

Accountancy Update

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Case notes

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Round-up

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Any comments or queries?

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LLP: Company or Partnership?

The Limited Liability Partnerships Regulations 2009 came into force on 1 October 2009. The Regulations implement those parts of the Companies Act 2006 that were intended to apply to LLPs, including provisions relating to trading disclosures and the retention of members' addresses. They do not include the ground-breaking Companies Act provisions governing directors' duties or other related provisions. Here we consider these issues against the background of the debate as to whether LLPs should be viewed as companies or incorporated partnerships.



Historically, there have been two opposing approaches to LLPs. On the one hand, a number of professional firms, with the major accounting firms leading the way, pressed for and embraced the reforms brought about by the Limited Liability Partnerships Act 2000. On the other, a number of firms (possibly the more traditional firms) were slow to convert to LLP status, citing cost, privacy concerns and possible client resistance.

Of late, both types of organisation have embraced the flexibility that LLP status offers. Some have built up complex group structures that include corporate members controlled by third parties. Others have set up different LLPs for different parts of their business. On the management front many larger firms have brought in professional managers to help run firms on a day-to-day basis. Others have brought in non-executive directors to sit on management boards. Furthermore, changes to the regulatory landscape are likely to lead to ever more inventive business models and new structures. For example, the Legal Services Act 2007 may ultimately permit a legal LLP and an accounting LLP to be members of the same group, possibly controlled by another LLP. It is, of course, likely to be some time before the regulators are in a position to license such practices, but the groundwork is already in place. In the meantime, many professional firms are taking advantage of the current uncertain climate to bring in new talent.

Against this background it seems surprising that the consultees for the LLP Regulations did not embrace some of the more modernising concepts of the Companies Act 2006, such as the regulation of directors' duties.

Directors' duties

The Companies Act codifies the common law on directors' duties so that a number of statutory duties are now imposed on directors, including the duty to promote the success of the company. However, these duties will not apply to LLPs. This is because during the consultation phase the Government was persuaded that the position of LLP members does not equate to that of company directors, primarily because there is no distinction between the ownership and management of LLPs. The Government also accepted the point that there is no equivalent case law on which to base LLP members' duties (most disputes are referred to confidential arbitration proceedings). The Government also noted that there was a general view that the internal arrangements of LLPs are best left to members to regulate. The effect is that members' duties will continue to be regulated by LLP agreements and by the 2001 default provisions on

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members' duties, to the extent that LLP agreements have not been expressly varied.

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Shadow directors

The Companies Act 2006 also retains reference to the 1985 Act's provisions in relation to shadow directors. For example, shadow directors must declare the nature and extent of their interest in any transaction or arrangement entered into by a company. Furthermore, where there is an equivalent common law principle applicable to shadow directors, the statutory duty replacing that common law provision will apply to shadow directors. However, in a similar approach to the question relating to directors' duties, the Government decided that reference to them in the 2009 LLP Regulations would be inappropriate. It therefore removed all reference to shadow members from the draft regulations. The justification for this is not entirely clear, but it must be arguable that those involved in fraudulent trading (section 993 of the Companies Act, which will apply to LLPs) are likely to have been involved in a shadow director or shadow member role and so this issue could perhaps have benefited from further thought.

Protection against unfair prejudice

The unfair prejudice provisions in the 2006 Companies Act introduce a wider range of circumstances in which an action may be brought by a shareholder than was the case under the common law. This has been extended to LLPs by the 2009 LLP Regulations, at least in part. LLPs may expressly exclude recourse to such proceedings by unanimous agreement in writing.

These generally appear to be sensible provisions. The codification of directors' duties and broadening of the rules in relation to unfair prejudice actions can be viewed as attempts to protect company shareholders. The owners of LLPs, as members, should in theory be able to protect their own interests. However, this may not always be the case. There may be situations where members of subordinate LLPs have little say over management. For example, there will be situations where an LLP may be controlled by another LLP, which is in turn run by a committee comprising of different members, none of whom sit on the subordinate LLP. There may then also be a chief executive and a non-executive director, again neither of whom are members of any of the LLPs. What recourse would the members in the subordinate LLP have against the members and chief executive in the dominant one?

The answer is that, depending on the LLP agreements and the service contracts of those involved, it may be very difficult for the members in the underlying LLP to pursue the controllers or "shadow members" in the group LLP. This suggests that for purposes of the LLP Regulations, the "traditionalists" may have won the debate over whether LLPs are companies or partnerships. However, this is not necessarily the case, since by leaving out the provisions relating to internal regulation there remains sufficient scope for LLPs to adopt their own preferred approach. For now though, the message is that new LLP members, whether lateral hires, merger partners or rising stars, should carefully check their new LLP's internal governance arrangements and should not assume that Companies Act legislation will protect them. Similarly, LLPs may want to check their own internal governance provisions to ensure that they are fit for purpose, particularly to ensure that their dispute resolution provisions are broad enough to exclude the new unfair prejudice provisions, if appropriate.

Confidentiality Orders

Although LLP Members' addresses can be withheld from the public register, they will still be available to credit reference agencies. Members who consider that there is a serious risk that they, or a person who lives with them, will be subjected to violence or intimidation as a result of the activities of at least one of the LLPs of which they were members or who may have worked for the security services, will still need to apply to the Registrar for an exemption from disclosure. The address details of holders of Confidentiality Orders under the old regime will be automatically protected from disclosure.

Case notes

Costs of an aborted mediation are recoverable

The decision in *Roundstone Nurseries v Stephenson Holdings*¹ serves as a warning to all parties that mediation costs may be recoverable, and that to avoid unintended consequences a mediation agreement should deal adequately with the costs position.

Proceedings in the action were stayed until 26 March 2009 to allow for the parties to comply with the Pre-action Protocol for Construction and Engineering Disputes (the Protocol).

The parties were due to mediate on 15 April 2009, beyond the expiry of the stay. However, on 9 April 2009 the defendant withdrew from the mediation. The claimant obtained default judgment against the defendant. One issue before the court was whether to grant the claimant costs in relation to the aborted mediation on an indemnity basis.

The court set out the following general principles:

- costs of a separate, standalone alternate dispute resolution process will not usually form part of the costs of litigation and so are not usually recoverable from the other parties
- costs incurred during the Pre-action Protocol process may be recoverable as costs incidental to the litigation

On the facts the court found that the mediation costs were part of the pre-action process as:

- the parties agreed to the mediation forming part of the Protocol process
- the Protocol required a without prejudice meeting between the parties
- there was no mediation agreement between the parties setting out who was to pay the mediation costs

The court granted costs to the claimant on the standard basis.



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Without prejudice discussions admitted to interpret a Settlement Agreement

In *Oceanbulk Shipping & Trading SA v TMT Asia Limited*² the court concluded that evidence of without prejudice discussions could be admitted to establish not only the conclusion of a settlement agreement, but also its terms.

The settlement agreement had been reached following without prejudice discussions. TMT sought to rely upon the without prejudice discussions to interpret the settlement agreement. Oceanbulk asserted that the evidence was inadmissible as it was conducted on a without prejudice basis.

Andrew Smith J considered the without prejudice discussions admissible. In doing so he relied on one of the exceptions outlined by Robert Walker LJ in *Unilever Plc v Proctor & Gamble Co*, namely: “when the issue is whether without prejudice communications have resulted in a concluded compromise agreement, those communications are admissible”.

Andrew Smith J considered that there was little difference between admitting evidence on whether a compromise agreement had been concluded and, as here, to establish what were the terms of the settlement agreement.

This is a surprising decision, extending the exceptions to the without prejudice rule. In practice, parties should be careful how they approach without prejudice discussions regarding compromise agreements, as such discussions could be admissible to interpret the underlying terms.

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A reminder of the reflective loss principle

In *Charles Frederick Webster v Sandersons Solicitors (a firm)*³ the Court of Appeal confirmed the legal principles which apply when a shareholder of a company seeks to recover losses which reflect losses suffered by the company.

Mr Webster sued Sandersons for negligence as they had failed to serve proceedings within the limitation period. Mr Webster had instructed Sandersons to bring a claim against his former solicitors, Walker Morris. Walker Morris had introduced him to a Mr Cramer. Mr Webster’s company Sterling Construction (Yorkshire) Limited (SCYL) and the pension fund operated by SCYL invested in a project advanced by Mr Cramer. SCYL and the pension fund suffered losses on their investments. Mr Webster sought personally to recover those losses.

The Court of Appeal confirmed the following principles:

- only a company may sue in respect of a loss caused by a breach of duty owed to it, unless it is impossible for the company to bring the action
- a shareholder may sue for losses sustained by a company, where a company has no cause of action
- where a company suffers loss caused by a breach of duty to it, and the shareholder suffers a separate and distinct loss from the company, the shareholder may sue for that loss

The court found that similar principles applied to the pension fund.

The court held that Mr Webster could not claim for personal losses reflected in the losses to SCYL and the pension fund. This case did not fall within the possible exception to the principles above, that a shareholder may recover reflective loss where the company has been disabled from bringing the claim itself, by the wrongful act committed against it. There was nothing to prevent SCYL (or subsequently SCYL's liquidator) or the pension fund trustees from bringing or pursuing proceedings.

Footnotes:

1. [2009] EWHC 1431 (TCC)
2. [2009] EWHC 1946 (Comm)
3. [2009] EWCA CIV 830

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Round-up

The end of the House of Lords

The House of Lords handed down its final judgments on 30 July 2009. Amongst the final judgments was *Moore Stephens v Stone & Rolls Ltd*. You can read Jane Howard and Ross Goodrich's report on that judgment on our website [by clicking here](#).

The Supreme Court replaces the House of Lords and is due to begin work this month. The new rules have recently been published and will apply to both civil and criminal appeals. They came into force on 1 October 2009 but are not substantively different to the old rules. The overriding objective is to ensure that the Supreme Court is "accessible, fair and efficient".

The Financial Reporting Review Panel's Annual Activity Report

The Financial Reporting Review Panel has published its annual activity report. The report details the Panel's findings from its review of 326 accounts in the year to 31 March 2009. Of the accounts reviewed, 112 companies were approached for further information or explanation and to the date of the report, 68 of these companies had undertaken to reflect the Panel's comments in their future reporting. Two companies agreed to restate amounts reported in prior periods.

The Panel concluded that the current standard of corporate reporting in the UK is good and the general quality of IFRS and UK GAAP annual reports and accounts is improving. The Panel added that all companies needed to continue to improve their disclosure of financial risks, judgements made on accounting policies and sources of estimation uncertainty.

The Civil Procedure (Amendment) Rules 2009

The 50th update to the Civil Procedure Rules came into force on 1 October 2009. Some of the amendments are required as a result of the remaining provisions of the Companies Act 2006 coming into force. Those amendments of most relevance to accountancy firms include the amendments to CPR 35, Experts and Assessors.

The amendments to CPR 35 provide a new definition of "expert" and "single joint expert" and state that in small claims or fast track cases, permission will normally only be given to call evidence from one expert only. An additional change is that written questions to experts must now be proportionate.

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ICAEW response to the Legal Services Act

The Institute of Chartered Accountants in England and Wales (ICAEW) has issued its response to the Legal Services Board's consultation paper on the proposed changes to be made under Sections 30 (internal governance) and 51 (control of practising fees) of the Legal Services Act 2007.

The ICAEW's response focused on the planned introduction of Alternative Business Structures (ABS) and the proposed approach to the regulatory framework. Accountancy services include activities and business services with legal elements. The ICAEW request that the new regulatory framework under the Legal Services Act has regard to:

- the arrangements that are currently in place for overlapping legal services
- the impact of ABS on the delivery of legal services
- the ability of ABS to compete on an equal basis with other structures

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News

Welcome to Vivien Tyrell

We are delighted to announce the addition of Vivien Tyrell to the RPC partnership. Vivien has been an Insolvency Practitioner since 1989 and is most widely known for her expertise in insurance insolvency and restructuring. She is recognised by The Legal 500, Chambers UK and Euromoney as a leader in this field and will head up RPC's Insolvency & Restructuring practice.



Breakfast Briefing

We will be hosting the next of our popular Breakfast Briefings on Thursday 19 November. Following recent press reports on the loss of confidential and important information, partners Jonathan Davies and Olly Bray will focus on the implications for FSA regulated firms and data security. For more information please email us at seminars@rpc.co.uk.

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