serle**speak**

ISSUE NO.8

Welcome to this new edition of Serlespeak on the law of LLPs and companies. LLPs have now been around for more than a decade and the extent of their popularity in all areas of commerce has probably surprised even those who promoted the legislation. In the lead article, I discuss the recent judgment of the Court of Appeal on the issue whether and when a member of an LLP can also be its employee. Elsewhere, David Drake examines the difficulties arising from the incorporation of "off the shelf" LLPs. Also in respect of LLPs, James Mather considers the extent to which members of an LLP owe fiduciary duties to one another and the LLP itself. Daniel Lightman's article addresses the question who may be a respondent to an unfair prejudice petition in both a company and LLP context. Finally, Matthew Morrison considers recent developments in the law relating to directors' duties, particularly in respect of the disclosure to the company of their own misconduct. **JOHN MACHELL**

IN *TIFFIN V LESTER ALDRIDGE LLP* [2012] EWCA CIV 25, THE COURT OF APPEAL HAS RECENTLY TACKLED THE DIFFICULT QUESTION OF THE PROPER CONSTRUCTION OF SECTION 4(4) OF THE LIMITED LIABILITY PARTNERSHIPS ACT 2000 (LLPA) AND THE STATUS OF FIXED SHARE PARTNERS.

The Court of Appeal's decision has been eagerly anticipated by those involved in advising and managing professional service firms – we don't get out very much! Many firms are divided into classes of partner with the fixed share partners ("FSP") being remunerated largely by reference to a fixed share of profits and a small variable element, being obliged to put in a small amount of capital and having limited voting rights. Whilst the question whether a person is an employee or a partner has been before the Courts on a number of occasions, there had previously been no authoritative consideration of the status of someone having typical modern FSP rights and obligations.

Mr Tiffin was a member of Lester Aldridge LLP. Following a parting of the ways, Mr Tiffin brought an employment tribunal claim against the LLP for unfair dismissal, breach of contract and redundancy. His claim was advanced on the basis that he was an employee, as well as a member, of the LLP. The question of his status was dealt with as a preliminary issue and the employment tribunal found that he was not an employee. The ET decision was upheld by the EAT and Mr Tiffin appealed to the Court of Appeal with the permission of Sedley LJ.

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Mea culpa, mea culpa, mea maxima culpa

IN A NUMBER OF RECENT CASES THE DECISION OF THE COURT OF APPEAL IN *ITEM SOFTWARE (UK) LTD V FASSIHI & ORS* [2004] EWCA CIV 1244 WHICH HELD THAT A DIRECTOR COULD FALL UNDER A DUTY TO DISCLOSE HIS OWN MISCONDUCT HAS BEEN APPLIED AND DEVELOPED.

Rather than being a stand-alone duty, the Court of Appeal held that the duty to disclose arose as part of loyalty *"to act in what he in good faith considers to be the best interests of his company"*. As such, this duty is not confined to directors and extends to all who owe fiduciary duties to the company (*Customer Systems plc v Ranson* [2011] EWHC 3304).

The Court of Appeal's decision in *Item Software* has been criticised for extending the scope of fiduciary duties beyond the traditional proscriptive no-conflict and no-profit rules. However, although such controversy has been recognised in subsequent first instance decisions, there has been a noticeable judicial enthusiasm for extending its scope.

Thus whereas in *Item Software* compensation was awarded for the loss of a business opportunity that occurred as a result of the defendant director's failure to disclose his misconduct during the negotiations, it was held by Jack J in *Brandeaux Advisers (UK) Ltd & Ors v Chadwick* [2010] EWHC 3241 (QB) that in principle it was also possible to recover remuneration paid to a defaulting employee owing fiduciary duties from the date her misconduct ought to have been disclosed if such disclosure would have led to her dismissal.

In the very recent first instance decision of *GHLM Trading Ltd v Maroo & Ors* [2012] EWHC 61 (Ch) Newey J went further still in considering an analogous claim made (among myriad others) against a company's former directors.

Newey J commenced his discussion by noting that the extension of fiduciary obligations from the proscriptive to the prescriptive might now be less controversial given that the codified duty of loyalty in section 174 of the Companies Act 2006 expressly provides that a director *"must act in the way he considers in good faith would be most likely to promote the success of the company for the benefit of its members as a whole…"* having regard to the various matters set out in section 172.

Emboldened by this, Newey J further held that the scope of the requisite disclosure was constrained only by what the director subjectively considered to be in the best interests of the company. As such it was capable of including an obligation to make disclosure to shareholders where, as in *GHLM*, there were no non-defaulting directors. Further, directors might be required to disclose not only their own wrongdoing, but also other matters of which they were aware such as the fact that certain transactions were unlawful and the insolvency of the company's business.

Newey J's decision confirms that the non-disclosure claim remains an important part of the armoury of a company seeking compensation from defaulting directors and other fiduciaries. However, it is important to bear in mind that the litmus test for liability is per Newey J *"that the fiduciary subjectively concluded that disclosure was in his company's interest or, at least, that the director would have so concluded had he been acting in good faith"* [194]. Proving that a defaulting fiduciary had such a subjective belief is a formidable forensic obstacle. Practitioners should also bear in mind the need to plead and put in cross- examination all instances of non-disclosure, and squarely to address the counterfactual question of what would have been done had such disclosure been made. It was the company's failure to do this in the *GHLM* case that ultimately led to Newey J's rejection of this part of its claim.

MATTHEW MORRISON has a broad company and insolvency practice with a particular emphasis on claims against directors. He is the author of the chapters *Directors' Liabilities in Insolvency and Directors Disqualification Claims* in *Butterworths Corporate Law Service.*

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Section 4(4) of the LLPA is not happily drafted. It provides that "A member of a limited liability partnership shall not be regarded for any purpose as employed by the limited liability partnership unless, if he and the other members were partners in the partnership, he would be regarded for that purpose as employed by the partnership." Although it is generally accepted that the effect of section 4 is that a person can be both a member of an LLP and an employee of it, there were commentators who took the contrary view.

In *Tiffin*, Rimer LJ (with whom Sir Nicholas Wall P and Jackson LJ agreed) noted at [31] that a partner in a partnership cannot be an employee of it because it is not possible for an individual to be an employee of himself and his co-partners and stated that, if read literally, the statutory hypothesis set out in subsection 4(4) would produce the same answer in each case, namely, that a person cannot be a member and an employee of an LLP. Rimer LJ went on *"If that had been parliament's intention when enacting section 4(4), it might just as well have ended the subsection immediately before the word "unless". That, however, was plainly not its intention. The subsequent words must be contemplating a practical inquiry that, in the particular factual circumstances, will yield a yes or no answer to the question whether a particular member of an the LLP is an employee of it. The subsection must, therefore, be interpreted in a way that avoids the absurdity inherent in a literal application …"*

Rimer LJ's solution is that one has to assume that the business of the LLP was carried on in partnership by two or more of its members as partners and, on that assumption, an enquiry is made as to whether or not the person whose status is in question would have been one of such partners. If the person would not have been a partner, then there must be a further enquiry as to whether he would have been an employee of that notional partnership. Why Parliament thought it sensible or appropriate to determine the status of someone who is a member of an LLP by reference to whether – had there been a partnership rather an LLP – he or she would have been a partner is unclear, but that is what the sub-section requires.

The judgment is also of interest because the terms governing Mr Tiffin's relationship with the LLP as a fixed share partner were reasonably typical: Mr Tiffin was entitled to a fixed share (which Rimer LJ treated as guaranteed) and had a small variable share of profits based upon an allocation of profit share points; he was obliged to contribute a small amount of capital, £5,000; and he was entitled to a vote on a number of, but not all, issues.

Rimer LJ said at [59] *"The problem which [Mr Tiffin faces] is that a reading of the members' agreement shows it to be tolerably obvious that it was intending to set up a relationship between the various signatories and adherents to it of a nature that, if analysed through the prism of the law relating to partnership under the Partnership Act 1890, could fairly be regarded as a partnership relationship between the full equity partners and fixed share partners. Of course their respective commercial interests in the firm were materially different, with the full equity partners putting a great deal more into it in the way of capital and also expecting to get a good deal more out of it in the way of profits, as well as having a materially greater voice in its management. But the character of the interests in the firm of these two classes of the LLP's members was nevertheless essentially the same."* Rimer LJ specifically stated that it made no difference that the basic fixed share of the fixed share partners was guaranteed.

Those who advise partnerships and LLPs will probably regard Rimer LJ's judgment as vindicating the advice they have given over the years in relation to FSP terms and consistent with the relatively liberal approach taken on the whole by HMRC. But those who approach matters from an employment law perspective may be surprised, first, that the Court of Appeal was not willing to examine more closely the substance of the rights and obligations between the parties – particularly the central disparity of real power – and, secondly, that Rimer LJ held at [67] that the ET's finding was a finding of fact rather than of law such that Mr Tiffin needed to show that the ET's decision was perverse. Since there were no relevant contractual terms other than those in the members agreement, it might have been thought that the question was one of law, based on the correct construction of a written instrument in accordance with *Carmichael v National Power plc* [1999] 1 WLR 2042.

JOHN MACHELL acted for Mr Tiffin in the Court of Appeal.

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"Off the shelf" LLPs

THE INCORPORATION AND SALE OF "OFF THE SHELF" COMPANIES BY COMPANY FORMATION AGENTS IS FAMILIAR AND UNCONTROVERSIAL. THE POSITION IN RELATION TO "OFF THE SHELF" LLPS IS MORE PROBLEMATIC. THERE ARE MANY SUCH LLPS REGISTERED AT COMPANIES HOUSE, AND MARKETED FOR SALE BY SOME COMPANY FORMATION AGENTS. YET THE LEGALITY OF THE INCORPORATION PROCESS IS OPEN TO QUESTION.

The issue arises because of the wording of section 2(1)(a) of the Limited Liability Partnerships Act 2000, which makes it a prerequisite of incorporation that *"two or more persons associated for carrying on a lawful business with a view to profit"* subscribe their names to an incorporation document. If an incorporation agent habitually uses the same nominees as subscribers in relation to multiple LLPs, without any particular business in mind for each LLP, how can it be said in relation to any of those LLPs that the nominees are *"associated for carrying on a lawful business with a view to profit"?* The only business which the nominees are associating to carry on is the business of incorporation agents; but it is clear in context that the "business" referred to in the section must be the one to be carried on by the specific LLP in question.

There is no parallel between these requirements and those in relation to companies. The restrictions flowing from section 2(1)(a) reflect wording influenced by section 1(1) of the Partnership Act 1890 *("Partnership is the relation which subsists between persons carrying on a business in common with a view to profit")*. There are, however, international parallels: similar issues could arise from the wording of Article 2(2) of the Limited Liability Partnerships (Jersey) Law 1997: *"A limited liability partnership may be registered where persons who wish a business to be carried on with a view of profit have agreed … that the business shall be carried on … in the form of a limited liability partnership …"*

Under section 2(1)(b) and (c) of the 2000 Act, the incorporation document must be delivered to the Registrar of Companies, along with a statement that the requirement of section 2(1)(a) has been complied with. The compliance statement can be made by one of the subscribers, or a solicitor engaged in the formation process. It is a criminal offence for a person to make a compliance statement which is false and which he, she or it knows to be false, or does not believe to be true. Whether this provides an effective sanction is debatable in circumstances where an incorporation agent uses asset-less offshore companies as the nominees which subscribe to the incorporation documents and execute the compliance statements.

There are other potential controls on impropriety. Under section 3, the Registrar's obligation to register the incorporation documents and issue a certificate of incorporation is only triggered *"if [he is] satisfied that the requirements of section 2 are complied with"*. But he may accept the compliance statement as sufficient evidence; and the presence on the register of numerous "off the shelf" LLPs suggests that he does so. Once a certificate of incorporation is issued, it constitutes conclusive evidence of compliance.

The Secretary of State may, under section 432(2) of the Companies Act 1985 (applied to LLPs by the Limited Liability Partnerships Regulations 2001) appoint inspectors to investigate the affairs of an LLP if it appears to him that there are circumstances suggesting, e.g. that it was formed for an unlawful purpose. But again the open marketing of "off the shelf" LLPs suggests that the issue is yet to trouble the Secretary of State.

DAVID DRAKE represents the claimant in *Raiffeisenlandesbank Niederösterreich-Wien AG v Maxfold Contracts LLP and Ors,* where this issue may fall to be decided.

Fiduciary duties in LLPs

IN THE FIRST DECADE OF THE VEHICLE'S EXISTENCE, IT HAS USUALLY BEEN ASSUMED THAT THE DUTIES OF LOYALTY OWED TO AN LLP BY ITS MEMBERS ARE SIMILAR TO THOSE OWED TO A COMPANY BY ITS DIRECTORS.

Case law in the company context establishes that the office of director carries with it an irreducible core of responsibilities: you cannot be a 'sleeping' director. Yet it would seem that you may be a sleeping, or even disloyal, member of an LLP.

So much emerges from the decision of Sales J in *F&C Alternative Investments (Holdings) Ltd v Barthelemy* [2011] EWHC 1731, which concerned a dispute between members of a hedge fund LLP. In considering first whether members of an LLP necessarily owe fiduciary duties to each other, he confirmed the conventional wisdom that they do not. Absent provision in the members' agreement, whether such duties are owed between members will depend on the application of general equitable principle to the facts of a given case. Sales J referred in this context to Lord Browne-Wilkinson's classic statement in *White v Jones* [1995] 2 AC 207, at 271D-G: *"The paradigm of the circumstances in which equity will find a fiduciary relationship is where one party, A, has assumed to act in relation to the property or affairs of another, B."*

Sales J also took these general principles as the starting point with regard to the question of whether duties were owed to the LLP by the parties to the dispute by virtue of their being its members. His conclusions in this regard will be more controversial. Their upshot is that a member of an LLP may or may not owe any fiduciary duties to it. In the case of a party which was a corporate member of the LLP at issue, but which was not a member of any of the committees assigned responsibilities for the management of the LLP's affairs by the members' agreement, he held that it *"does not have direct control over the affairs or property of the LLP, and so there is missing the usual basis on which the law would impose a fiduciary duty."* (paragraph 217).

The only fiduciary duty which he acknowledged all members potentially to owe arose from section 6(1) of the Limited Liability Partnerships Act 2000, which provides that *"every member of a limited liability partnership is the agent of the limited liability partnership"*. Thus if a member enters into a transaction on the LLP's behalf, Sales J noted, he will owe fiduciary duties to the LLP in relation to that transaction. This did not provide the basis of any more generalised fiduciary duties, however.

> "Sales J's analysis emphasises members' freedom to decide on the LLP's constitutional arrangements."

Sales J's analysis therefore emphasises members' freedom to decide on the LLP's constitutional arrangements and to limit their fiduciary obligations to responsibilities assumed in that context. What his focus on the LLP's internal arrangements arguably ignores, however, is the onus placed on membership by the legal framework with regard to the regulation of the LLP's outward-facing role. In particular, the insolvency legislation as carried across to LLPs places members in the same position as that of company directors: statutory obligations are a necessary consequence of office. This is an aspect of the protection afforded to outsiders dealing with a limited liability entity. So too, it may be argued, are the duties of loyalty required of all an LLP's members.

JAMES MATHER specialises in civil fraud, company and partnership law and general commercial and chancery litigation.

Chambers news

Awards

We are delighted that Serle Court was named Chancery Set of the Year at the Chambers & Partners Bar Awards. We were described by Chambers & Partners as *"one of the most impressive chancery commercial sets in the market"*. Serle Court was also one of only 6 chambers short-listed for the Chambers of the Year award at this year's British Legal Awards.

The achievements of individual members have also been recognised. Congratulations to Jonathan Adkin, one of 12 barristers included in The Lawyer Magazine's "Hot 100 2012"; and Ruth den Besten who was one of 10 junior barristers named by Legal Week in their annual future Stars at the Bar feature.

Directories

In the 2012 Chambers & Partners directory Serle Court again increased its recommendations. We now have 109 individual recommendations placing us 7th in "sets with most barrister rankings" and 4th in the "recommendations per member" table. As a set we are recommended in 11 practice areas, including the new Offshore section and are included in the Client Service at the Bar section, as 1 of only 16 sets. Alan Boyle QC, Philip Jones QC and Philip Marshall QC have all been ranked as "stars at the bar" along with only 16 other barristers in this prestigious category.

In the new edition of the Legal 500 directory, Serle Court is recommended as a set in 10 practice areas and individually members gained 9 more recommendations, taking the total to an impressive 114. We are extremely grateful to all our clients for recommending us so highly.

Publications

The new Research Handbook on International Insurance Law and Regulation was published in January. Julian Burling is one of the two joint editors and has also contributed a chapter on the authorisation of Lloyd's in the UK and overseas.

Julian has also recently contributed a new chapter on the Lloyd's market in the 3rd edition of *"Insurance Disputes"*, edited by Mance, Merkin and Goldrein and published by Informa in December 2011.

Brigitte Lindner, together with her co-editor Ted Shapiro, has published *Copyright in the Information Society: A Guide to National Implementation of the European Directive*. The book celebrates the 10th anniversary of Directive 2001/29/EC on copyright in the information society with an in-depth review of its implementation at the national level.

People

We are delighted to announce that Sophie Holcombe, our third six pupil, became a member of chambers in December. Sophie has a broad commercial and chancery practice with a particular interest in intellectual property, civil fraud, corporate insolvency and contentious trusts.

Conferences and Seminars

Serle Court is sponsoring the prestigious Trusts & Estates Litigation Forum for the fifth year running. The forum is the leading event in its field, attracting the very best speakers and attendees from across the globe. We are delighted that Frank Hinks QC has been invited to speak, and Dominic Dowley QC and Nicholas Lavender QC will both be attending. The forum runs from the 1st to 3rd March.

Finally we will be running a seminar in Norwich on the 29th of March on business and property law and litigation at which Nicholas Lavender QC, Christopher Stoner QC, Michael Edenborough QC, Andrew Francis, Andrew Bruce and Thomas Braithwaite will speak.

Edited by Jonathan Fowles

Respondents to unfair prejudice petitions

WHAT ARE THE CATEGORIES OF RESPONDENT AGAINST WHOM RELIEF CAN BE GRANTED IN RELATION TO AN UNFAIR PREJUDICE PETITION PRESENTED UNDER SECTION 994 OF THE COMPANIES ACT 2006?

The statute itself does not place any limit on the classes of potential respondents.

In most cases the principal respondents against whom relief is sought are current members of the company or LLP. But that need not be the case. In an appropriate case, relief may be sought against a former or non-member – in *Re a Company (No 005287 of 1985)* [1986] BCLC 68, the respondent alleged to be responsible for the conduct complained of had disposed of his shares – or a non-shareholder director (e.g. *Atlasview Ltd v Brightview Ltd* [2004] 2 BCLC 191).

In *Lowe v Fahey* [1996] 1 BCLC 262, it was held that if the unfairly prejudicial conduct alleged was diversion of corporate funds, a petitioner could seek relief not only against members and former members, but also against directors involved or third parties who knowingly received or improperly assisted in the diversion.

In *Clark v Cutland* [2003] 2 BCLC 393 a trustee of the pension fund to which company monies had been improperly paid (by the other trustee, who was a member and director of the company) was included as a respondent.

The joinder of a party as respondent is obviously connected with the availability of relief against him. Whether relief can be granted against a respondent to a section 994 petition was explored in the recent case of *F&C Alternative Investments (Holdings) Ltd v Barthelemy* [2011] EWHC 1731 (Ch). In that case, the issue arose as to what the relevant test of attribution of unfairly prejudicial conduct to a respondent to a section 994 petition should be.

Sales J decided that the test was whether the respondent *"is so connected to the unfairly prejudicial conduct in question that it would be just, in the context of the statutory regime contained in sections 994 to 996, to grant a remedy against [him] in relation to that conduct* [1096]."

At a high level of abstraction, he stated, the standard of justice to be applied reflects the requirements of fair commercial dealing inherent in the statutory regime. However, in practice, he added, everything will depend upon the facts of the particular case and the court's assessment of whether what was done involved unfairness in which the relevant respondent was sufficiently implicated to warrant relief being granted against him (or her). In considering that question, the court should not take a narrow legalistic view, but should look at the business realities of the situation.

> "In an appropriate case, relief may be sought against a former or non-member."

It will be interesting to see whether (and, if so, with what results) this test is applied in other cases – and how frequently petitioners will seek to join as respondents to section 994 petitions persons who have never been either members or directors of the company in question.

DANIEL LIGHTMAN is the author of Chapter 3 (derivative claims) and co-author of Chapter 8 (unfair prejudice: procedure) of Joffe, *Minority Shareholders: Law, Practice and Procedure* (4th Ed, 2011) and has extensive experience of advising and acting in relation to inter-shareholder disputes.

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6 New Square, Lincoln's Inn, London WC2A 3QS
T:+44 (0)20 7242 6105 F:+44 (0)20 7405 4004
www.serlecourt.co.uk