed?
10. What should be the disclosure requirements for an LLP?
11. What should be the procedure for existing firms, private companies and unlisted public companies to convert to LLP?
12. How should the Act deal with foreign LLPs?
13. What should be the procedure for the merger, amalgamation and demerger of LLPs?
14. What should be the procedure for the winding up and dissolution of LLPs?
15. What provisions of the Companies Act, 1956 should apply to LLPs?
16. What all other legislations, rules, regulations and procedures need to be amended for facilitating a smooth entry of LLPs?
17. What can be the various forms of contribution?
18. Whether a partner can bring his share of contribution in installments?
19. For how long an LLP should be allowed to carry on business with less than two partners?
20. Should the audit of financial records be made mandatory for all LLPs?
21. Should LLPs be required to file an annual report with the Registrar?
22. What should be the period of claw back?
23. What should be the disqualifications of a partner and manager?
24. Whether the provision for compulsory insurance for LLPs be provided?
25. Who shall regulate and administer the LLPs?

CONCLUSION

Following international trends, predominantly those in the United States of America, United Kingdom and Singapore, the debate on Limited Liability Partnership (LLP) structure in India is recent one. This structure is recognized as the “world’s best practice” structure, designed to not only attract venture capital from offshore institutional investors but also to retain domestic investment. Some of the advantages of this form of business structure include low cost of incorporation, unlimited capacity, limited individual liability, flexible management structure, tax benefits and less audit and filing requirements.

However, at the same time this form of business structure is susceptible to abuse as well. Probably the weakest link is the private limited liability partnership agreement. Especially, after the Enron collapse, it is felt that limited liability has a degree of correlation with professional lapses and malpractices. The OECD also identifies limited liability partnership as being a corporate vehicle, which is vulnerable to misuse, principally for the reason that it is less regulated than corporations.

The limited liability partnership form of business structure is keenly awaited in India. However, such introduction will require amendments in several legislations and Regulations. Therefore, an in-depth understanding of the concept is inexorable.

References

7. Margaret Bartschi, Foundations of Business Organizations for Paralegals, Thomson Delmar Learning, p. 3.


