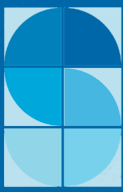

serle court

CASE COMMENT

LLPs and Derivative Actions: *Homes for England v (1) Nick Sellman (Holdings) Ltd (2) Bromham Road Development LLP* [2020] EWHC 936 (Ch)

Introduction

In *Homes for England v (1) Nick Sellman (Holdings) Ltd (2) Bromham Road Development LLP*, Zacaroli J confirmed for the first time that the test to be applied in determining whether to grant permission for a member to continue a derivative claim on behalf of an LLP is the common law test in *Foss v Harbottle* not that contained in the Companies Act 2006.

Background

The claimant (**'HoE'**) and the first defendant (**'Holdings'**) were each 50% partners in the LLP, which held a property in Bedford. That property had been financed by way of a commercial loan and a loan from HoE. The commercial loan expired on 14 January 2018 and failure to repay the loan with 14 days thereof would result in 2% penalty interest charges. By 22 January 2018, HoE had negotiated new financing to repay the commercial loan but – HoE said in breach of duty – Holdings did not execute the documents until 20 February 2018. It was HoE's claim initially that this resulted in a penalty payment on the commercial loan of £206,000, which resulted in a commensurate reduction in the amount the LLP could afford to repay of HoE's own loan. When Holding defended the claim on the basis that HoE's claimed loss was purely reflective, HoE amended its claim to include one brought derivatively on behalf of the LLP for the same amount.

Issue for the Court

The only substantive issue for Zacaroli J on the appeal was whether the correct test to be applied in considering whether to grant HoE permission to bring the derivative claim was the common law or statutory test in the 2006 Act.

Decision of Zacaroli J

The Limited Liability Partnerships Act 2000 permits regulations to be made specifying which aspects of companies legislation should apply to LLPs. Those regulations are the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009. The law relating to derivative actions in respect of companies is contained in ss.260-264 of the 2006 Act, and s.263 sets out the substantive criteria the court must consider in determining whether to grant permission. The 2009 Regulations do not apply ss.260-264 to LLPs.

HoE contended, however, that test for permission in s.263 of the 2006 Act applied to LLPs by virtue CPR r.19.9C. R.19.9C(1) states that the rule applies when a "body corporate" – which includes LLPs – to which Chapter 1 of Part 11 of the 2006 Act does not apply has a claim and a member seeks to bring that claim on its behalf. R.19.9C(2)-(3) provides that such a member must seek the court's permission to bring the claim by way of application notice under CPR Part 23. The procedure for such applications in respect of companies under ss.261, 262 or 264 applies as if the body corporate were a company: R.19.9C(4).

Zacaroli J held that the correct was test was that at common law for the following reasons:

1. CPR r.19.9C *specifically* only applies to the procedures set out

in ss.261, 262 and 264 and not to s.263. The omission *'appears to be deliberate'* and his Lordship noted that none of the included sections cross-refer to s.263.

2. The provisions of CPR 19.9-19.9F deal only with procedural matters and the sections of the 2006 Act applied to LLPs by CPR r.19.9C likewise are procedural only. By contrast,s.263 contained substantive rules of law as to the test to be applied in determining whether to give permission to continue a derivative action on behalf of a company. To extend s.263 to LLPs would substantively change the laws applicable to that type of body corporate which was not apt to be done by a set of procedural rules, i.e the CPR This conclusion was fortified by the failure of CPRr.19.9C to extend s.260 of the 2006 Act, which specifically abolishes the common law rules on derivative actions in respect of companies, to claims in respect of LLPs.

3. The form annexed to CPR PD19C for permission claims in respect of a company contains a statement of the factors in s.263 which the court must take into account whereas the form in respect of other bodies corporate contains no such statement.

4. It was no argument that s.261, which *does* apply to LLPs, could confer a broad discretion on the court when considering permission applications in respect of LLPs, which was somehow entirely unfettered by the rule in *Foss v Harbottle*. Such a conclusion would be entirely inconsistent with s.263 which (in respect of companies) specifically states the factors to be considered when the court exercises its discretion. Zacaroli J considered that s.261(4) said nothing about the test to be applied.

His Lordship's findings led him to consider and apply the exceptions to the rule in *Foss v Harbottle* to determine whether or not HoE should be given permission to continue the derivative claim on behalf of the LLP. Only the fourth exception was applicable, *viz* permission would only be given if Holdings acted fraudulently in the sense of deliberately and dishonestly in breach of duty *or* Holdings had acquired a personal benefit at the expense of the LLP (applying *Abouraya v Sigmund* [2014] EWHC 277 (Ch)). Zacaroli J considered the application of the test to be a question of considering the pleadings. On their face, there was no allegation of dishonest breach of duty nor had Holdings acquired any relevant financial benefit at the expense of the LLP. Permission was, therefore, refused.

Discussion

Zacaroli J confirms the *obiter* comments of the Court of Appeal in *Harris v Microfusion* 2003-2 LLP [2016] EWCA Civ 1212 and those in the 4th edition of *The Law of Limited Liability Partnerships* (which is edited by John Machell QC of Serle Court).

The decision is also right as a matter of first principles. It would be anomalous, and open to serious question, if the Rules Committee were able to effectively change substantive parts of English corporate law by incorporating certain sections of the 2006 Act into the CPR. On the other hand, as a matter of policy, it is regrettable that the reforms contained in s.263 are not extended to LLPs. The common law was notorious for being needlessly complex and difficult to apply. It is unclear why those issues are any less pertinent when considering derivative actions by members of LLPs, particularly when the court enjoys a broad discretion under s.263 to weed out unmeritorious claims? Much has been written about the continued application of the common law to double derivative actions and it is suggested reform efforts ought to also include LLPs.

Gregor Hogan
Year of Call: 2016