An overview of the major concerns on LLPs and the latest position

Protection of consumer interest

1. The key policy intent of the Bill, quoted from time to time by the Administration, is to strike a suitable balance between protecting innocent LLP partners on the one hand and consumers of legal services on the other hand.

Consumer Council's views

2. The Consumer Council does not object to the introduction of LLPs for solicitors provided that there are sufficient safeguards to protect consumers' interest. The major concerns expressed by the Consumer Council included the following[1]:

   (a) the introduction of LLPs would shift the risk of sustaining losses caused by the negligence or wrongful acts of a solicitor partner from the partnership to the consumers, as the aggrieved customer would only be able to seek remedy against the negligent partner instead of any or all of the partners of the firm as he/she was currently entitled to do so;

   (b) in view of the benefits of limited liability and the absence of substantial hurdle to conversion, it was likely that the majority of the local firms would be converted to LLPs, which would limit customers' choice; and

   (c) the displacement of joint and several liability by liability limited to defaulting partner would result in a disincentive for ethical scrutiny and internal control over the quality of work among members or partners of the firm.

3. The Consumer Council made the following suggestions[2]:

   (a) raising the statutory professional indemnity limit and/or requiring top-up insurance for LLPs;

   (b) making an LLP a separate legal entity which was liable for the wrongful acts and omission of its members to the same extent as the members so acting;

   (c) making provisions for preservation of the assets of LLPs which could be claimed by consumers; and

   (d) making sufficient disclosure to consumers so that they could assess the risk in dealing with LLPs.

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[1] The Consumer Council's submission dated May 2009 at Annexure 1
[2] Paragraph 22 of the Consumer Council's submission dated June 2009 at Annexure 2

Professional indemnity

4. With respect to the suggestion to raise the statutory professional indemnity limit, the claims history well demonstrates that the existing statutory limit is sufficient.[3]

5. The Consumer Council suggested that the statutory indemnity limit be regularly reviewed in order to address any change of circumstances that may call for an increase of the limit.[4]

Disclosure

6. With respect to making sufficient disclosure to consumers, the Bill has ensured transparency of the LLP status of a law firm through various provisions[5]:

   (a) The name of an LLP must include the words "Limited Liability Partnerships" or abbreviation "LLP" or "L.L.P." so that the public know that the firm operates with limited liability;

   (b) The name must be displayed visibly and legibly to the public at or outside its offices and on its office documents;

   (c) An LLP must give 7-day advance notice of its particulars to the Law Society;

   (d) An LLP must notify its existing clients within 30 days of the fact that it has become an LLP and how liabilities of a partner of a law firm are affected by the law firm becoming an LLP;

   (e) The Law Society keeps a list of LLPs for public inspection free of charge.

Right to seek redress against LLP

7. With respect to the rights of consumers to seek redress against LLPs, a claimant may choose to sue the firm and enforce the judgment against the firm's assets.[6]

Consumer choice

8. Judging from the experience of overseas jurisdictions where different forms of legal practice including sole proprietorships, partnerships and LLPs were permissible, there was no sign of LLPs becoming the dominant form of legal practice[7].

9. The above issues, namely, professional indemnity, disclosure, consumer choice, right to seek redress against LLP were considered resolved.

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[3] Claims statistics extracted from the Law Society submission dated 30 July 2009 at Annexure 3
[4] Extracted from paragraph 13 of the submission by the Consumer Council dated September 2010 at Annexure 4
[5] Sections 7AE, AF, AG and AJ of the Bill at Annexure 5
[6] Order 81 Rule of High Court at Annexure 6
[7] A table showing the percentages of LLPs in different jurisdictions extracted from the Law Society submission dated 30 July 2009 at Annexure 7

10. However, two concerns raised by the Consumer Council remain. They are:[8]

(a) limitation of liability being a disincentive for ethical scrutiny and internal control; and

(b) preservation of LLP assets to settle claims of consumers.

Constructive knowledge

11. To address the concern of the Consumer Council that partners of an LLP will avoid supervision to escape liability, the Administration introduced a provision[9] to exclude an LLP partner from LLP protection if he ought reasonably to have known of a default at the time of its occurrence and failed to exercise reasonable diligence to prevent its occurrence.

Proposal welcomed by the Consumer Council

12. The Consumer Council notes that this provision may enhance incentive for ethical scrutiny and internal control over the quality of work among members or partners of the firm.[10]

The Law Society's views

13. In the first place, there is absolutely no cause for concern that partners in an LLP will abandon proper supervision. Even if there is such concern, which the Law Society submits is an unnecessary concern, expressly legislating on the attachment of liability to constructive knowledge will not resolve the issue.

14. The constructive knowledge provision is objectionable on the basis that[11]:

(a) it is uncertain because in legal practice, rarely will default be constituted by a single act and it is difficult to determine when one has acquired knowledge of the default and whether one should be considered as having failed to prevent the occurrence if it was irreversible;

(b) it will invite claimants to adopt a catch all approach by relying on such an express provision leading to excessive litigation;

(c) most overseas jurisdictions provide only for actual knowledge of the default rather than constructive knowledge.

15. The Administration referred to Ontario and Texas as the two jurisdictions having similar constructive knowledge provisions[12]. However, it must be noted that these two jurisdictions provide a full shield LLP model which is different from the partial

[8] As referred to in paragraphs 2(c) and 3(c) of this paper
[9] Section 7AC of the Bill at Annexure 5
[10] Extracted from Consumer Council's submission dated September 2010 at Annexure 4
[11] Paragraphs 17 to 22 of the Law Society submission dated 6 August 2010 at Annexure 8
[12] Paragraph 12 of the Administration's Paper dated September 2010 at Annexure 9

shield provided in the Bill. Further, the Administration was not able to pinpoint any problems encountered by Alberta, British Columbia and Manitoba where there was no constructive knowledge provisions in their LLP statutes except some academic commentaries[13].

Counter proposal by the Law Society

16. For certainty and clarity, the Law Society counter proposed to replace the constructive knowledge provision by a provision that excludes LLP protection from a partner where the default was committed by someone who was directly responsible in a supervisory role and the partner failed to provide such adequate and competent supervision as would normally be expected of a partner in those circumstances[14].

17. This counter proposal was not accepted by the Administration because it took the view that [15]

    (a) it did not offer additional safeguards because a partner is already liable at common law for negligence of a person under his direct supervision;

    (b) it might negate the partner's collective liability for failing to establish a proper system of supervision;

    (c) it might provide disincentive for LLP partners to monitor activities of the firm for the benefit of the firm and its clients by confining LLP partner's liability to matters that he knows or under his direct supervision.

Notification requirement to replace constructive knowledge provision[16]

18. Discussion then commenced on options to replace the constructive knowledge provisions. The Law Society proposed that, in addition to the requirements on disclosure of LLP status in the Bill and the existing solicitors' professional conduct requirements on duty of care, the Solicitors' Professional Conduct Guide be amended or a new Practice Direction be issued by the Law Society Council to require LLPs to inform their clients of the name and status of the person responsible for the conduct of the matter on a day-to-day basis; the partner responsible for the overall supervision of the matter and any subsequent changes.

19. The above additional practice requirement serves to directly ensure that all cases are supervised by a named partner and offers a practical solution to the remote concern of LLP partners abandoning supervision to avoid liability. Any breach of a Practice Direction will subject the solicitor to disciplinary actions.

20. The Administration has proposed that the practice requirement be modified into a notification requirement in the legislation as follows:

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[13] Paragraph 2 of the Administration's Paper dated November 2010 at Annexure 10. A response to the academic commentaries by the Law Society is at paragraphs 5 to 9 in its submission dated 1 February 2011 at Annexure 11

[14] Paragraphs 23 and 24 of the Law Society submission dated 6 August 2010 at Annexure 8

[15] Paragraphs 15 to 18 of the Administration's Paper dated September 2010 at Annexure 9

[16] Extracted from the Law Society submission dated 1 February 2011 at Annexure 11

(a) an LLP will be required to issue a signed written notice to its clients in respect of every matter, within 30 days after acceptance of instructions of the matter, stating the name of the responsible partner for the matter and containing an undertaking by the LLP to inform the client of any subsequent changes of the responsible partner; and

(b) the loss of LLP protection for the firm in respect of that matter should the LLP fail to issue the written notice, unless the client knew who the responsible partner was prior to the default and within 30 days from the firm's acceptance of instructions in respect of that matter.

21. The Law Society has no objection to the imposition of a notice requirement, but the Law Society considers the suggested sanction disproportionate to such a procedural formality.

Notification requirement evolves into elaborate regulation on liability of "designated partner"[17]

22. In May 2011, the Administration proposed a new subsection 7AC(2A)(b)[18] which effects a fundamental change to the LLP structure. New subsection 7AC(2A)(b) provides that the limitation on liability does not apply to the designated partner. This means that the supervising partner will automatically lose the entitlement to LLP protection even though he is innocent and in the absence of any proof of negligence on his part.

23. The Law Society takes a strong view against this fundamental change and finds it wholly unacceptable because:

(a) It goes against the spirit and essence of LLPs which are introduced so that innocent partners will not be jointly and severally liable for others' default solely by reason of being a partner of the firm.

(b) It goes against the principle which we have all along been adhering to - the principle that the introduction of LLPs is not intended to change the common law position with respect to the proof of negligence. Based on the proposal, the supervising partner is treated automatically the same way as a negligent partner without him being proved to be negligent in any way.

Preservation of LLP assets

24. Another concern of the Consumer Council is the need to preserve the assets of an LLP to meet claims by consumers. In response to this concern, the Administration introduced a claw back provision to regulate the distribution of partnership property.[19]

[17] Extracted from the Law Society submission dated 9 June 2011 at Annexure 12
[18] CSAs at Annexure 13
[19] Section 7AI of the Bill at Annexure 5

Consumer Council welcomed the proposal

25. The Consumer Council supports the claw back provisions.[20]

The Administration's position

26. The Administration claimed that the Bill, unlike some other jurisdictions (California, British Columbia, Manitoba and Saskatchewan), does not prohibit distributions by LLPs in general. It allows the LLP to decide for itself whether to make a distribution taking into account all relevant considerations.[21] Further, it noted that "contingent liabilities" is not defined in other legislation. The Administration further disagreed that the unfair preference provisions in the Bankruptcy Ordinance can assist the claimant to claw back the partnership distribution given to an innocent partner of the firm.[22]

27. In respect of the limitation period, the Administration proposed a period of two years from the date the claimant discovered the distribution made. This was not acceptable to the Law Society as the proposed limitation period of two years which only started to run from the date of discovery by the claimant was equally uncertain.[23]

28. The Administration then proposed six years from the date of distribution based on section 4(1) of the Limitation Ordinance (Cap 347)[24].

The Law Society's position on claw back

29. Looking at LLP provisions around the world, claw back provisions are uncommon. Most other major jurisdictions like UK, Singapore or New York will simply rely on the general insolvency or fraudulent transfers provisions that do not apply only specifically to LLPs.

30. The Law Society has submitted before and it reiterates its position that on the premises that consumers will not be disadvantaged, Hong Kong should be in line with most other jurisdictions in designing its LLP legislation so that it can truly achieve the objective of enhancing Hong Kong's competitiveness through a modernization of its legal infrastructure that is comparable to other jurisdictions. Consumers will not be disadvantaged without clawback because:

    (a) the mandatory Professional Indemnity Scheme has proven to be sufficient protection based on past claims experience;

    (b) the Bankruptcy Ordinance will apply to claw back assets that should not have been transferred out in the event that the firm becomes insolvent and the partners are bankrupt;

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[20] Paragraph 7 of the Consumer Council's submission dated September 2010 at Annexure 4
[21] Paragraphs 4 and 5 of the Administration's Paper dated November 2010 at Annexure 15
[22] Paragraphs 16 and 17 of the Administration's Paper dated November 2010 at Annexure 16
[23] Paragraphs 8 and 9 of the Administration's Paper dated January 2011 at Annexure 17
[24] Section 4(1) of the Limitation Ordinance (Cap 347) at Annexure 18

(c) the general remedy of Mareva injunction will apply should there be any risk of dissipation of firm's assets.

31. Further, the current section 7AI is practically unworkable. Section 7AI allows any person to whom the partnership owes any partnership obligation at the time of distribution to take out proceedings to enforce a partner's liability to return that distribution to the partnership if the value of the partnership property is less than that of the partnership obligations.

32. Section 7AI(4) specifically provides that "partnership obligations" cover actual and contingent obligations.

33. Accordingly, section 7AI will effectively allow a claimant to commence proceedings to enforce a partner's liability to return a distribution to the partnership even before the claimant has obtained judgment on his negligence claim as long as the partnership property is less than the partnership obligations taking into account his claim (which is a contingent partnership obligation).

34. The issue is where judgment has not been obtained for the claim, how much of the claim should be allowed for the purpose of determining if the value of partnership obligation is more than that of partnership property. It poses problems for the following reasons:

(a) the amount of the claim may be over-inflated;

(b) an assessment of quantum at the early stage of the claim proceedings is extremely difficult.

35. If a comparison is made with the few Canadian jurisdictions that have provisions regulating distribution of partnership property in LLPs, it is noted that they do expressly provide for the bases to determine whether a distribution should have been made, namely,

"(a) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;

(b) on a fair valuation;

(c) on another method that is reasonable in the circumstances."[25]

36. If it is the view of the Bills Committee that a clawback provision must be provided in the legislation, the inclusion of such objective bases will add certainty and predictability to the existing section 7AI so that at the very least, an LLP will know how to ensure compliance with the provision. There is no use imposing a requirement if no one knows how to comply with it.

37. In relation to the limitation period of a clawback action, the Administration has proposed a period of 6 years. In a bankruptcy scenario, the relevant period for restoration is 2 years before presentation of bankruptcy petition where unfair

[25] Based on section 85(5) Manitoba Partnership Act and Section 83(5) Saskatchewan Partnership Act (attachment to Annexure 15)

preferences were given to associates of debtors and a person is an associate with whom he is in partnership under sections 50, 51 and 51B of the Bankruptcy Ordinance (Cap 6)[26].

38. The spirit of the proposed clawback is the same as that of the restoration of assets in a bankruptcy situation and the period should be consistent.

39. Further, comparing with the few Canadian jurisdictions[27] that have provisions regulating the distribution of property for LLPs, the period of limitation to enforce a liability under all of those provisions is 2 years.

40. There are two reasons given by the Administration for proposing 6 years instead of 2 years as the limitation period:

(a) clients do not know when a distribution has been made; and

(b) it takes more than 2 years for a client to obtain a first instance judgment on his negligence claim before he is in a position to enforce the judgment debt.

41. On the client's knowledge of distribution, a comparison can be made with the bankruptcy scenario where similarly the claimant would not have knowledge of any unfair transfer of assets, the restoration period is still legislated as 2 years. The Law Society does not see any justification for LLPs to depart from the policy of existing legislation.

42. For the second reason on the need of more than 2 years to obtain a first instance judgment, section 7AI provides that the claimant can take out a clawback action even before he obtains judgment. This is thus not a valid reason.

43. The Law Society submits that if the Bills Committee considers a clawback provision must be provided in the legislation, the limitation for a person to enforce a liability under such a provision should be 2 years in line with the bankruptcy regime and other overseas LLP legislation, e.g. British Columbia, Manitoba, Nova Scotia and Saskatchewan.

Latest position

44. In its latest submission dated 29 June 2011[28], the Law Society suggests that the CSAs be revised as follows by:

(a) deleting all provisions relating to the regulation of liability of a "designated partner";

(b) changing the 6-year claw back to a 2-year claw back;

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[26] Sections 50,51 and 51B of the Bankruptcy Ordinance (Cap 6) at Annexure 19
[27] British Columbia, Manitoba, Saskatchewan, Nova Scotia
[28] Paragraph 48 of the Law Society submission dated 29 June 2011 at Annexure 20

(c) clarifying the defence to a claw back claim.

45. On 19 December 2011, the Administration provided a revised draft Bill.

(a) The "designated partner" provisions have not been deleted, but a defence is added to allow a designated partner to claim LLP protection if he can prove that the default was committed by another person.

(b) The 6-year claw back has not been changed

(c) The defence to a claw back claim has not been clarified.

46. On the basis of the December draft, to become an LLP, the practical steps will be as follows:

(a) Enter into a written agreement between the partners to designate the firm as a partnership to which Part IIAAA of the Legal Practitioners Ordinance applies.

(b) 7 days before commencement of practice as an LLP, submit a written notice of the following to the Law Society:

(i) date of commencement as an LLP
(ii) name of the LLP (must include "LLP")
(iii) name of each partner
(iv) address of LLP

(c) Ensure proper display of LLP name in office premises, stationery, publications and websites.

(d) Within 30 days of becoming an LLP, send a written notice to all existing clients on the effects of becoming an LLP including all exclusions to LLP protection and the liability of a designated partner and his defence (This requirement does not apply to a new LLP).

(e) For every matter, within 30 days of a partner becoming a designated partner for that matter, send a written notice to the client of that matter to notify him of the identity of the designated partner and explain the effects of becoming an LLP including all exclusions to LLP protection and the liability of a designated partner and his defence.

(f) The notice of a designated partner must be given to the client before a default occurs or else it has no effect on liability for a partnership obligation.

47. Based on the December draft, the situations whereby a partner in an LLP will lose LLP protection are as follows:

(a) the partner knew of the default at the time it occurred and failed to exercise reasonable care to prevent it;

(b) the default was committed by the partner himself or by someone under his supervision;

(c) the partner is a designated partner unless he proves that the default was committed by another partner or by someone under the supervision of another partner;

(d) the default occurred at a time when there was no designated partner for that matter;

(e) no proper designated partner notice has been served on the client or the client had no actual knowledge of any partner acting as a designated partner and of the effects of an LLP on its partners' liabilities.

48. In relation to the claw back, the latest CSAs maintain a 6-year clawback with a defence to the partner receiving the distribution if the partner can show that the distribution was made after having made a reasonable assessment that the financial position of the LLP would not be insolvent after the distribution.

49. Subsequent to the receipt of the December draft, the Law Society had further discussions with the Administration.

50. The Department of Justice has made a counter proposal[29] to replace the designated partner provisions with a statutory requirement on the LLP to keep a client informed of the identity of at least one partner who is responsible for the overall supervision of a client matter and failure to comply with this requirement will result in loss of LLP protection for all partners. The Department of Justice will elaborate more on its counter proposal at the Members' Forum on 13 February 2012.

The Working Party on Limited Liability Partnerships
The Law Society of Hong Kong
10 February 2012

[29] DOJ's proposal dated 10 February 2012 (Annexure 21)

INDEX

Annexure 1

Consumer Council's Submission to
the Legislative Council
Panel on Administration of Justice and Legal Services

Limited Liability Partnership (LLP) for Legal Practice

Introduction

1. The Council does not object to the adoption of limited liability partnership ("LLP") as a matter of principle, provided that there are sufficient safeguards for consumers.

2. Nonetheless, as the Council observes, consumer interests have not been adequately addressed under the proposed LLP system.

3. The Council also notices, from the attachment to the Law Society's letter dated 24 March 2009 to the Panel Chair, that a partner of LLP "is not personally liable for any obligations or liabilities of the partnership or any other person solely by reason of the fact that he is a partner of the firm". In other words, the proposed limited liability framework can be understood as covering not only liability arising from negligence, which the Council was given to understand as the only liability to which LLP applied, but also those from wrongful acts committed in the course of practice.

Council's concerns

Consumers' chance of recovery

4. One of the Council's major concerns is that the change from general partnership status to limited liability partnership status of a solicitors firm would mean a shift of the risk of sustaining losses, caused by negligence or wrongful acts of a partner of a solicitors firm committed during the course of his practice, from the partnership to the consumers.

5. Under such a change, a consumer aggrieved by the negligence or wrongful acts of a partner would be able to seek remedy against that partner only instead of any or all of the partners of the firm as he or she is currently entitled to. This would diminish his or her chance of recovery.

6. The Council recognizes that the Professional Indemnity Scheme ("the Scheme") does render certain protection to consumer in securing claim

recovery from the defaulting partner. However, it is noted that such protection is limited in terms of amount and scope: -

i) The indemnity is capped at HK$10 million per claim.

ii) The Scheme applies only to professional negligence claims against solicitors and any person employed in or in connection with their practice. Losses arising out of claims for personal injuries, physical damage to property and fraudulent act or fraudulent omission are expressly excluded.

7. The Council is given to understand that the statutory indemnity is proposed to remain to be capped at HK$10 million per claim. In the current general partnership system, a consumer seeking to recover the outstanding award for a negligence claim in excess of the limit of indemnity may enforce it against any or all of the partners. On the other hand, although non-negligence claims are not covered by the Scheme, the consumer may seek recovery from any or all of the partners.

8. However, the introduction of LLP would necessarily diminish the chance of recovery of the outstanding award for a negligence claim in excess of the limit of indemnity or an award of damages for non-negligence claims outside the Scheme, particularly, where the defaulting partner has no financial capacity to satisfy the claims or his whereabouts cannot be located.

9. It is also noted that the statutory limit has been kept unchanged since 1994. The Council wonders whether the present limit is still adequate to meet the current demands (for instance, the value of properties have increased considerably since 1994 and there are now a significant number of transactions involving properties worth over $10 million). We consider that should LLP be introduced, the Scheme should be reviewed to ensure that the interests of consumers for legal services are sufficiently safeguarded.

10. The Council would suggest that consideration should be given to: -
    (i) expanding the scope of the Scheme so as to cover losses arising from the claims currently excluded; and

(ii) raising the statutory indemnity limit.

Unfairness in bearing risks

11. On the other hand, it seems to be often the case that a consumer seeking to retain the service of a solicitors firm places trust on the partnership rather than a particular partner. He is usually referred to the legal clerks or assistant solicitors of the firm for the services. He has no idea on which partner is going to handle or supervise his case; not to mention, the handling partner's professional competence and financial capacity in satisfying claims. He is not in a position to make any choice amongst the partners. To him, it is the firm with which they entered into the contract for legal services.

12. The partners of a firm are supposed to know each other well. They are in a position to decide whether or not to enter into partnership and place their trust in one another. In contrast, such knowledge of the partners' competence etc. is not generally available to the average consumers of legal service.

13. Therefore, it would be unfair to consumers to bear the risk of sustaining losses caused by negligence or wrongful acts of the defaulting partner, which is used to be borne by the partnership.

Consumers' choice

14. To minimize the risk of failing to recover from the handling partner for losses caused by his negligence or wrongful acts, when seeking to hire the legal services, a consumer under the LLP system may have to ascertain whether his handling partner is with "deep pocket". .However, it is difficult to envisage that consumers will have any means to ascertain the actual financial viability of the handling partner.

15. Currently, in terms of chance of recovery from professional negligence, consumers would feel more secured to retain a partnership than a sole proprietorship. It is the Council's concern that the introduction of LLP may limit consumer's choice because in terms of liability there may not be difference between the two.

Destruction of the unlimited liability framework

16. As noted from the said letter of 24 March 2009 from the Law Society to the Panel Chair, another vehicle of limited liability, namely the Solicitor Corporation, is proposed. It is intended to provide an option for sole proprietorship to turn itself into a limited liability entity.

17. It raises the Council's concern over the destruction of the unlimited liability framework which has been for hundreds of years an optimal safeguard for consumer interests.

Impact on professional and ethical performances

18. Further, the Council is also concerned about whether the displacement of joint and several liability by liability limited to defaulting partner would result in a disincentive for ethical scrutiny and internal control over the quality of work among members or partners of the firm.

19. We are of the view that the joint and several liability of general partnership has the advantage of ensuring that partners would maintain a direct interest in the business of the partnership and the conduct of their fellow partners and employees. It is conducive to the assurance of observance of both ethical and professional responsibilities.

Conclusion

20. To conclude, there seems to be an absence of mechanism preventing consumer interests from being derogated as a result of the change from the general partnership system to the LLP system. Moreover, the Council is not able to envisage that the proposed LLP system will confer any additional benefit to consumers. In the premises, the Council feels unable to support the current LLP proposal.

21. The Council is looking forward to a proposal that would duly address the consumer interests and assure high professional and ethical standards of the legal practice.

May 2009
Consumer Council

Annexure 2

Consumer Council's Submission to
the Legislative Council
Panel on Administration of Justice and Legal Services

Limited Liability Partnership (LLP) for Legal Practice

Introduction

1. In light of the discussion at the Panel Meeting on 25 May 2009 and the Law Society's confirmation that the proposed LLP System will apply only to liability arising from negligence of a partner, the Council resubmits its views on the said issue as follows. This submission shall supersede the Council's earlier submission sent to the Panel on 21 May 2009.

2. The Council does not object to the adoption of limited liability partnership ("LLP") as a matter of principle, provided that there are sufficient safeguards for consumers.

3. Nonetheless, as the Council observes, consumer interests have not been adequately addressed under the proposed LLP system.

4. The Council is given to understand that LLP is a business structure proposed for legal practices, which confers privileges of limited liability on innocent partners so as to insulate their personal assets from claims incurred by the negligence of other partners.

5. It is noted from the 2nd page of the attachment to the Law Society's letter dated 24 March 2009 to the Panel Chair ("the Letter") that the proposed LLP is not a separate legal entity. It follows that it cannot sue or be sued.

6. It is stated on page 4 of the Letter that an LLP survey was conducted in May 2008 and "some of the firms that responded were international law firms and expressed support for the introduction of LLPs in Hong Kong". There is no mention of the degree of support amongst local law firms from which ordinary consumers would turn to for legal services. Nevertheless, the benefits of limited liability and the absence of substantial hurdle to conversion would make LLP an attractive option too for local law firms. It appears from the attachment to the Letter that conversion to LLP will be

simple - there will be no requirement for financial disclosure or prior approval of the Law Society on formation, nor is there additional implication on taxation. As such, there is a possibility that majority of the local law firms will be converted to LLPs.

Council's concerns

Consumers' chance of recovery

7. One of the Council's major concerns is that the change from general partnership status to limited liability partnership status of a solicitors firm would mean a shift of the risk of sustaining losses, caused by negligence of a partner of a solicitors firm committed during the course of his practice, from the partnership to the consumers.

8. Under such a change, a consumer aggrieved by the negligence a partner would be able to seek remedy against that partner only instead of any or all of the partners of the firm as he or she is currently entitled to. As the proposed LLP is not a separate legal entity, the Council wonders if the aggrieved consumer can seek redress from it. Therefore, the change from general partnership to LLP would diminish the consumer's chance of recovery.

9. The Council recognizes that the Professional Indemnity Scheme ("the Scheme") will render certain protection to consumers in securing recovery for a negligence claim against defaulting partners of LLP.

10. However, the Council is given to understand that the statutory indemnity is proposed to remain to be capped at HK$10 million per claim. In the current general partnership system, a consumer seeking to recover the outstanding award for a negligence claim in excess of the limit of indemnity may enforce it against any or all of the partners.

11. A consumer of LLP would find lesser chance of recovery of the outstanding award for a negligence claim in excess of the limit of indemnity, particularly, where the defaulting partner has no financial capacity to satisfy the claims or his whereabouts cannot be located.

12. It is also noted that the statutory limit has been kept unchanged since 1994. The Council wonders whether the present limit is still adequate to meet the current demands (for instance, the value of properties has increased considerably since 1994 and there are now a significant number of transactions involving properties worth over $10 million). We consider that should LLP be introduced, the Scheme should be reviewed to ensure that the interests of consumers for legal services are sufficiently safeguarded.

Unfairness in bearing risks

13. On the other hand, it seems to be often the case that a consumer seeking to retain the service of a solicitors firm places trust on the partnership rather than a particular partner. He is usually referred to the legal clerks or assistant solicitors of the firm for the services. He has no idea on which partner is going to handle or supervise his case; not to mention, the handling partner's professional competence and financial capacity in satisfying claims. He is not in a position to make any choice amongst the partners. To him, it is the firm with which they entered into the contract for legal services.

14. The partners of a firm are supposed to know each other well. They are in a position to decide whether or not to enter into partnership and place their trust in one another. In contrast, such knowledge of the partners' competence etc. is not generally available to the average consumers of legal service.

15. To minimize the risk of failing to recover from the handling partner for losses caused by his negligence, when hiring the legal services, a consumer under the LLP system may have to ascertain whether his handling partner is with "deep pocket". However, it is difficult to envisage that consumers will have any means to ascertain the actual financial viability of the handling partner.

16. Therefore, it would be unfair to consumers to bear the risk of sustaining losses caused by negligence of the defaulting partner, which is used to be borne by the partnership.

Consumers' choice

17. Currently, in terms of chance of recovery from professional negligence, consumers would feel more secured to retain a partnership than a sole proprietorship. It is the Council's concern that the introduction of LLP may limit consumer's choice. As mentioned, it is quite likely that LLP would become a prevailing business model for law firms. Under such circumstances, consumers will be left effectively not much of a choice but to retain the service of a LLP. However, in terms of liability there may not be difference between a LLP and a sole proprietorship.

Destruction of the unlimited liability framework

18. As noted from the said letter of 24 March 2009 from the Law Society to the Panel Chair, another vehicle of limited liability, namely the Solicitor Corporation, is proposed. It is intended to provide an option for sole proprietorship to turn itself into a limited liability entity.

19. The Council is concerned that there will be not much left for the unlimited liability framework to function as an optimal safeguard for consumer interests as it did for hundreds of years.

Impact on professional and ethical performances

20. Further, the Council is also concerned about whether the displacement of joint and several liability by liability limited to defaulting partner would result in a disincentive for ethical scrutiny and internal control over the quality of work among members or partners of the firm.

21. We are of the view that the joint and several liability of general partnership has the advantage of ensuring that partners would maintain a direct interest in the business of the partnership and the conduct of their fellow partners and employees. It is conducive to the assurance of observance of both ethical and professional responsibilities.

<u>Conclusion</u>

22. At the present stage, with information available to the Council, it is suggested that consideration should be given to:

(i) raising the statutory indemnity limit and /or requiring for top-up insurance for LLPs;

(ii) making LLP a separate legal entity which is liable for the wrongful acts

and omission of its members to the same extent as the members so acting;

(iii) making provisions for preservation of the assets of LLP which can be claimed by consumers;

(iv) making sufficient disclosure to consumers so that they can assess the risks in dealing with LLPs.

23. The Council is looking forward to a proposal that would duly address the consumer interests and assure high professional and ethical standards of the legal practice.

June 2009
Consumer Council

Annexure 3

Extract from the submission from the Law Society's Working Party on Limited Liability Partnerships dated 30 July 2009

(b) Professional indemnity cover

(i) For the past 10 indemnity years from 1988/89 to 2007/08, the average gross settled claim size (including large multiple claims) ranged from HK$0.002 million to HK$3.922 million, well below the statutory indemnity limit of HK$10 million per claim.

(ii) From the 1994/95 indemnity year to 2 July 2009, there have been 3,321 claims on the Hong Kong Solicitors Indemnity Fund (including notifications), out of which, only 53 claimants, i.e. 1.6 %, have sought HK$10 million or more.

(iii) Of these 53 claims:

(aa) Payout of HK$10 million

There are 12 claims in which the Fund paid HK$10 million (including defence cost but less the indemnified's deductible).

Of these claims, 11 were brought by companies and one by an individual.

(bb) Payout between HK$8 million and HK$10 million

There are 15 claims in which the actual or expected payment by the Fund (including defence costs) is or will be more than HK$8 million but less than HK$10 million.

Of these claims, 13 were brought by companies and 2 by individuals.

(cc) Payout of less than HK$8 million

There are 12 claims that were settled for less than HK$8 million (including defence costs).

Of these claims, 10 were brought by companies and 2 by individuals.

(dd) Payout that may reach HK$10 million for open claims

There are 7 open claims in which it is anticipated that the claim payments (including defence costs) will reach HK$10 million (including the deductible).

Of these claims, 5 were brought by companies, one by an individual and one by joint claimants, being one company and two individuals.

(ee) Payout that may be less than HK$8 million for open claims

There are 7 open claims in which it is anticipated that the claims will settle for less than HK$8 million (including defence costs).

All of these claims were brought by companies.

7. The above statistics support the Law Society's assertion that the existing statutory professional indemnity limit of HK$10 million per claim which is proposed to apply equally to LLPs is generally sufficient for indemnity protection of individual consumers.

8. Further, out of the claims seeking over HK$10 million, most of them were brought by corporations rather than individual consumers.

9. Any increase to the statutory indemnity limit of HK$10 million per claim will inevitably lead to an increase in insurance premium. The extra cost will in turn be passed onto the consumers who will have to pay more to get higher indemnity cover.

10. As the statutory professional indemnity limit of HK$10 million per claim which is public knowledge is already generally sufficient, the Law Society does not consider that there is a need to further consider the suggestion of requiring an LLP to disclose its individual top up insurance coverage publicly.

11. Such suggestion in any event is not feasible as firms are often bound by confidentiality obligations under their respective top up insurance policies.

Annexure 4

LC Paper No. CB(2)2260/09-10(01)

Consumer Council's Submission to
the Bills Committee of the Legislative Council

Legal Practitioners (Amendment) Bill 2010 -
Limited Liability Partnership (LLP) for Legal Practice

Introduction

1. The Council has previously made its submissions on the introduction of LLP for legal practice in May 2009. It would like to take this opportunity to submit its views on the Legal Practitioners (Amendment) Bill 2010 which is proposed for the introduction and regulation of the LLP.

2. The Council reiterates its position that it would not oppose the introduction of LLP for legal practice provided that consumer interest would be sufficiently safeguarded.

Requirements for protection of limited liability

3. The Council welcomes the proposed s.7AC(3) which provides that the protection of limited liability under s.7AC(1) will not be available to a partner in a LLP if he or she knew or ought reasonably to have known of the default of any other party at the time of its occurrence, and failed to exercise reasonable diligence to prevent its occurrence. This proposed provision will hopefully have the positive effect of enhancing incentive for ethical scrutiny and internal control over the quality of work among members or partners of the firm.

4. The Council also supports the proposed s.7AC(4) which provides that a partner may be protected from the liability arising from a claim made by a client only if (a) the partnership was a LLP 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 LLP at that time.

5. The requirement as stated in (a) may prevent the abuse of converting a general partnership into a LLP so as to limit the liability of the partners when a cause of action of a claim against the firm has actually accrued or is likely to have accrued.

6. Further, the requirement as stated in (b) may encourage a law firm to inform its clients of the fact that it is a LLP as early as possible and ensure the compliance of the provisions under the proposed ss.7AE, 7AF and 7AG respectively concerning the presentation of the name of LLP, the display of the name by LLP and the notice by a LLP to its existing clients. The Council expects that these provisions may help ensure that consumers are aware that they are dealing with a LLP instead of a general partnership.

Preservation of LLP's property

7. An aggrieved consumer may turn to the LLP, apart from the defaulting partner, for compensation for loss or damage. The Council notes that it is important to preserve the property of a LLP to meet the liabilities arising from the default of a partner. The Council therefore supports the proposed s.7AI which regulates distribution of partnership property for the purpose of preserving property of a LLP to meet its liabilities.

Right to seek redress against LLP

8. It is also desirable to bring home to the consumers aggrieved by the default of a partner of a LLP committed in the course of its business their right to seek redress against the LLP.

9. It is provided in the proposed s.7AM that all relevant laws applicable to a partnership, except in so far as they are inconsistent with the proposed LLP provisions, remain applicable to a LLP, and Partnership Ordinance is expressly referred to as one of the relevant laws. Moreover, the proposed s.7AC(5) provides that the limited liability protection does not apply to any interest of a partner in the partnership property from claims against the partnership.

10. The Council understands that a legally trained person could locate the relevant provision (i.e. s.12) in the Partnership Ordinance, read that provision together with the proposed s.7AC(5) of the Bill, and come to the conclusion that a LLP is liable to the same extent as the partner who committed a wrongful act or omission in the course of the LLP's business or with its authority, and that the liabilities of the LLP shall be met out of its property. However, it would not be a task achievable by an average consumer. Therefore, a direct and express provision clearly spelling out the liability of a LLP as mentioned is

preferred.

Limit of the professional indemnity scheme

11. The Council is of the view that the Professional Indemnity Scheme does render certain protection to consumer in securing recovery for negligence claim from the defaulting partner. Such protection would be even more vital to a consumer of LLP where the defaulting partner has no financial capacity to satisfy the claims or his whereabouts cannot be located; and the partnership property is not adequate to satisfy the claim or the outstanding award.

12. The Council is given to understand that, previously most of the claims seeking over the HK$10 millions indemnity limit were brought by corporations rather than individual consumers. However, the recent sharp rise in the prices of private residential properties seems to suggest that it may not always be the case.

13. As such, the Council submits that the statutory indemnity limit should be regularly reviewed in order to address any change of circumstances that may call for a rise of the limit.

September 2010
Consumer Council

Annexure 5

LEGAL PRACTITIONERS (AMENDMENT) BILL 2010

CONTENTS

A BILL

To

Amend the Legal Practitioners Ordinance.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Legal Practitioners (Amendment) Ordinance 2010.

2. Commencement

This Ordinance comes into operation on a day to be appointed by the Secretary for Justice by notice published in the Gazette.

3. Section 2 amended (Interpretation)

Section 2(1) of the Legal Practitioners Ordinance (Cap. 159) is amended by adding—

""partnership" (合夥) includes a limited liability partnership as defined by section 7AA;".

4. Part IIAAA added

The following is added immediately after section 7A—

"PART IIAAA

LIMITED LIABILITY PARTNERSHIPS

7AA. Definitions (Part IIAAA)

(1) In this Part—

"business" (業務)—

(*a*) in relation to a Hong Kong firm, means the business of practising as solicitors; and

(*b*) in relation to a foreign firm, means the business of practising or advising on foreign law;

"client" (客戶), in relation to a law firm, means a person who retains or employs the firm;

"default" (失責行為) means any negligent or wrongful act or omission, or any misconduct;

"limited liability partnership" (有限責任合夥) has the meaning given by section 7AB;

"partnership obligation" (合夥義務), in relation to a partnership, means any debt, obligation or liability of the partnership, other than debts, obligations or liabilities of the partners as between themselves, or as between themselves and the partnership;

"partnership property" (合夥財產) has the same meaning as in the Partnership Ordinance (Cap. 38).

(2) If a law firm is constituted as a limited liability partnership when it commences business in Hong Kong, a reference in this Part to the date on which it becomes a limited liability partnership is a reference to the date on which it commences business in Hong Kong.

7AB. Limited liability partnership

For the purposes of this Part, a limited liability partnership is a partnership that is for the time being—

(*a*) a Hong Kong firm or a foreign firm; and

(*b*) designated by written agreement between the partners as a partnership to which this Part applies.

7AC. Effect on liabilities of partners in limited liability partnership

(1) Subject to subsections (3), (4) and (5), a partner in a limited liability partnership is not, solely by reason of being a partner, jointly or severally liable for any partnership obligation (whether founded on tort,

contract or otherwise) that arises from a default of any other partner in the partnership, or of an employee, agent or representative of the partnership, in the course of the business of the partnership as a limited liability partnership.

(2) The protection of a partner from liability under subsection (1) applies irrespective of whether the liability is in the form of indemnification, contribution or otherwise.

(3) Subsection (1) does not protect a partner from liability if the partner—

(*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.

(4) 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.

(5) Subsection (1) does not protect any interest of a partner in the partnership property from claims against the partnership.

(6) If a partner is protected from liability under subsection (1)—

(*a*) the partner is not a proper party to any proceedings brought by or against the partnership for the purpose of recovering damages or claiming other relief in respect of the liability; and

(*b*) the proceedings may, if they could apart from this section be brought by or against the partnership, continue to be brought by or against the partnership.

7AD. Advance notice to Society in respect of limited liability partnership

(1) A law firm must ensure that, at least 7 days before the date on which it becomes a limited liability partnership, a written notice of the following particulars is given to the Society—

(*a*) the date on which the firm becomes a limited liability partnership;

(*b*) the name of the partnership;

(*c*) the name of each partner in the partnership;

(*d*) each address at which the partnership carries on its business;

(*e*) any other particulars prescribed by rules made under section 73.

(2) A law firm must ensure that, at least 7 days before the date on which it ceases to be a limited liability partnership, a written notice of that date is given to the Society.

(3) Subsection (1) does not apply to a foreign firm that is constituted as a limited liability partnership when it commences business in Hong Kong.

7AE. Name of limited liability partnership

A limited liability partnership must—

(*a*) if it has a Chinese name, include the words "有限責任合夥" as part of that Chinese name; and

(*b*) if it has an English name, include the following as part of that English name—

(i) the words "Limited Liability Partnership"; or

(ii) the abbreviation "LLP" or "L.L.P.".

7AF. Notification of name by limited liability partnership

(1) A limited liability partnership must display its name, in a clearly visible and legible manner, at or outside every office or place in which it carries on its business.

(2) A limited liability partnership must state its name, in a clearly visible and legible manner, in its correspondence, notices, publications, invoices and bills of costs, and on its websites.

7AG. Notice by limited liability partnership to existing clients

(1) Except as provided in subsection (2), a law firm must, within 30 days after it becomes a limited liability partnership, by written notice inform each of its existing clients of that fact.

(2) A specified foreign firm must, within 30 days after it becomes a limited liability partnership, by written notice inform each of its existing clients in Hong Kong of that fact.

(3) For the purposes of subsection (2), a foreign firm is a specified foreign firm if, before becoming a limited liability partnership, it has been carrying on, in a foreign jurisdiction, the practice of law as a partnership with limited liabilities under the law of that jurisdiction.

(4) A written notice issued under this section must be in a form specified by the Council.

(5) The form specified under subsection (4) must include a brief statement stating how liabilities of partners of a law firm are affected by the law firm becoming a limited liability partnership under section 7AC.

(6) In this section, "existing client" (現有客戶), in relation to a law firm, means a person who is a client of the firm at the time the firm becomes a limited liability partnership.

(7) For the purposes of subsection (2), an existing client of a specified foreign firm is its existing client in Hong Kong if—

(*a*) the client is a body corporate, and it has its registered office or a place of business in Hong Kong; or

(*b*) the client is not a body corporate, and the last correspondence address provided by the client to the firm is in Hong Kong.

(8) This section does not apply to a law firm that is constituted as a limited liability partnership when it commences business in Hong Kong.

7AH. Other requirements relating to practice of law firm in rules made under section 73

Sections 7AD, 7AE, 7AF and 7AG are in addition to, and do not affect, any other provisions relating to the practice of a law firm as prescribed by rules made under section 73.

7AI. Provisions regulating distribution of partnership property

(1) If a limited liability partnership makes a distribution of any of its partnership property to a partner, or to an assignee of a partner's share in the partnership, as a consequence of which—

(*a*) the partnership would be unable to pay its partnership obligations as they become due; or

(*b*) the value of the remaining partnership property would be less than the partnership obligations,

then the partner or assignee is liable as provided in subsection (2).

(2) The partner or assignee who receives the distribution is liable to the partnership for—

(*a*) the value of the property received by the partner or assignee as a result of the distribution; or

(*b*) the amount necessary to discharge the partnership obligations at the time of the distribution,

whichever is the lesser.

(3) Proceedings to enforce any of the liabilities arising under this section as a result of the distribution may be brought by—

(*a*) the partnership;

(*b*) any partner in the partnership; or

(*c*) any person to whom the partnership owes any partnership obligation at the time of the distribution.

(4) In this section, a reference to partnership obligation is a reference to partnership obligation (whether actual or contingent).

(5) This section does not affect a payment made as reasonable compensation for current services provided by a partner to the partnership, to the extent that the payment would be reasonable if paid to a person who is an employee of, but not a partner in, the partnership as compensation for similar services.

7AJ. List of limited liability partnerships

(1) The Council must keep a list of law firms that are or have been limited liability partnerships.

(2) The list must, in relation to each such law firm, contain—

(*a*) its name;

(*b*) each address at which it carries on its business or, if it has ceased its business, each address at which it last carried on its business; and

(*c*) the date on which it first became a limited liability partnership and, if applicable, the dates from which or periods during which it has ceased to be a limited liability partnership.

(3) As soon as practicable after becoming aware of any matter that would require the list to be updated, the Council must update the list accordingly.

(4) For the purpose of enabling any member of the public to ascertain whether a law firm is, or has been, a limited liability partnership and to ascertain the particulars of the partnership, the Council must make the list available for public inspection, free of charge, at the office of the Council during office hours.

7AK. No dissolution of partnership, etc.

(1) The fact that a partnership becomes, or ceases to be, a limited liability partnership—

(*a*) does not cause the partnership—

(i) to be dissolved; or

(ii) to cease continuing in existence as a partnership; and

(*b*) does not affect any of the rights and liabilities (whether actual or contingent) of the partnership, or of any person as a partner, that have been acquired, accrued or incurred before the partnership becomes, or ceases to be, a limited liability partnership.

(2) Subsection (1)(*a*) operates subject to any written agreement between the partners to the contrary.

7AL. This Part to prevail over inconsistent agreement

(1) In relation to a limited liability partnership, this Part prevails over any inconsistent provisions in any agreement between any persons, whether as partners in the partnership or otherwise.

(2) To avoid doubt, this section does not affect the operation of section 7AK(2).

7AM. Law not inconsistent with this Part continues to apply

(1) All relevant laws, except so far as they are inconsistent with this Part, continue to apply in relation to a partnership that is a limited liability partnership.

(2) In this section, "relevant laws" (有關法律) means the Partnership Ordinance (Cap. 38) and every other law that applies in relation to a partnership (whether an enactment, or a rule of equity or of common law).".

5. Section 73 amended (Power of the Council to make rules)

Section 73(1) is amended by adding—

"(*df*) in relation to the practice of limited liability partnerships—

(i) prescribing particulars for the purposes of section 7AD(1)(*e*); and

(ii) regulating any matters of procedure or matters incidental, ancillary or supplemental to the provisions of Part IIAAA;".

Consequential Amendment

Summary Disposal of Complaints (Solicitors) Rules

6. Schedule amended (Scheduled items)

The Schedule to the Summary Disposal of Complaints (Solicitors) Rules (Cap. 159 sub. leg. AD) is amended, under the heading "**Legal Practitioners Ordinance (Cap. 159)**", by adding—

"2.	Section 7AD(1)	10,000	15,000
3.	Section 7AD(2)	10,000	15,000
4.	Section 7AE(*a*)	10,000	15,000
5.	Section 7AE(*b*)	10,000	15,000
6.	Section 7AF(1)	10,000	15,000
7.	Section 7AF(2)	10,000	15,000
8.	Section 7AG(1)	10,000	15,000
9.	Section 7AG(2)	10,000	15,000".

Explanatory Memorandum

The purpose of this Bill is to amend the Legal Practitioners Ordinance (Cap. 159) ("the principal Ordinance") to introduce limited liability partnerships for law firms in Hong Kong.

Preliminary provisions

2. Clauses 1 and 2 provide for the short title and commencement.

3. Clause 3 adds to section 2(1) of the principal Ordinance a new definition of "partnership" to make it clear that a reference to this term throughout the principal Ordinance and its subsidiary legislation generally includes a limited liability partnership.

New Part IIAAA of the principal Ordinance

4. Clause 4 adds to the principal Ordinance a new Part IIAAA on limited liability partnerships, which consists of the proposed sections 7AA to 7AM.

5. The proposed section 7AA provides for the interpretation of expressions used in the new Part IIAAA.

6. The proposed section 7AB sets out the meaning of a "limited liability partnership" in the Bill, namely, a Hong Kong firm or a foreign firm (both terms are defined in section 2(1) of the principal Ordinance) that is designated by written agreement between the partners as a partnership to which the new Part IIAAA applies.

7. Under the Partnership Ordinance (Cap. 38), every partner in a firm is liable jointly and severally for certain wrongful acts or omissions for which the firm becomes liable. The proposed section 7AC varies this rule for law firms that are limited liability partnerships. According to the proposed section 7AC(1), a person will not, solely by reason of being a partner, become jointly or severally liable for any partnership obligation if the firm is a limited liability partnership and the partnership obligation arises from the default of another partner, or of an employee, agent or representative of the firm.

8. 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. Also, a failure to establish a proper system of staff supervision can be the basis for a claim that all partners of a limited liability partnership are jointly and severally liable for negligence.

9. The proposed section 7AC(3) further provides that the protection under section 7AC(1) is not available to a partner in a limited liability partnership if he or she 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. Moreover, a partner may be protected from the liability arising from a claim made by a client only if the partnership was a limited liability partnership 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 a limited liability partnership at that time (see the proposed section 7AC(4)).

10. Under the proposed section 7AD, a law firm must ensure that a written notice of its relevant particulars is given to The Law Society of Hong Kong ("the Law Society") at least 7 days before it becomes, or ceases to be, a limited liability partnership. However, a foreign firm constituted as a limited liability partnership when it commences business in Hong Kong is not required to give a separate notice under the proposed section 7AD(1) because it will have already provided the relevant particulars to the Law Society for prior approval of its registration under Part IIIA of the principal Ordinance.

11. The proposed section 7AE requires that the name of a limited liability partnership must 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. That name must be displayed at every place of business of the partnership and stated in its correspondence and other publications as required by the proposed section 7AF.

12. The proposed section 7AG requires an existing law firm to notify all its existing clients within 30 days after it becomes a limited liability partnership. However, an existing foreign firm only needs to notify its existing clients in Hong Kong if it has already been practising law as a partnership with limited liabilities under the law of another jurisdiction.

13. The proposed section 7AH makes it clear that any other requirements relating to the practice of law firms as prescribed by rules made by the Council of the Law Society under section 73 of the principal Ordinance will not be affected by the proposed sections 7AD, 7AE, 7AF and 7AG.

14. The proposed section 7AI regulates the distribution of a limited liability partnership's property in circumstances where, as a result of the distribution, the partnership would be unable to pay its obligations as they become due, or the value of the remaining partnership property would be less than its obligations.

15. Under the proposed section 7AJ, the Council of the Law Society is required to keep a list of limited liability partnerships and to make the relevant information available for public inspection.

16. The proposed section 7AK provides that a partnership's existence as a partnership (subject to any contrary agreement between the partners), and the pre-existing rights and liabilities of the partnership and of its partners, will not be affected by the fact that it becomes, or ceases to be, a limited liability partnership.

17. While the proposed section 7AL further states that the new Part IIAAA prevails over inconsistent provisions in any agreement, the proposed section 7AM makes it clear that all relevant laws applicable to a partnership, except so far as they are inconsistent with that Part, remain applicable to a limited liability partnership.

Further provisions

18. Clause 5 amends section 73 of the principal Ordinance to empower the Council of the Law Society to make rules respecting the practice of limited liability partnerships for giving full effect to the new Part IIAAA.

19. Clause 6 makes a consequential amendment to the Summary Disposal of Complaints (Solicitors) Rules (Cap. 159 sub. leg. AD) so that a complaint against a breach of any requirement in the proposed sections 7AD to 7AG may be submitted to the Tribunal Convenor of the Solicitors Disciplinary Tribunal Panel for disposal under the summary procedure provided by those Rules.

Annexure 6

ORDER 81

PARTNERS

Contents

Editorial Introduction

81/0/2 This Order provides a code for civil proceedings by or against partnerships and must be construed as a whole. Unlike corporations, which have a legal identity apart from their members, two or more people carrying on business, whether under their own name or under a firm name, do not. This rule therefore does not confer corporate status on such businesses but merely provides a convenient way in which they may sue and be sued. In addition an individual carrying on business under a name other than his own may be sued in that name (r.9).

In a straightforward debt action against a small firm it may be better to sue the individual trader or partners in their own names rather than the firm name as it is easier to enforce a default judgment against the individuals. In order to enforce a default judgment entered in the firm name, the partners or proprietor have to be identified and leave has then to be obtained on a summons served personally before execution can issue (r.5(4)). Judgment entered against the individuals, who may be served by post, may be enforced immediately.

When suing a firm care must be taken to ensure that the requirements of service set out in r.3 are followed. Equally when acknowledging service (r.4) care must be taken to acknowledge in the proper form, otherwise persons who are not partners or were not at the material time may find themselves liable to satisfy any judgment obtained.

This order does not enable foreign partnerships to be served out of the jurisdiction in the firm name.

Related Sources

81/0/3
- Partnership Ordinance, Cap. 38 (Partnership Act 1890)
- Limited Partnerships Ordinance, Cap. 37 (Limited Partnership Act 1907)
- Business Registration Ordinance, Cap. 310 (Business Names Act 1985)
- Companies Ordinance, Cap. 32, and Insolvency Act 1986
- RHC, O.10, r.1
- RHC, O.11
- RHC, O.49, r.1
- Chancery Guide, para.12.8, Partnership actions (*The Supreme Court Practice 1999*, Vol.2, Section 2B, para.2B–287)

Forms

81/0/4 The following Practice Form in Volume 3 is relevant to O.81:

- No. 3, FM–PF3

Actions by and against firms within jurisdiction (O.81, r.1)

81/1 **1.** Subject to the provisions of any written law, any 2 or more persons claiming to be entitled, or alleged to be liable, as partners in respect of a cause of action and carrying on business within the jurisdiction may sue, or be sued, in the name of the firm (if any) of which they were partners at the time when the cause of action accrued.

Scope of Order—This Order was taken from the former English RSC (Rev.) 1962, O.81, which had been taken, without any material change, from the former O.48A, which itself was introduced by RSC 1891, apparently as the result of observations made by the judges in *Davies & Co. v. Andre & Co.* (1890) L.R. 24 Q.B.D. 598, CA, and *Western National Bank, etc. v. Perez Triana & Co.* [1891] 1 Q.B. 304, CA. 81/1/1

The rules of this Order form a code relating to partnership firms and must be construed together (*Worcester City and County Banking Co. v. Firbank Pauling & Co.* [1894] 1 Q.B. 784, *per* Lord Esher M.R. at 788; *MacIver v. G. & J. Burns* [1895] 2 Ch. 630, *per* Lindley L.J. at 634).

This Order only applies to firms and single individuals suing or being sued in their firm or trading name, and not to cases where the partners or a single individual are or is sued in their or his individual names or name. For instance, it applies to actions by or against "Jones & Smith", or "John Jones & Co.", or "The Dairy Supply Co.", or whatever other name has been adopted as the firm or trading name, but not to actions by or against John Jones and Thomas Smith sued as individuals, even though the description "trading as Jones & Smith", or whatever the firm name may be, is added.

This is important, especially (1) with regard to the question of service, since the special mode of serving a firm by service upon the controller or manager of the business cannot be employed where partners are sued individually only; and (2) with regard to the question of execution against partnership goods, since such execution can only be issued when the judgment is against the firm, and not when the judgment is against the individual partner or the individual partners, at any rate not without leave (see r.6).

Registration of firms and persons carrying on business—See the Business Registration Ordinance, Cap. 310. 81/1/2

Application of rule—This rule was taken from the former English RSC (Rev.) 1962, O.81, r.1, which had been taken from the former O.48A, r.1. It applies to actions by and against firms within the jurisdiction. 81/1/3

(a) When firm are plaintiffs—The rule enables two or more persons carrying on business within the jurisdiction to issue a writ or originating summons (r.8) in the name of their firm, without setting out the names of all the individual partners, and to give as their address that of their place of business instead of the private addresses of the individual members. It applies whenever they are carrying on business within the jurisdiction notwithstanding that they may not be Hong Kong subjects, nor residents within the jurisdiction. But if they are not carrying on business within the jurisdiction, even though they may be Hong Kong subjects or resident within the jurisdiction, the rule does not apply and the individual names and addresses must be set out. 81/1/4

(b) When firm are defendants—The firm may, under like circumstances to the above, be sued in their firm-name without the necessity of finding out the names of the individual partners, and they may be described as of the address at which their business is carried on. But it must be remembered that they may be sued "in the name of the firm of which they were co-partners at the time of the accruing of the cause of action", and that the firm name is merely a convenient method of expressing those persons. A plaintiff who sues such partners in their firm-name sues them individually just as much as if he had set out all their names (*Western National Bank, etc. v. Perez Triana & Co.* [1891] 1 Q.B. 304, CA, *per* Lindley L.J. at 314). Inaccuracy in the description of a defendant firm's trade name will not affect the defendants' liability, as long as the partners have been individually identified and collectively named as defendants in the action (*Liu Moon Ping v. Wong Kwok Tung & Others* [2006] 1 H.K.L.R.D. 358 *per* Kwok D.J. at 364). 81/1/5

Where, therefore, there has been a change in the firm since the cause of action accrued, it must be taken prima facie that the firm name used to describe the defendants means those persons who constituted the firm at the time of the accrual of the cause of action, and not at the time of issue of the writ. Where there has been an entire change in the persons constituting the firm between the accrual of the cause of action and the issue of the writ, suing in the firm name might cause difficulty. See *Re Sawers, ex p. Blain* (1879) L.R. 12 Ch.D. 522 at 533, *per* James L.J. Cf. *Tam Yuen Fun v. Day & Chan & Others* (unrep., DCCJ 17040 of 2001) [2004] H.K.E.C. 296, where it was held that notwithstanding such an entire change, an action could still be brought against the defendant in its firm-name even though each partner had also been sued individually. There was nothing in the Order that prevented this course being taken and no conceivable prejudice, procedural or substantive, could arise therefrom. And where there has been a partial dissolution to the knowledge of the plaintiff, it may not advantage the plaintiff much if he sues in the firm name, since he must serve every person within the jurisdiction whom he seeks to make liable (r.3(3)).

"May sue or be sued"—A firm consisting of "two or more persons" may sue or be sued, even though one of them is under a disability (*Harris v. Beauchamp Bros.* [1894] 1 Q.B. 801). If one of the partners is an infant the minority of one partner cannot be utilised by the other or others, as a means of deferring payment of the firm's debt (*Harris v. Beauchamp Bros.* [1894] 1 Q.B. 801). See also n. "Minor partner", para.81/5/8. The action may be brought against the firm, but the judgment 81/1/6

should be against the firm "other than *A.B.* a minor". In such a case bankruptcy proceedings will lie against the firm other than the minor partner (*Lovell v. Beauchamp* [1894] A.C. 607).

A person other than a moneylender trading by himself as a firm, or in an assumed or trading name, must *sue* in his own name, though he may *be sued* in his trading name (*Mason v. Mogridge* (1892) 8 T.L.R. 805). However, it has been held that the incorrect naming of such a plaintiff on the writ only amounts to an irregularity which is curable by amendment, and does not render the proceedings a nullity: *Wong Ming-chin t/a Tai Lak School v. Hong Kong Times Ltd* [1968] H.K.L.R. 99. See r.9. As to "owners of cargo" in an Admiralty action *in rem* suing as such in lieu of trading name, see *The Assunta* [1902] P. 150.

81/1/7 **Firm name**—The firm name is a mere expression, for a firm is not a legal entity, nor for some purposes is it a "person," although for convenience under this Order, the firm name may be used for the purpose of suing and being sued (*per* Farwell L.J., in *Sadler v. Whiteman* [1910] 1 K.B. 868 at 889, cited, *per* Hamilton J. in *R. v. Holden* [1912] 1 K.B. 483 at 487 *per* Godfrey J.A. in *Kao, Lee & Yip v. Koo Hoi Yan Donald* [1995] 1 H.K.L.R. 248 at 250; [1994] 2 H.K.C. 228 at 231; and see *Re Vagliano Anthracite Collieries Ltd* (1910) 79 L.J.Ch. 769; *Chan, Leung & Cheung (A Firm) v. Tse Mei Lin*; [2005] 1 H.K.L.R.D. 251 at 259). Order 81, r.1 is a rule of procedural convenience only. While a partnership may be sued in the firm's name and service effected on any partner, or at the firm's principal place of business (O.81, r.3), the firm has no separate legal identity outside its partners (*Kao, Lee & Yip v. Koo Hoi Yan & Others* [2003] 1 H.K.L.R.D. 125 at 134, 135; [2002] 3 H.K.C. 323 at 331, *per* Ma J., referring to Godfrey J.A.'s observations in *Kao Lee & Yip v. Koo Hoi Yan Donald* [1995] 1 H.K.L.R. 248 at 250; [1994] 2 H.K.C. 228 at 231; *Chan, Leung & Cheung (A Firm) v. Tse Mei Lin*; [2005] 1 H.K.L.R.D. 251 at 259).

As the composition of a partnership may change over time, by the admission or departure of partners, it is necessary to ascertain the time for determining who are partners. Upon every admission of a new partner, the law considers there is an implied dissolution of the old partnership, and the formation of a new partnership. Hence, a firm is not the same after a change in composition, even if the same firm name is used after the change. As a matter of fact, they are a different group of people, and regarded as such in law. (*Lo Wai Sing v. Allianz Insurance (Hong Kong) Ltd* (unrep., HCA 4084 of 2001) [2005] H.K.E.C. 231 Lam J.)

Nevertheless, when the firm is suing or is sued in the firm name, especially where the firm name might be taken for the name or names of one or more individuals, e.g. "John & James Smith", it is advisable in the title of the action to add in brackets after the firm name the words "a firm" or "sued as a firm".

The name of a newspaper is not usually a firm name under which the proprietors carry on business, and they should not be so sued (*De Bernales v. New York Herald* [1893] 2 Q.B. 97n.).

Executors carrying on business in the testator's firm name, as authorised by the will, are not partners, and cannot be sued as such (*Re Fisher & Sons* [1912] 2 K.B. 491).

For a case in which a cost-book mining company was sued in its partnership name, see *Escott v. Gray* (1878) 39 L.T. 121.

81/1/8 **Action against club**—A proprietary club may be sued in the name of the club as a firm name (*Firmin & Sons v. The International Club* (1889) 5 T.L.R. 614, CA).

A members' club cannot be sued in the club name (*Grossman v. Granville Club* (1884) 28 S.J. 513; *Campbell v. Thompson* [1953] 1 Q.B. 445; [1953] 1 All E.R. 831; [1953] 2 W.L.R. 656).

81/1/9 **Trade unions and employers' associations**—The registration of a trade union renders it a body corporate by the name under which it is registered, and, subject to the provisions of the Trade Unions Ordinance (Cap. 332) with power to *inter alia*, institute and defend suits and other legal proceedings: see s.13 of Cap. 332. An action against a registered trade union, whether of employees or employers, in respect of any tortious act alleged to have been committed in contemplation or furtherance of a trade dispute by or on behalf of such trade union, shall not be entertained in court: see s.43 of Cap. 332. This provision does not affect the liability of a registered trade union, or any trustees thereof, to be sued in any court touching and concerning any property, or any right or claim to property, of such trade union, except in respect of any tortious act committed by or on behalf of such trade union in contemplation or furtherance of a trade dispute: see s.43(2) of Cap. 332. Notice of intention to defend shall be in the name of the trade union. For the definition of "trade union," see s.2 of Cap. 332 (s.28(1) of the 1974 Act).

81/1/10 **Partners generally**—The liability of partners for debts is joint; *Kendall v. Hamilton* (1879) 4 App.Cas. 504; *Pilley v. Robinson* (1888) L.R. 20 Q.B.D. 155; and *cf.* the Partnership Ordinance, Cap. 38, ss.11, 14 (Partnership Act 1890, ss.9, 10, 12), and *Weall v. James* (1893) 68 L.T. 515). As a general rule a suit by or against an ordinary partnership would have been defective for want of parties, unless all the partners were before the court (*Lindley and Banks on Partnership* (18th ed., 2002)) but now the firm may be sued without first ascertaining who all the partners are. It must be noted, however, that although a partner's liability is joint, it is not several. Consequently, a partner cannot set off his personal debts against a debt owed to the partnership, and a pleading consisting of such a set off is liable to be struck out: *Chan Shu Kong v. Kwong Hing Trading Co. Ltd & Another* [2007] H.K.E.C. 1119 and [2007] H.K.E.C. 1971.

Executors who carry on the business of their testator in the firm name in which he traded should be sued individually on their liability as joint debtors. In an action against a firm so carried on it was held that executors so trading were not partners within s.1 of the Partnership Act, 1890 (s.3 of Partnership Ordinance, Cap. 38), and the court refused to adjudicate them bankrupt (*Re Fisher & Sons* [1912] 2 K.B. 491).

"Partners at the time when the cause of action accrued"—These words enable the co-partners in a firm dissolved before action to sue or be sued as a firm provided the co-partnership existed at the time the cause of action accrued. The composition of the firm at the date of the issue of the proceedings is normally irrelevant. Therefore a suggestion that a plaintiff described by its firm-name in an action referred to the current and not the former partnership at the time when the cause of action accrued was held to be misconceived (*Chan, Leung & Cheung (A Firm) v. Tse Mei Lin* [2005] 1 H.K.L.R.D. 251). Where the fact of dissolution is known to the plaintiff before the action against the firm is commenced, the writ must be served personally on every person within the jurisdiction sought to be made liable, r.3(2). If one or some of such persons are out of the jurisdiction leave to serve would have to be obtained under O.11. And by the operation of r.9, it enables an individual trading in a name other than his own name at the time the cause of action accrued to be sued in his trading name, although he has ceased to so trade at the time the action is brought. **81/1/11**

It is only possible to sue or be sued in a firm name if the partners were using that firm name at the time when the cause of action accrued (*Ernst & Young v. Butte Mining Plc (No. 2)* [1997] 1 W.L.R. 1485).

Partners disagreed—Where one partner commenced an action in the name of the firm against the express wishes of his co-partners, the action was stayed until the partner bringing the action had given his co-partner a full indemnity, coupled with security, against all costs, charges, or liability by reason thereof (*Davey & Co. v. Alby United Carbide Factories Ltd,* unreported, Coleridge J. in chambers, March 19, 1914; *Chan, Leung & Cheung (A Firm) v. Tse Mei Lin* [2005] 1 H.K.L.R.D. 251 at 259). In these cases the decision in *Seal and Edgelow v. Kingston* [1908] 2 K.B. 579, was referred to. See n. "Discovery against firm", para.81/1/15. In the last case a similar order was made, but was held not to exempt the objecting partner from complying within an order for discovery. While financial ability to honour an indemnity to co-partners is a relevant factor, there is no provision in the Rules or elsewhere which limits the relevant factors in determining whether security should be given to support such an indemnity. The court has jurisdiction to order security where the justice of the case so requires (*Kao, Lee & Yip v. Koo Hoi Yan & Others* [2003] 1 H.K.L.R.D. 125 at 138, 139; [2002] 3 H.K.C. 323 at 336, 337, *per* Ma J.). For instance, where an unwilling partner has nothing to gain from pursuing litigation, but potentially much to lose, and has no control over the conduct of the proceedings. **81/1/12**

It may be just to limit such security to an unwilling partner's potential liability for the opposite party's future costs, as opposed to past costs, where the partner had previously been a willing participant (*Kao, Lee & Yip v. Koo Hoi Yan & Others* [2003] 1 H.K.L.R.D. 125 at 140; [2002] 3 H.K.C. 323 at 337, 338, *per* Ma J.).

Deceased partner—Where a partner dies before action, and the action is brought against the firm alone in the firm name, the deceased partner is not a party to the action at all so far as his private estate is concerned. If in an action against a firm in the firm name a partner dies between service of the writ and judgment, the estate of the deceased partner is not bound. Unless his personal representative is a defendant, judgment is against the surviving partners and can only be enforced against them and the partnership assets (*Ellis v. Wadeson* [1899] 1 Q.B. 714; and see *Phillips v. Homfray* (1883) L.R. 24 Ch.D. 439; *Re Shephard* (1890) L.R. 43 Ch.D. 131 at 136). Where a person who was a partner at the date of the accrual of the cause of action dies before action brought, it would seem that his executors need not be made parties to the action. **81/1/13**

The estate of a deceased partner is not liable for goods ordered before, but not delivered till after, his death (*Bagel v. Miller* [1903] 2 K.B. 212).

Actions between partners—It was not quite clear that actions between a firm and one of its members, or between two firms with a common member, were maintainable in the firm's name; but this doubt was removed by O.81, r.6 which applies the rules of this Order to such actions, provided the firm or firms carry on business within the jurisdiction; and with the further proviso that execution in such case may not issue except with the leave of the court. **81/1/14**

Discovery against firm—An order for discovery against a firm suing or being sued is an order against the partners. Where the dissolution of partnership one partner in the firm brought an action in the firm name and indemnified against costs his co-plaintiff and former partner who dissented from the action being brought, an order for discovery of documents was, at the instance of the defendant, made against the firm. The dissenting partner refused to file his affidavit, and his co-plaintiff was held entitled to apply for attachment against him to enforce obedience to the order (*Seal & Edgelow v. Kingston* [1908] 2 K.B. 579, CA). **81/1/15**

81/1/16 **Judgment against firm—action against partner upon the judgment**—A judgment against the firm has the same effect that a judgment against all the partners had formerly. See *Clark v. Cullen* (1882) (1881–1882) L.R. 9 Q.B.D. 355.

81/1/17 **Action against firm and partner**—A firm cannot acknowledge service as a firm; but if a partner is made co-defendant together with the firm, he may put in separate defences, one for himself, and one for the firm (*Taylor v. Collier* (1882) 30 W.R. 701).

81/1/18 **Joint creditor—deceased partner**—As to the remedies of a joint creditor against estate of a deceased partner, *Re Hodgson* (1886) L.R. 31 Ch.D. 177.

81/1/19 **"Carrying on business within the jurisdiction"**—If the firms carry on business within the jurisdiction within the meaning of the cases cited below, they may sue or be sued in the firm name. It happens that in all the cases cited in this and the n. "Foreign firms", para.81/1/20, the points raised turned upon the question whether the *defendants* were rightly sued. But the principle laid down in those cases applies equally to a plaintiff firm as to a defendant firm, the right to "sue or be sued" being given by the same sentence of this rule. It is therefore the practice of the High Court Registry to refuse to issue a writ wherein a foreign firm is either plaintiff or defendant, unless the individual names of the partners are given.

"Carrying on business" means the possession within the jurisdiction of a place of business held in the name of the firm, where business is carried on on behalf of the firm by a partner or by a person or persons in the pay of the firm. It makes no difference whether the partners are or are not out of the jurisdiction, or whether or not they have another place of business out of the jurisdiction. If they are carrying on business within the jurisdiction in the firm name they can be sued as a Hong Kong firm, and service at their Hong Kong place of business on the person having the management or control, as prescribed by r.3, is good service on the firm and its partners, so far as regards any partnership property within the jurisdiction. See *Worcester City and County Banking Co. v. Firbank Pauling & Co.* [1894] 1 Q.B. 784, CA; *Shepherd v. Hirsch, Prichard & Co.* (1890) L.R. 45 Ch.D. 231; *Lysaght v. Clark* [1891] 1 Q.B. 552. If the firm have no place of business in Hong Kong held in the name of the firm, they do not carry on business within the jurisdiction, even though the partners come to Hong Kong regularly and employ an agent here to purchase goods to be sent to the firm abroad (*Singleton v. Roberts & Co.* (1894) 70 L.T. 687). See also *Heinemann & Co. v. S.B. Hale & Co.* [1891] 2 Q.B. 83, CA. If two or more persons claim to be entitled in respect of a cause of action as partners under O.81, r.1, and use a firm's name, but do not "carry on business" within the jurisdiction, the institution of such proceedings is irregular, but are not nullified. (*Frank Dinardo Jnr & Others t/a one Sylvan Road North Associates v. Lark International Ltd*, unreported, HCA 14565 of 1998, June 2, 1999, Yuen J.)

81/1/20 **Foreign corporations**—A foreign corporation is different from a firm, and may be sued as an individual, and service may be ordered under O.11.

81/1/21 **Foreign firms**—A partnership firm which has no place of business in Hong Kong within the meaning of the words "carrying on business within the jurisdiction", as defined in that note, can neither sue nor be sued in the firm's name. The partners must sue or be sued individually in their own names and served as ordinary defendants.

The procedure in O.81, r.1 where a local partnership could be sued in the firm's name as an alternative to suing the partnership in the names of all the individual partners in their capacity as partners, did not apply to foreign partnerships which do not carry on business within the jurisdiction (*Oxnard Financing SA v. Rahn (Legal Personality of Swiss Partnership)* [1998] 1 W.L.R. 1465, CA; [1998] 3 All E.R. 19).

In *Western National Bank, etc. v. Perez Triana & Co.* [1891] 1 Q.B. 304, CA, it was held, following the principle laid down in *Russell v. Cambefort* (1889) L.R. 23 Q.B.D. 526, that a firm, none of whose partners was resident or domiciled in England, ought not to be sued in the firm name, Lindley L.J. saying that if one of the partners was resident abroad it would not be prudent to sue them in the firm name. Since those cases were decided, namely in June, 1891, the Rules as to actions by and against partnership firms were altered and collected together under this Order. The words "carrying on business within the jurisdiction" were introduced with the object of bringing within the scope of this Order any foreign firm which had a place of business in Hong Kong. Such firms may therefore be now sued and served in the same way as Hong Kong firms are sued and served (*Worcester City and County Banking Co. v. Firbank Pauling & Co.* [1894] 1 Q.B. 784, CA, cited n. "Carrying on business within the jurisdiction", para.81/1/19). Subject to that qualification foreign firms cannot be sued as firms, and even where the claim was within O.11, r.1, and leave was obtained to serve a foreign firm out of the jurisdiction, judgment was refused because the order was for service *on the firm* (*Dobson v. Festi Rāsini & Co.* [1891] 2 Q.B. 92; *Von Hellfeld v. Rechnitzer* [1914] 1 Ch. 748, CA). An order for substituted service of a writ on a foreign firm carrying on business outside the jurisdiction may be made, although the firm also carries on business within the jurisdiction, as Orders 11 and 81 are to be read together (*Hobbs v. Australian Press Association* [1933] 1 K.B. 1, CA). In that case such an order was made; but when the plaintiff applied for leave to serve out of the jurisdiction he was unaware of the fact that the defendants carried on business within the jurisdiction.

Where partners in a foreign firm are sued individually, they are subject to the general rules as to service. Service on any one of them while temporarily in Hong Kong is good service so far as the individual is concerned, otherwise they can only be served by order for service out of the jurisdiction. See, as to the converse of this, *Carrick v. Hancock* (1895) 12 T.L.R. 59. As to service on the manager of an English branch, see *Meyer v. Louis Dreyfus* [1940] 4 All E.R. 157, CA; (1940) 67 Ll.L.Rep. 562.

Foreign firm employing agent in Hong Kong—The mere employment of an agent in Hong Kong who collects orders for the firm on commission, but has no power to accept or reject such orders, is not carrying on business in Hong Kong, even though the firm's name is painted on the door of the agent's office (*Grant v. Anderson & Co.* [1892] 1 Q.B. 108, CA, followed, and applied to a foreign corporation having an agent in England, in *Okura & Co. Ltd v. Forsbacka Jenverks Aktiebolag* [1914] 1 K.B. 715, CA; *Thames and Mersey Marine Insurance Co. v. Austrian-Lloyd Co.* (1914) 111 L.T. 97, CA; *Baillie v. Goodwin* (1886) L.R. 33 Ch.D. 604). See also *Morgan Crucible Co. Ltd v. Vulcan Crucible Co.* (1906) 23 R.P.C. 229. 81/1/22

As to the liability of one partner where the other partner has ratified the act of an agent done in excess of his authority, see *Keen v. Mear* [1920] 2 Ch. 574.

Foreign individual trading as a firm—A single individual residing abroad and being a foreign subject, trading in a name other than his own must be sued individually in his own name, even though he has an office in England (*St Gobain v. Hoyermann's Agency* [1893] 2 Q.B. 96, CA; *Taylor Brothers & Co. Ltd v. A. Johnson & Co.* [1917] W.N. 341). See r.9. 81/1/23

Foreign firms agreeing to be served within the jurisdiction—A defendant firm may contract itself out of the rules and rulings as to foreign firms by agreeing to receive service at some place within the jurisdiction (*Tharsis Sulphur and Copper Co. Ltd v. Société des Métaux* (1889) 58 L.J.Q.B. 435; *Montgomery Jones & Co. v. Liebenthal & Co.* [1898] 1 Q.B. 487). But an agreement that the court shall have power to *order* service on the foreign firm, even though the case is not within O.11, is of no effect. The jurisdiction of the court as to ordering service out of the jurisdiction cannot be extended by agreement (*British Wagon Co. Ltd v. Gray* [1896] 1 Q.B. 35). 81/1/24

Counterclaim against a foreign firm—A foreign firm suing in the Hong Kong court is liable to have a counterclaim pleaded against it, even though the nature of the counterclaim is such as to preclude the possibility of bringing an action upon it under O.11 (*Griendtoveen v. Hamlyn & Co.* (1892) 8 T.L.R. 231). 81/1/25

Limited partnerships—The Limited Partnerships Ordinance, Cap. 37 (Limited Partnerships Act 1907) authorises the formation of limited partnerships—i.e. firms trading in a firm name having one or more "general partners" whose liability is not limited, and one or more "limited partners" whose liability is limited to a stated amount which they contribute as capital, and beyond which they are not liable, provided the partnership is duly registered as prescribed, including the names of the limited partners and the sum contributed by them respectively. A corporate body may be a limited partnership. See ss.3, 4, 7, 8, 9 of Cap. 37 (ss.4, 5, 8, 9, 10). 81/1/26

A limited partnership must be registered with the Registrar of Companies. On partnerships liable to be wound up, see r.5 n. "Dissolution or winding-up of limited partnership", para.81/5/15.

The Limited Partnerships Ordinance, Cap. 37 is silent as to the procedure to be adopted in actions by or against limited partnerships, and the following suggestions may be found useful:

(1) Suing or being sued—The expressions "firm", "firm name" and "business" mean the same in the case of limited partnerships as in the case of ordinary partnerships defined by s.2 and 6 of Partnership Ordinance, Cap. 38 (s.4(1) and s.45 of the Partnership Act 1890): Limited Partnerships Ordinance, Cap. 37, s.2 (Limited Partnerships Act 1907, s.3). They therefore come within this rule as to suing and being sued in the name of the firm. It would seem that a limited partnership, being registered as such, could only sue or be sued in the firm name, and could not adopt the alternative open to ordinary partnerships of suing in the names of the partners, with the description "trading as ——"; nor could it be so sued. It hardly seems that limited partners could be properly imported into an action by or against the firm, though, after judgment they might be made liable to execution: see r.5 n. "Limited partners, execution against", para.81/5/14. 81/1/27

(2) Service upon—From the terms of the Limited Partnerships Ordinance, Cap. 37 it would appear that r.3, applies to service on limited partnerships, subject only to one limitation. The first method of service prescribed by that rule, namely "upon one or more of the partners", should apparently be read as *excluding* a limited partner. The Limited Partnerships Ordinance, Cap. 37, s.5 (Limited Partnerships Act 1907, s.6), provides that a limited partner "shall not take part in the management of the partnership business, and shall not have power to bind the firm". It would appear from this that if the limited partner cannot bind the firm, neither can the firm be bound by service of legal process upon him. Therefore the writ should be served only on the general partners, or the person in control of the business, not on the limited partners. 81/1/28

81/1/29 *(3) Acknowledgment of service by limited partners*—Rule 4 provides that partners sued in the name of their firm shall acknowledge service individually in their own names. As stated in the preceding n. (2) a limited partner cannot bind the firm, or take any part in its business. The word "business" is defined as "every trade, occupation or profession" Partnership Ordinance, Cap. 38, s.2 and Limited Partnership Ordinance, Cap. 37, s.2 (Partnership Act 1890, s.45; Limited Partnerships Act 1907, s.3) which does not appear to include defending an action. It has been held that any one partner in a firm sued may himself defend on behalf of the firm: see n. "Defence", para.81/4/6. Whether this can be applied to limited partners is a question which awaits decision. If a limited partner wishes to acknowledge service as a partner, the words of the rule clearly entitle him to do so, but it is doubtful if it would be to his interest to do so: see n. "Limited partners, execution against", para.81/5/14. He should describe himself as "a limited partner in the defendant firm".

Disclosure of partners' names (O.81, r.2)

81/2 2.—(1) Any defendant to an action brought by partners in the name of a firm may serve on the plaintiffs or their solicitor a notice requiring them or him forthwith to furnish the defendant with a written statement of the names and places of residence of all the persons who were partners in the firm at the time when the cause of action accrued; and if the notice is not complied with the Court may order the plaintiffs or their solicitor to furnish the defendant with such a statement and to verify it on oath or otherwise as may be specified in the order, or may order that further proceedings in the action be stayed on such terms as the Court may direct.

(2) When the names of the partners have been declared in compliance with a notice or order given or made under paragraph (1), the proceedings shall continue in the name of the firm but with the same consequences as would have ensued if the persons whose names have been so declared had been named as plaintiffs in the writ.

(3) Paragraph (1) shall have effect in relation to an action brought against partners in the name of a firm as it has effect in relation to an action brought by partners in the name of a firm but with the substitution, for references to the defendant and the plaintiffs, of references to the plaintiff and the defendants respectively, and with the omission of the words "or may order" to the end.

81/2/1 HISTORY OF RULE—This rule is taken from the former English RSC (Rev.) 1962, O.81, r.2, which had been taken from the former O.48A, rr.1 and 2, and is derived through RSC 1883, O.7, r.2, from the Common Law Procedure Act 1852, s.7.

81/2/2 **Effect of rule**—The effect of the rules is as follows: (1) under paras (1) and (2) it enables a *defendant* to call upon a plaintiff firm, even if it is out of the jurisdiction, to disclose the names and addresses of all the partners at the time when the cause of action accrued (*not* the date of the issue of the writ) and, in default, an order may be obtained compelling such disclosure or staying the action, but if the request is complied with, the action continues as if it had been brought by the partners as plaintiffs; (2) under para.(3) it enables a *plaintiff* suing a defendant firm to call upon the defendant firm to disclose the names and addresses of all the partners at the time when the cause of action accrued, and in default an order may be obtained compelling such disclosure.

Order 81, r.2 arises because O.81, r.1 is a rule of procedural convenience, where a partnership sues or is sued in the firm's name. In effect, O.81, r.1 is mere shorthand for the individual partners as the plaintiffs or defendants as the case may be (*Kao, Lee & Yip v. Koo Hoi Yan & Others* [2003] 1 H.K.L.R.D. 125 at 134, 135; [2002] 3 H.K.C. 323 at 331, *per* Ma J.; *Chan, Leung & Cheung (A Firm) v. Tse Mei Lin* [2005] 1 H.K.L.R.D. 251 at 259). See para.81/1/7.

In an action by or against a limited partnership, this rule would appear to be inapplicable, as all partners' names are registered under the Limited Partnerships Ordinance, Cap. 37, s.7(d) (Limited Partnerships Act 1907, s.8).

81/2/3 **Application for disclosure of names of plaintiff or defendant firm**—The application for an order to furnish the names and places of residence of the partners to the plaintiff or defendant firm at the time when the cause of action accrued is made by summons to the master or district judge.

The making of the order is discretionary, and presumably the defendant or the plaintiff, as the case may be, should show the grounds upon which the order is sought.

An order to disclose the names of partners hereunder is not an order for discovery within O.24, r.16 (*Pike v. Keene* (1876) 24 W.R. 322). Where an affidavit has been filed stating the names of the partners in the plaintiff firm, there is no power to direct a cross-examination on

The acknowledgment of service is given without leave. It should follow from (4) or (5) given in "Forms of acknowledgment of service" para.81/4/3.

It will be observed that the person acknowledging service of the writ may adopt one of two courses. He may, in the first place, apply by summons to set aside service on the ground that he was not a partner or liable as such. On the return to the summons there may be a serious conflict of testimony. In that case the court, exercising the power conferred by para.(4) may order an issue, but it is conceived that the issue would then have to be limited to the question whether "he was a partner or liable as such". In the second place, the person acknowledging service of the writ may allow the action to proceed, and serve a defence denying liability as a partner and/or the liability of the defendant firm. This defence having been delivered, plaintiff or defendant may apply for a special order pursuant to para.(4).

If the plaintiff desires to contest the denial of partnership, he too can apply for an order under para.(4) directing the question as to the liability of the defendant to be tried as a preliminary issue; or he may take the course indicated in the n. "Deemed to be served as a partner", para.81/3/11.

81/4/10 **No acknowledgment of service except by partners**—Para.(5) was taken from the former English RSC (Rev.) 1962, O.81, r.4(5) which had been taken from the former O.48A, r.6. An acknowledgment of service of the writ tendered by a person describing himself as the person having the control or management of the business is refused at the Registry. If he is a partner in the firm sued he should acknowledge service of the writ as such. If he is not such a partner but is served as a partner, he can acknowledge service of the writ denying the partnership under para.(2).

Enforcing judgment or order against firm (O.81, r.5)

81/5 5.—(1) Where a judgment is given or order made against a firm, execution to enforce the judgment or order may, subject to rule 6, issue against any property of the firm within the jurisdiction.

(2) Where a judgment is given or order made against a firm, execution to enforce the judgment or order may, subject to rule 6 and to the next following paragraph, issue against any person who—

(a) acknowledged service of the writ in the action as a partner, or

(b) having been served as a partner with the writ of summons, failed to acknowledge service of it in the action, or

(c) admitted in his pleading that he is a partner, or

(d) was adjudged to be a partner.

(3) Execution to enforce a judgment or order given or made against a firm may not issue against a member of the firm who was out of the jurisdiction when the writ of summons was issued unless he—

(a) acknowledged service of the writ in the action as a partner, or

(b) was served within the jurisdiction with the writ as a partner, or

(c) was, with the leave of the Court given under Order 11, served out of the jurisdiction with the writ as a partner;

and, except as provided by paragraph (1) and by the foregoing provisions of this paragraph, a judgment or order given or made against a firm shall not render liable, release or otherwise affect a member of the firm who was out of the jurisdiction when the writ was issued.

(4) Where a party who has obtained a judgment or order against a firm claims that a person is liable to satisfy the judgment or order as being a member of the firm, and the foregoing provisions of this rule do not apply in relation to that person, that party may apply to the Court for leave to issue execution against that person, the application to be made by summons which must be served personally on that person.

(5) Where the person against whom an application under paragraph (4) is made does not dispute his liability, the Court hearing the application may, subject to paragraph (3), give leave to issue execution against that person, and, where that person disputes his liability, the Court may order that the liability of that person be tried and determined in any manner in which any issue or question in an action may be tried and determined.

81/5/1 HISTORY OF RULE—Amended by S.I. 1979 No. 1716 and S.I. 1980 No. 2000.

Application of rule—This rule was taken from the former English RSC (Rev.) 1962, O.81, r.5, which had been taken from the former O.48A, r.8. It enables execution upon a judgment or order against a firm, in the firm name, to be issued: 81/5/2

(1) against the property of the firm within the jurisdiction;
(2) without leave, against the private property of certain partners, *viz.* anyone has acknowledged service of the writ, or was served, as a partner, or who admitted in his pleading or was adjudged to be a partner; and
(3) with leave, against the private property of any other person who is liable to satisfy the judgment or order as a member of the firm.

The effect of the rule is to enable the judgment creditor to issue execution concurrently in all the cases mentioned above.

The rule also restricts the issue of execution against a partner who was out of the jurisdiction unless he acknowledged service of the writ or was server within the jurisdiction or with leave under O.11 outside the jurisdiction, as a partner.

Execution against partnership property—Upon a judgment or order against a firm, in the firm name, execution issues as of course without leave against the property of the firm within the jurisdiction. This is the corollary of Partnership Ordinance (Cap. 38), s.25 (s.23(1) of the Partnership Act 1890), that execution shall not issue against any partnership property except on a judgment against the firm, see r.10. Where judgment has been recovered against the firm, the plaintiff is not confined to the remedy given by this rule, but may still bring an action on the judgment against the individual members of the firm, without any special leave of the court (*Clark & Son v. Cullen* (1882) L.R. 9 Q.B.D. 355; see also *Davis v. Morris* (1883) L.R. 10 Q.B.D. 436). 81/5/3

The retirement of a partner is no bar to execution against the firm (*Re Frank Hill* [1921] 2 K.B. 831); nor does the death of a partner prevent execution against the partnership property (*Ellis v. Wadeson* [1899] 1 Q.B. 714 at 718) nor does the fact that a partner is out of the jurisdiction.

Execution against private property of partners without leave—In each of the cases specified in para.(2) execution issues as of course without leave against the private property of the partner concerned. The fact a firm is a Hong Kong or overseas partnership does not affect a partner's status and liability as a partner. (*Brand Farrar Buxbaum LLP v. Samuel-Rozenbaum Diamond Ltd and Another* [2005] 2 H.K.L.R.D. 342, CA). But where the judgment against the firm is entered in default of acknowledgment of service on proof of service only on the person in control of the business, and afterwards the writ is served upon a partner, personal execution cannot be issued without leave against such partner. He can be made liable only by an order under para.(5). 81/5/4

Leave to issue execution against person liable as a member of the firm—Paragraph (4) entitles a plaintiff who has obtained judgment against a firm to apply for leave to issue execution against any other person as being a member of the firm at the time the cause of action arose, provided he had not to the knowledge (actual or constructive) of the plaintiff left the firm before the issue of the writ. 81/5/5

An order for execution under this rule cannot be made against a partner in a firm sued which has been dissolved to the knowledge (actual or constructive) of the plaintiff before action brought, where the person alleged to have been a partner thereby ceased to be a partner. In such a case the plaintiff is bound by r.3 to serve the writ on every person sought to be made liable, and if he omits to do so, he cannot remedy the defect by applying for an order under para.(4). See *Mart Treasure Investment Ltd v. Chiu Kwok Wing Benedict* [2004] H.K.E.C. 810. See also *Wigram v. Cox & Co.* [1894] 1 Q.B. 792.

Leave to issue execution is also required in every case where the action is between a firm and one or more of its members, or between firms having one or more members in common. See r.6.

Where the defendant is a small partnership or an individual carrying on a business under a name other than his own (O.81, r.9) it may be better to issue the writ in the names of the individuals. This obviates the need for personal service under para.(4) if the plaintiff obtains a judgment in default of notice of intention to defend.

Application for leave to issue execution—Where the judgment or order is against the firm, an application for leave to issue execution against a person not before the court who is alleged to be a partner is made by summons before a master. The summons must be served personally on the person sought to be made liable as a partner, subject to O.65, r.4. The summons must be supported by an affidavit which should state the grounds to show that the person in question was a partner in the firm at the material time. 81/5/6

If liability is not disputed, or, if disputed and it is quite clear that he was a partner at the time of the accrual of the cause of action, leave may be given forthwith; but where liability is disputed, an issue will usually be directed to be tried to determine the question (*Worcester Banking Co. v. Trotter* (1887) 3 T.L.R. 709).

The form of the issue may be whether A.B. was or has held himself out as a partner in the defendant firm (*Davis v. Hyman & Co.* [1903] 1 K.B. 854, CA). Such an issue is eminently suitable for trial by consent before a master (see O.36, r.11). Pleadings will generally be dispensed with, but discovery and if necessary interrogatories may be ordered (*Allen v. Garton & Co.*, unreported, Bucknill J. in chambers, March 22, 1910).

81/5/7 **Partner out of the jurisdiction**—By r.3, service as there prescribed is deemed good service *on the firm* "whether any of its members are out of the jurisdiction or not". The firm's goods within the jurisdiction, therefore, can be taken in execution under para.(1) of this rule without leave, and also the private property within the jurisdiction of any person, whether residing out of the jurisdiction or not, who has acknowledged service of the writ in his own name or has been served within the jurisdiction as a partner, and has thereby submitted to the jurisdiction.

A partner, however, who resides out of the jurisdiction, who has neither been served as a partners while within the jurisdiction, nor submitted to the jurisdiction by acknowledging service as a partner, is, by the words of this rule, protected against execution against his personal property within the jurisdiction unless he was served with leave under O.11, out of the jurisdiction and so made a party to the action.

Under the corresponding Irish Rules, where a partner sought to be made liable was out of the jurisdiction, judgment was entered in default of acknowledgment of service against the firm, and leave was given under O.11, r.1, to issue a concurrent writ and serve it on the partner out of the jurisdiction. The partner so served acknowledged service of the concurrent writ, and the plaintiff proceeded against him and obtained judgment under O.14. On appeal, the judgment was upheld as properly entered for the purpose of making the absent partner liable under this rule (*Lindsay v. Crawford and Lindsays* (1911) 45 Ir.L.T. 52).

81/5/8 **Minor partner**—It has been held by the House of Lords in *Lovell v. Beauchamp* [1894] A.C. 607 (a) that a minor can be a partner in a firm; (b) that though a partner he cannot contract debts by trading and is not therefore liable for the debts of the firm; (c) that the adult partner is entitled to insist that all the assets of the partnership shall be applied in payment of the liabilities of the partnership, and until this is done the minor partner has no claim on them; (d) that a judgment against a firm contained a minor partner, and bankruptcy proceedings based upon such judgment, must specifically exclude the minor partner (*cf.* also *Harris v. Beauchamp* [1894] 1 Q.B. 801. See also *Re Toper* (1920) 89 L.J.K.B. 477).

81/5/9 *Form of judgment*—The form of judgment in such a case, therefore, is as follows: "Adjudged that the plaintiff recover against the defendant firm, other than *A.B.* a minor partner", etc.

81/5/10 *Limit of execution*—On a judgment so worded execution issues as of course on the property of the firm, irrespective of the question of minority of any member thereof. But no execution can issue against the private property of the infant partner.

81/5/11 *Service on minor partner*—It would seem to follow from the above that a minor partner could not be served as a partner, though *semble* the firm might be served by service on him as the person in control of the business.

81/5/12 *Minor trading as a firm*—See this note at para.81/9/9.

81/5/13 **Bankruptcy proceedings**—See Bankruptcy Ordinance (Cap. 6) and Companies Ordinance (Cap. 32). A bankruptcy notice may be issued against the firm founded upon the judgment against it in the firm name, and a receiving order made against the firm; but all the members of the firm must have been served with the writ of summons (*Re Ide* (1886) L.R. 17 Q.B.D. 755); but a creditor cannot issue a bankruptcy notice against a partner without obtaining leave to issue execution under para.(4) unless such partner is liable to execution under para.(2) (*ibid.*; and see *Re Young, ex p. Young* (1882) L.R. 19 Ch.D. 124, CA; *Re Beauchamp Brothers* [1894] 1 Q.B. 1, CA and [1894] A.C. 607).

A judgment properly recovered against a partnership firm after dissolution of partnership is sufficient to ground bankruptcy proceedings against the partners individually. And where each partner had been served personally with the writ, and, after judgment, with a bankruptcy notice against the firm, and knowledge of the dissolution afterwards came to the plaintiff, it was held that such services were sufficient to support separate petitions against the individual partners (*Re Wenham* [1900] 1 Q.B. 698).

81/5/14 **Limited partners, execution against**—As to the general effect of the Limited Partnerships Ordinance, on actions against firms, see n. "Limited partnerships", para.81/1/26.

Para.(1) of this rule appears to apply to limited partnerships as to ordinary partnerships. On a judgment or order against the firm, execution may issue as a course without leave against any property of the firm within the jurisdiction.

As to para.(2)(a), (c) and (d) it applies, no doubt, to the "general partners" in a limited partnership in precisely the same way as it applies to the partners in an ordinary firm, but seems to have no application at all to "Limited partners". In the case of foreign firms in the form of a limited liability partnership, it must be shown that when the firm carried on its practice in Hong Kong, Hong Kong law recognizes the limited nature of the partners' liability. Section 4 of the Limited Partnerships Ordinance (Cap. 37) requires registration of a limited partnership; and in default of registration it shall be deemed to be a general partnership and every limited partner shall be deemed to be a general partner. (*Brand Farrar Buxbaum LLP v. Samuel-Rozenbaum Diamond Ltd. and Another* [2005] 2 H.K.L.R.D. 342 at 346).

In the improbable contingency of a limited partner acknowledging service of the writ (see n. "Limited partnerships (3)", para.81/1/29) it would still appear to be necessary, for the reasons

given below, that an order should be obtained before execution could be issued in any case against the personal property of a limited partner. As to the words of this clause "who has admitted on the pleadings that he is, or has been adjudged to be a partner", they appear to be entirely inapplicable to any partner in a limited partnership, whether "general" or "limited" for the names of all partners of both kinds are registered: see Limited Partnerships Ordinance (Cap. 37), ss.7 and 8 (Limited Partnerships Act, s.8) and all changes of partners (*ibid.*, s.9).

As to para.(2)(b) it would seem that service of the writ on a limited partner would be *ipso facto* void: see n. "Limited partnerships—(2) Service upon", para.81/1/28. Even if this were not so, an order for execution against the limited partner would still be necessary, for the liability, being limited, might be less than the judgment debt. The clause applies, not doubt, to "general" partners in a limited partnership in the same way as to partners in an ordinary firm.

The Limited Partnerships Ordinance provides that a limited partner shall at the time of entering into the partnership contribute thereto a sum or sums as capital, or property valued at a stated amount, and shall not be liable beyond the amount so contributed s.3(2) (s.4(2) 1907 Act). The sum contributed must be registered, and whether paid in cash or *how otherwise* s.7(g) (s.8(g) 1907 Act). The share of a limited partner may be charged for his separate debt s.5(6)(c) (s.6(5)(d) 1907 Act). In view of these provisions it would seem that personal execution against a limited partner could only be obtained by order under the latter part of this rule, namely, on a summons in chambers, on which the limited partner could be heard, and an issue directed if necessary to try the question of liability and its extent in relation to the judgment debt and limit of liability.

Dissolution or winding-up of limited partnership—Except in cases where a petition in bankruptcy is appropriate, an ordinary partnership action seem to be the only proceeding now possible where a general or a limited partner desires to have the partnership dissolved or wound up. But provision has been made in s.326 of the Companies Ordinance (Cap. 32) for the application of some or all of the provisions in Part X of that Ordinance to partnerships. 81/5/15

Although a limited partner is not entitled to dissolve the partnership by notice; s.5(6)(e) of the Limited Partnerships Ordinance (Cap. 37) (s.6(5)(c) of 1907) he may be entitled to take proceedings for dissolution if the general partner neglects or mismanages the business (*Re Hughes & Co.* [1911] 1 Ch. 342).

Enforcing judgment or order in actions between partners, etc. (O.81, r.6)

6.—(1) Execution to enforce a judgment or order given or made in— 81/6

(a) an action by or against a firm in the name of the firm against or by a member of the firm, or

(b) an action by a firm in the name of the firm against a firm in the name of the firm where those firms have one or more members in common,

shall not issue except with the leave of the Court.

(2) The Court hearing an application under this rule may give such directions, including directions as to the taking of accounts and the making of inquiries, as may be just.

Application of rule—This rule was taken from the former English RSC (Rev.) 1962, O.81, r.6, which had been taken from the former O.48A, r.10. 81/6/1

This rule does not affect the general law of retainer in the administration of estates (*Re Jennes* (1909) 53 S.J. 376); and neither this rule nor any of the rules of this Order alters the substantive law, and therefore it seems that if one or more partners, using the name of the firm under this rule, were to bring an action against another partner claiming money as due to the plaintiff firm in connection with the affairs of the firm, "the only relief which the plaintiff could obtain would be an account of the dealings and transactions of the partners". (*Meyer & Co. v. Faber* (*No. 2*) [1923] 2 Ch. 421 at 435, 439, CA, applied in *Leung Wing Yiu v. Siu King Yuen & Others* [2003] 2 H.K.L.R.D. 21; and see *Public Trustee v. Elder* [1926] Ch. 776, CA). The position is the same in regards disputes arising out of dissolution of partnerships, as "to order specific sums to be paid by reference to a particular transaction before an account is taken is to put the cart before the horse" (*per* Le Pinchon J.A., *Heybridge Ltd & Others v. Chan Sze Sze Gabrielle & Another* (CACV 172 of 2007) [2007] H.K.E.C. 1760 at para.25). See also *Kwok Chi Pin v. Lin Suk Han* [2008] H.K.E.C. 1527 in the context of a partnership being dissolved on the just and equitable ground.

Application for leave to issue execution under this rule is by summons before the master.

Attachment of debts owed by firm (O.81, r.7)

7.—(1) An order may be made under Order 49, rule 1, in relation to debts due or accruing due from a firm carrying on business within the jurisdiction 81/7

Annexure 7

Takeup of LLPs

Jurisdiction	Mode of Practice	Percentage of LLPs
England and Wales, United Kingdom	- sole proprietorship - partnership - limited liability partnership - company recognised by the Solicitors Regulation Authority - Legal Disciplinary Partnership	8.5% (as at 31 July 2008)
Ontario, Canada	- sole proprietorship - partnership - association - Limited Liability Partnership - Professional Corporation - Affiliation - Multi-Discipline Partnership	8% (807 out of 10,036 active law firms on record)
Singapore	- sole proprietorship - firm of solicitors - limited liability law partnership - law corporation	Approximately 4% out of the overall number of law practices
India	- can practise law individually - or form groups called the law firms	A handful of law firms are registered under LLP law
New York, USA	- solo practitioners - partnerships - professional corporations - limited liability companies - limited liability partnerships	No information on percentages for each category

Source : Submission from the Law Society's Working Party on Limited Liability Partnerships dated 30 July 2009

Annexure 8

Submission to the Bills Committee
on Legal Practitioners (Amendment) Bill 2010

Purpose

1. This paper sets out the Law Society's comments on the Legal Practitioners (Amendment) Bill 2010, after consulting its members on the draft Bill.

Background

2. The Law Society's aim in proposing the introduction of limited liability partnerships ("LLPs") for solicitors is to make available to its members an additional choice of a mode of practice that:

   (a) allows Hong Kong to catch up with the global trend as most jurisdictions including international financial centres like New York, London and Singapore have all adopted LLPs;

   (b) addresses the unfairness to law firm partners who have to shoulder personal liability even in cases where they are not at fault;

   (c) combines the features of limited liability to be offered by solicitor corporations and the culture of operating in a partnership that has traditionally been treasured by the profession;

   (d) offers an attractive form of business organisation to those solicitors who wish to expand their operation by forming a larger partnership with partners who possess expertise in different practice areas thereby:

      (i) facilitating a diversification of the scope of practice areas and legal services on offer in the same firm to meet the different needs of a client;

      (ii) cultivating the concept of a one-stop shop making available a wide range of services for consumers' convenience;

      (iii) expands the scale of operation leading to an economy of scale that benefits both the law firms and the consumers; and

   (e) is simple and straightforward to implement.

3. LLPs are not intended to create new "privileges" to solicitors. Being a common mode of operation around the world, the introduction of LLPs is intended as a minor innovation to ensure that Hong Kong, being an international financial centre, is keeping itself abreast with the global modernisation of the law and the legal infrastructure.

4. The Background Brief for the Bills Committee dated 13 July 2010 (CB2/BC/2/09) ("Background Brief") explains the pace at which the matter has progressed. Six years have elapsed since our initial proposal in 2004 and precious time has been lost for the profession to catch up with the world trend.

Comments on the Bill

5. The Law Society is pleased that there is general consensus that Hong Kong is lagging behind other jurisdictions in implementing professional liability reform and that the introduction of LLPs which is a relatively simple reform ought to be implemented as soon as possible (as noted in paragraph 6 of the Background Brief by LegCo Secretariat dated 13 July 2010).

6. The Law Society is however disappointed that the LLP model currently embodied in the Bill is different from the one that the Law Society has proposed.

7. The Law Society is fully conscious of the importance to strike a balance between modernisation of the legal infrastructure and protection of consumer interests.

8. As such, the Law Society has agreed to the inclusion of the following safeguards in the Bill:

   (a) The name of an LLP must include the words "Limited Liability Partnerships" or abbreviation "LLP" or "L.L.P." so that the public know that the firm operates with limited liability;

   (b) The name must be displayed visibly and legibly to the public at or outside its offices and on its office documents;

   (c) An LLP must give 7-day advance notice of its particulars to the Law Society;

   (d) An LLP must notify its existing clients within 30 days of the fact that it has become an LLP and how liabilities of a partner of a law firm are affected by the law firm becoming an LLP;

   (e) The Law Society keeps a list of LLPs for public inspection free of charge.

9. The above provisions ensure transparency of the LLP status of a law firm. The public can make an informed choice when engaging the services of a legal practice.

10. Further, the existing statutory professional indemnity limit of HK$10 million per claim will apply equally to LLPs and relevant claims statistics (Appendix III attached to the Background Brief dated 13 July 2010) show that the indemnity level is generally sufficient for the protection of individual

consumer interests.

Partial shield

11. A major modification by the Administration of the Law Society's initial proposal is the change from a full shield model to a partial shield model. For ease of reference, the following major jurisdictions do offer a full shield model:

    (a) New York, US;

    (b) Ontario and British Columbia, Canada;

    (c) UK;

    (d) Singapore;

    (e) India.

12. Limited liability of solicitor partners on the operational cost of the business of a law firm has never been a cause of concern as law firms may carry out the necessary administrative functions in connection with the running of the practice through service companies.

13. The introduction of LLPs is a convenient opportunity to simplify the artificial structure of routing the engagement of administrative services through service companies. No useful purpose is served by requiring LLPs to artificially complicate their structure at additional cost to form service companies to achieve the same result.

14. It harms the operation of law firms by forcing them to incur extra cost and administrative work, and yet the extra burden imposed on law firms does not result in any added protection to consumers. The Law Society finds the absurdity of insisting on such a lose-lose outcome incomprehensible.

15. The Law Society has spent considerable time in explaining its viewpoints to the Administration. It has also made previous submissions to the Panel on Administration of Justice and Legal Services on this issue.

16. The Law Society leaves it to the decision of the Bills Committee. In the event that the Committee agrees that the partial shield ought to be changed to a full shield, the Law Society suggests that a new subsection (b) be added to section 7AC(1) as follows:

    "(1) Subject to subsections (3), (4) and (5), a partner in a limited liability partnership is not, solely by reason of being a partner, jointly or severally liable for:

    (a) any partnership obligation (whether founded on tort, contract or otherwise)

that arises from a default of any other partner in the partnership, or of an employee, agent or representative of the partnership, in the course of the business of the partnership as a limited liability partnership; or

(b) any other partnership obligations that are incurred in the course of the business of the partnership as a limited liability partnership."

Constructive knowledge

17. Section 7AC(3) provides that the limited liability afforded to an LLP does not protect a partner from liability if the partner knew or ought reasonably to have known of the default at the time of its occurrence and failed to exercise reasonable diligence to prevent its occurrence.

18. The Law Society agreed with the observation made in paragraph 7 of the Legal Service Division Report by the LegCo Secretariat dated 28 June 2010 on this knowledge provision which is extracted below:

"..... In legal practice, rarely would default be constituted by a single act at a specific point of time. It may be difficult to determine when knowledge would be knowledge after the occurrence. It is also not clear whether a partner is absolved from any obligations to salvage or remedy a position caused by another partner's default before it becomes wholly irreversible."

19. The uncertainty created by the constructive knowledge provision may be exploited by claimants to cast their net unnecessarily wide leading to excessive litigation. It is also not clear whether the claimant or the innocent partner should bear the burden of proof with respect to the constructive knowledge element.

20. Further, if a partner knew of the default and failed to take reasonable action to prevent it, he would have been negligent himself and would not be protected by the LLP status of the firm in any event.

21. With respect to the constructive knowledge element, the Law Society has reviewed a number of overseas jurisdictions. Among them, it is noted that most only provide for actual knowledge and not constructive knowledge, even where the LLP model offers full shield protection.

22. For example, the British Columbia Partnership Act (which provides for full shield LLPs) provides for actual knowledge only:

"Subsection (1) does not relieve a partner in a limited liability partnership from personal liability

(a) for the partner's own negligent or wrongful act or omission, or

(b) for the negligent or wrongful act or omission of another partner or an employee of the partnership if the partner seeking relief

(i) knew of the act or omission, and

(ii) did not take the actions that a reasonable person would take to prevent it."

Apart from British Columbia, for ease of reference, the following jurisdictions, which include references to the role of knowledge in LLPs, also provide for actual knowledge only in their relevant legislation:

(a) Alberta Partnership Act;

(b) Manitoba Partnership Act;

(c) Texas Business Organisation Code.

23. To minimise uncertainty that may lead to excessive litigation, the Law Society proposes to elaborate the provision as follows:

"(3) Subsection (1) does not operate to protect a partner from liability

(a) where the partner knew of the default at the time it was committed and failed to take reasonable steps to prevent its commission, or

(b) 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."

The above proposed wording is adopted from the Alberta Partnership Act which provides for partial shield LLPs.

24. The Law Society takes the view that the proposed wording will be an improvement to the original section 7AC(3) because of its certainty and clarity. There will be two definite situations where exclusion from LLP protection applies:

(a) to those who knew of the default and failed to take reasonable steps to prevent it; and

(b) to those who were directly responsible for supervising the defaulting employee but failed to provide adequate and competent supervision as would normally be expected.

25. The Law Society notes that some stakeholders have previously raised concerns as to the possibility of a total lapse of supervision because all partners will try to avoid getting involved in supervising a matter in order to escape personal liability.

26. There is absolutely no cause for concern. If there is no supervision by a responsible partner in a matter because the partners of an LLP fail to establish a proper system of supervision, that systemic failure might be the basis of a claim that all partners of the LLP could be held liable for negligence.

27. There is also a suggestion that LLPs may lead to firms opening all case files under the name of a "scapegoat partner" to facilitate avoidance of incurring personal liability. However, such a ploy will not work as any court can pierce through the veil of form and focus on the substance behind in identifying the culpable partner in question.

28. Further, the legal profession is a highly disciplined and competitive profession. No partner will risk loosening up on supervision and damaging his hard earned reputation simply because the firm is an LLP.

29. Further, if the Solicitors Indemnity Fund pays out damages on behalf of a claim made against a firm, the firm will become "claims loaded" and this will affect the firm's loss ratio and impact on the calculation of insurance premium loading payable by the firm to the Fund.

Distribution of partnership property

30. Section 7AI is aimed at the preservation of partnership assets.

31. The Law Society appreciates the concern of consumers to maximise the pool of assets that can be applied to settle claims against an LLP. This concern understandably arises out of worries that consumers will be exposed to the risk of not being sufficiently compensated in a claim as a result of the exclusion of the personal assets of the innocent partners in an LLP.

32. However, this concern is over exaggerated. As stated in a previous submission, from 1994/95 indemnity year to July 2009, only 1.6% of the claims on the Fund have sought HK$10 million or more and out of these claims, only one claim was brought by an individual who was paid HK$10 million (including defence cost but less the indemnified's deductible).

33. Rarely does a claimant have to resort to the personal assets of the culpable partner, let alone the partnership assets because the statutory indemnity limit of HK$10 million is already sufficient to settle the claim amount.

34. On the basis of the claims history, the operation in the form of an LLP or a general partnership does not make much real practical difference with respect to the sufficiency of indemnity protection to consumers.

35. In the event that the firm becomes insolvent and the partners are bankrupt, the Bankruptcy Ordinance will apply.

36. The Law Society takes the view therefore that a restriction on the distribution of partnership property (on the basis of the cash-flow or net assets of the partnership) which does not exist for general partnerships is unnecessary for LLPs and should be deleted.

37. However, if it is the view of the Bills Committee that a restrictive provision on the distribution of partnership property must remain in addition to bankruptcy laws, the Law Society suggests that there should be a time limit for commencement of proceedings to enforce a liability under section 7AI.

38. As currently drafted, section 7AI is unlimited in time. This is unreasonable and unworkable because it will create the prospect of a claim against individual partners in perpetuity. There should be certainty in rules governing the distribution of profits and assets, i.e. a distribution should not be subject to scrutiny of an indefinite period of time.

39. In a bankruptcy scenario, the relevant period for restoration is 2 years before presentation of bankruptcy petition where unfair preferences were given to associates of debtors and a person is an associate with whom he is in partnership under sections 50, 51 and 51B of the Bankruptcy Ordinance (Cap.6).

40. The Law Society therefore proposes that a new subsection (6) be added to section 7AI as follows:

"(6) No proceedings to enforce a liability under this section shall be commenced later than two years after the date of the distribution to which the liability relates."

The above wording is adopted from the Manitoba Partnership Act and the British Columbia Partnership Act.

41. The Law Society holds very strong views against section 7AI in its present form and will find it very difficult to render its support to the Bill if the section is not deleted or changed as proposed above.

Conclusion

42. In summary, the Law Society proposes the following amendments to three sections of the Bill:

Section 7AC(1)

"(1) Subject to subsections (3), (4) and (5), a partner in a limited liability partnership is not, solely by reason of being a partner, jointly or severally liable for:

(a) any partnership obligation (whether founded on tort, contract or otherwise) that arises from a default of any other partner in the partnership, or of an employee, agent or representative of the partnership, in the course of the business of the partnership as a limited liability partnership; or

(b) any other partnership obligations that are incurred in the course of the business of the partnership as a limited liability partnership."

Section 7AC(3)

"(3) ~~Subsection (1) does not protect a partner from liability if the partner~~
~~(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.~~

Subsection (1) does not operate to protect a partner from liability

(a) where the partner knew of the default at the time it was committed and failed to take reasonable steps to prevent its commission, or

(b) 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."

Section 7AI

"(6) No proceedings to enforce a liability under this section shall be commenced later than two years after the date of the distribution to which the liability relates."

The Law Society of Hong Kong
6 August 2010

Annexure 9

LC Paper No. CB(2)2233/09-10(02)

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 legislation[1]. 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

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[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-

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[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 Alberta[3], Ontario[4], Texas[5], British Columbia[6] and Manitoba[7] 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 Ontario[8] and Texas[9] has a similar provision to remove LLP protection for a partner who ought reasonably

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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 liability .....if...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 liable ....unless [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 liability .....if...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 liable ....unless [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 partners[10]. 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 supervision[11]. 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 –

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[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.

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[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
September 2010

#356701 v 9A

Annexure 10

LC Paper No. CB(2)344/10-11(03)

Bills Committee on
Legal Practitioners (Amendment) Bill 2010 ("Bill")

Problems, if any, encountered by Alberta, British Columbia and Manitoba which do not impose liability on a partner of a limited liability partnership ("LLP") based on his constructive knowledge of a default by other member(s) of the LLP

Purpose

At the meeting on 17 September 2010, the Bills Committee asked the Administration to provide a paper to illustrate the problems, if any, encountered by jurisdictions as mentioned in paragraph 11 of LC Paper No. CB(2)2233/09-10(02) (namely, Alberta, British Columbia and Manitoba) which do not impose liability on an LLP partner based on his constructive knowledge of a default by other member(s) of the LLP.

2. The LLP statutes in Alberta, British Columbia and Manitoba have only been introduced in recent years[1] and despite our repeated efforts in so doing, the Administration has not found any specific case from these 3 jurisdictions which is directly relevant to the subject as stated in paragraph 1 of this paper above.

Relevant Comments by Eminent Authors

3. However, relevant discussion is found in materials from the United States, namely, the authoritative work on LLP "Bromberg and Ribstein on Limited Liability Partnerships, The Revised Uniform Partnership Act, and The Uniform Limited Partnership Act (2001)", Wolters Kluwer (2009 Edition) and in journal articles.

Disincentive Effects for LLP Partners and its implications on consumer protection

4. As previously mentioned in paragraph 18 of LC Paper No. CB(2)2233/09-10(02), Bromberg and Ribstein are of the view that

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[1]

LLP Statute	Year of Enactment	Citation
Alberta	1999	Sections 12, 81 – 104 of the *Alberta Partnership Act*
British Columbia	2004	Sections 94 - 129 of the *British Columbia Partnership Act*
Manitoba	2002	Sections 67 – 88 of the *Manitoba Partnerships Act*

confining an LLP partner's liability to matters that he has actual knowledge or under his direct supervision may provide disincentive for LLP partners to monitor their co-partners, because the partners' personal liability for participating in misconduct would exceed their partners' share of the firm's vicarious liability.[2]

5. This view is shared by Susan Fortney, another learned author on professional liability issues:

> "Conversion to a limited liability firm undercuts these incentives in two ways. First, it eliminates unlimited liability as an economic incentive to devote time and resources to monitoring the conduct of firm players. Second, lawyers may avoid managerial and supervisory roles and even assisting other lawyers because such activities may subject the lawyer to personal liability for the acts of others. ...
>
> Those limited liability statutes that impose supervisory liability ... actually create a disincentive, undermining partners' willingness to participate in firm management and supervisory activities. As a partner with no vicarious liability exposure, why should one get involved in firm management and supervision if those precise activities expose one's personal assets? Is the desire to protect the firm's reputation and assets enough to risk personal liability exposure?"[3] [emphasis added]

6. Fortney has also criticized that, apart from a minority of US jurisdictions which require that LLPs maintain an adequate level of insurance or assets on a per lawyer basis, no US legislation "addresses the other detrimental consequences of eliminating unlimited liability, including the risk that firm members will shirk responsibility for the conduct of other firm members".[4]

7. The "Disincentive Effects for LLP Partners" as outlined in paragraphs 4 to 6 above would erode consumer protection as, for example, LLP partners would "avoid managerial and supervisory roles and even assisting other lawyers because such activities may subject the lawyer to personal liability for the acts of others". The scenario as described by the learned author could be avoided if the proposed section 7AC(3)(a) (which provides that *"Subsection (1) does not protect a partner from liability if the partner- (a) knew or ought reasonably to have known of the default at*

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2 Bromberg and Ribstein, at p.128.

3 Susan Saab Fortney, "Tales of Two Regimes for Regulating Limited Liability Law Firms in the US and Australia: Client Protection and Risk Management Lessons", *Legal Ethics* (United Kingdom), Volume 11, Issue 2, Winter 2008, 230 at 235.

4 *Ibid* at 237.

the time of its occurrence") is maintained. In such case, it would not help an LLP partner by his avoiding managerial and supervisory roles and/or assisting other lawyers, if the circumstances are such that he ought reasonably to have known of the default by other members of his firm at the time of its occurrence. Hence, the proposed section 7AC(3)(a) is conducive to consumer protection.

Concerns over Lost Collegiality and its implications on consumer protection

8. According to an article named "The Economics of Limited Liability: An Empirical Study of New York Law Firms" [5] by Ms Kimberly D. Krawiec[6] and Mr. Scott Baker[7], partners of New York law firms[8] were interviewed on the factors affecting their decision to opt for the LLP status for their firms, and it was found out that "concerns over lost collegiality"[9] is one of the most frequently cited cases in deciding whether a general partnership should be converted to an LLP. The article has also provided the following elaboration on this point:

> "b. Collegiality
>
> Every partner we interviewed identified fears regarding a loss in firm collegiality as an issue that arose in their firms' debates over whether to become an LLP. ...
> ...
> ... A commonly asserted fear was that partners would hesitate to advise fellow partners or pitch in on matters if doing so would create

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5 At page 107 of the 2005 University of Illinois Law Review

6 Professor of Law, the University of North Carolina

7 Associate Professor of Law, the University of North Carolina

8 New York's LLP legislation does not impose personal liability on the ground of constructive knowledge. Section 26(c) of the New York Partnership Law provides:
"Notwithstanding the provisions of subdivision (b) of this section,
(i) each partner, employee or agent of a partnership which is a registered limited liability partnership shall be personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services on behalf of such registered limited liability partnership and
(ii) each ... partner, employee and agent of a ... registered limited liability partnership, foreign limited liability partnership or professional partnership that is a partner, employee or agent of a partnership which is a registered limited liability partnership shall be personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services in his or her capacity as a partner, employee or agent of such registered limited liability partnership. ..." [emphasis added.]

9 See n5 at 145.

> additional liability risk. A handful of partners at firms that had become LLPs believed that this fear had been well-founded at their firm and that certain partners now avoided helping out on other partners' projects, out of a desire to limit their personal exposure."[10] [emphasis added.]

9. As noted from the article quoted above, "loss of collegiality" would erode consumer protection as "certain partners now avoided helping out on other partners' projects, out of a desire to limit their personal exposure". Again, for reasons as explained in paragraph 7 above, this problem could be minimized by retaining the constructive knowledge element in the proposed section 7AC(3)(a) of the Bill. In such a case, an LLP partner shall not be able to limit his personal exposure if the circumstances are such that he ought reasonably to have known of the default by other members of his firm at the time of occurrence.

Conclusion

10. The relatively young history of LLPs in certain Canadian jurisdictions has made it difficult to locate a specific case from those jurisdictions to illustrate the problems encountered by the relevant LLP jurisdictions that do not impose liability on an LLP partner based on his having constructive knowledge of a default by other member(s) of the LLP. However, as shown in paragraphs 4 to 9 above, concerns were raised by eminent authors on LLPs over removing constructive knowledge on the part of an LLP partner as a basis for holding him liable for the default of other members of his firm. The Administration in its preparation of the Bill had sought to address the above concerns by including in the Bill the proposed section 7AC(3)(a) in its present form.

Department of Justice
November 2010

#357950-v11A

[10] See n5 at 146.

Annexure 11

Submission to the Bills Committee on

Legal Practitioners (Amendment) Bill 2010

Purpose

1. This paper sets out the Law Society's comments on the Administration's policy position on the following issues in its submission in January 2011:

   (a) the constructive knowledge element of the proposed section 7AC(3)(a); and

   (b) the limitation period for clawback actions under the proposed section 7AI.

Inclusion of constructive element in section 7AC(3) unnecessary in the first place

2. Section 7AC(3) of the Bill excludes a partner from the liability protection of an LLP under section 7AC(1) if the partner:

   (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.

3. Section 7AC(3) covers two aspects, namely, actual knowledge and constructive knowledge.

4. On actual knowledge, there is no need to include an express provision. If a partner knew of the default and failed to take reasonable action to prevent it, he would have been negligent himself and would not be protected by the LLP status of the firm in any event.

5. On constructive knowledge, the Law Society is given to understand that the Administration believed, based on academic commentaries that it was more likely for partners in an LLP to avoid personal liability by not getting involved in any supervision at all. The Administration therefore concluded that consumers would consequently end up having no "culpable" partner to shoulder liability for any negligence claim.

6. Academic commentary can be useful in evaluating legislative and policy alternatives. However, at the same time, it is necessary to review the commentary carefully to understand the scope of the subject being addressed by the author, the perspective from which the issue is being considered and any limitations on the research underlying the paper and the quality of the scholarship in general.

7. More importantly, any extract from academic commentaries in support of a view needs to be put in context. The following statement from Kraiwec and Baker was quoted in support of the Administration's view on concerns of lost collegiality in an LLP:

"A handful of partners at firms that had become LLPs believed that this fear had been wellfounded at their firm and that certain partners now avoided helping out on other partners' projects, out of a desire to limit their personal exposure."

However, this was not the conclusion of the article. The article goes on to say the following, in the very next sentence:

"Most partners, however, indicated that becoming an LLP had not impacted in any way the relations among partners. As stated by one law firm partner, 'partners who were uncollegial before [the firm became an LLP] are still uncollegial and partners who were collegial before are still just as collegial [after the firm became an LLP].'"

8. The belief and fear of the Administration that LLPs will lead to partners abandoning proper supervision of their legal practice is unrealistic and over exaggerated. The legal profession is a highly disciplined and competitive profession. No partner will risk loosening up on supervision and damaging his hard earned reputation simply because the firm is an LLP.

9. The Department of Justice itself reported in its submission in November 2010 that it has not found any specific case from Alberta, British Columbia and Manitoba (whose LLP legislations do not include any constructive knowledge provisions) that was relevant in illustrating that there was any problem with the lack of an express provision on constructive knowledge.

Constructive knowledge provision does not resolve the concern on supervision

10. There is absolutely no cause for concern that partners in an LLP will abandon proper supervision. Even if there is such a concern, which the Law Society submits is an unnecessary concern, expressly legislating on the attachment of liability to constructive knowledge will not resolve the issue.

11. It will simply invite claimants to adopt a catch-all approach by easily relying on such an express provision to include all partners as defendants on the basis that being partners in the same firm, they all ought to have known of the default. This defeats the purpose of the introduction of limited liability partnerships. Innocent partners will unreasonably be dragged into negligence claims.

Practical solutions to address the remote concern, if any at all, of LLP partners abandoning supervision to avoid liability

12. In its submission dated 29 September 2010, the Law Society proposed that, in addition to the requirements on disclosure of LLP status in the Bill and the existing solicitors' professional conduct requirements on duty of care, the Solicitors' Professional Conduct Guide be amended or a new Practice Direction be issued by the Law Society Council to require LLPs to inform their clients of the name and status of the person responsible for the conduct of the matter on a day-to-day basis; the partner responsible for the overall supervision of the matter and any subsequent changes.

13. The above additional practice requirement serves to directly ensure that all cases are supervised by a designated partner and offers a practical solution to the remote concern of LLP partners abandoning supervision to avoid liability. Any breach of a Practice Direction will subject the solicitor to disciplinary actions.

Consequence of failure to issue notice

14. The Administration has proposed that the practice requirement be modified into a notification requirement in the legislation as follows:

    (a) an LLP will be required to issue a signed written notice to its clients in respect of every matter, within 30 days after acceptance of instructions of the matter, stating the name of the responsible partner for the matter and containing an undertaking by the LLP to inform the client of any subsequent changes of the responsible partner; and

    (b) the loss of LLP protection for the firm in respect of that matter should the LLP fail to issue the written notice, unless the client knew who the responsible partner was prior to the default and within 30 days from the firm's acceptance of instructions in respect of that matter.

15. The Law Society has no objection to the imposition of a notice requirement or the content to be included in the notice as set out in paragraph 14(a) above. However, the Law Society considers the suggested sanction as set out in paragraph 14(b) disproportionate to such a procedural formality.

16. The decision to become an LLP is no casual decision for a firm. The conversion impacts on the firm's overall operation and long term development planning. Once it was set up as an LLP, held out to the public as an LLP and complied with the disclosure requirements in the Bill relating to its LLP status, then the firm should be afforded the certainty that it can operate as an LLP in respect of all matters.

17. Providing for the stripping of a firm's LLP status (albeit only in respect of a particular matter) on the basis of a failure to comply with a mere formality of issuing a written notice renders the LLP status a sham.

18. Very often, work may not actually start for more than 30 days after acceptance of instructions and yet on the basis of the Administration's proposal, if the required notice is issued, say, one day after the expiry of 30 days from the acceptance of instructions, the LLP status will be lost in respect of the matter.

19. The Law Society considers the proposed sanction of the loss of LLP status highly draconian, in particular the requirement relating to the 30-day limit as illustrated by the example given in paragraph 18 above, and hence, does not support it.

20. If the Bills Committee considers otherwise, the Law Society strongly urges the Bills Committee to remove the 30-day limit to the effect that if a client knew who the responsible partner was prior to the occurrence of the default, irrespective of whether it was within or beyond 30 days from the acceptance of instructions, the LLP status of the firm remains intact.

21. Further, to clarify, it is the Law Society's understanding that the sanction of the loss of LLP status in respect of a particular matter will not extend to a breach of undertaking to inform the client of any subsequent changes of the responsible partner for the matter on the basis that the client will not be disadvantaged because:

    (a) the client can still claim from the partner named in the initial notice and join the subsequent partner as a co-defendant when the latter's identity is known;

    (b) alternatively and invariably, to exonerate himself, the partner named in the initial notice will join the subsequent responsible partner as a third party to the proceedings.

Clawback of a distribution of partnership property

22. Looking at LLP provisions around the world, claw back provisions are uncommon.[1]

23. Most other major jurisdictions like UK, Singapore or New York will simply rely on the general insolvency or fraudulent transfers provisions that do not apply only specifically to LLPs.

24. The Law Society has submitted before and it reiterates its position that on the premises that consumers will not be disadvantaged, Hong Kong should be in line with most other jurisdictions in designing its LLP legislation so that it can truly achieve the objective of enhancing Hong Kong's competitiveness through a modernization of its legal infrastructure that is comparable to other jurisdictions. Consumers will not be disadvantaged without clawback because:

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[1] Extracted from paragraph (d) on Effect of LLP Status on Other Partnership Rules on p.187 - p.189 of *Limited Liability Partnerships, The Revised Uniform Partnership Act, and The Uniform Limited Partnership Act (2001), 2010 Edition by Alan R. Bromberg and Larry E. Ribstein*

(a) the mandatory Professional Indemnity Scheme has proven to be sufficient protection based on past claims experience;

(b) the Bankruptcy Ordinance will apply to claw back assets that should not have been transferred out in the event that the firm becomes insolvent and the partners are bankrupt;

(c) the general remedy of Mareva injunction will apply should there be any risk of dissipation of firm's assets.

25. Further, the current section 7AI is practically unworkable.

26. Section 7AI allows any person to whom the partnership owes any partnership obligation at the time of distribution to take out proceedings to enforce a partner's liability to return that distribution to the partnership if the value of the partnership property is less than that of the partnership obligations.

27. Section 7AI(4) specifically provides that "partnership obligations" cover actual and contingent obligations.

28. Accordingly, section 7AI will effectively allow a claimant to commence proceedings to enforce a partner's liability to return a distribution to the partnership even before the claimant has obtained judgment on his negligence claim as long as the partnership property is less than the partnership obligations taking into account his claim (which is a contingent partnership obligation).

29. The issue is where judgment has not been obtained for the claim, how much of the claim should be allowed for the purpose of determining if the value of partnership obligation is more than that of partnership property. It poses problems for the following reasons:

(a) the amount of the claim may be over-inflated;

(b) an assessment of quantum at the early stage of the claim proceedings is extremely difficult.

30. If a comparison is made with the few Canadian jurisdictions that have provisions regulating distribution of partnership property in LLPs, it is noted that they do expressly provide for the bases to determine whether a distribution should have been made, namely,

"(a) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;

(b) on a fair valuation;

(c) on another method that is reasonable in the circumstances."[2]

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[2] Based on section 85(5) Manitoba Partnership Act and Section 83(5) Saskatchewan Partnership Act

31. If it is the view of the Bills Committee that a clawback provision must be provided in the legislation, the inclusion of such objective bases will add certainty and predictability to the existing section 7AI so that at the very least, an LLP will know how to ensure compliance with the provision. There is no use imposing a requirement if no one knows how to comply with it.

32. In relation to the limitation period of a clawback action, the Administration has proposed a period of 6 years.

33. In a bankruptcy scenario, the relevant period for restoration is 2 years before presentation of bankruptcy petition where unfair preferences were given to associates of debtors and a person is an associate with whom he is in partnership under sections 50, 51 and 51B of the Bankruptcy Ordinance (Cap 6).

34. The spirit of the proposed clawback is the same as that of the restoration of assets in a bankruptcy situation and the period should be consistent.

35. Further, comparing with the few Canadian jurisdictions[3] that have provisions regulating the distribution of property for LLPs, the period of limitation to enforce a liability under all of those provisions is 2 years.

36. There are two reasons given by the Administration for proposing 6 years instead of 2 years as the limitation period:

    (a) clients do not know when a distribution has been made; and

    (b) it takes more than 2 years for a client to obtain a first instance judgment on his negligence claim before he is in a position to enforce the judgment debt.

37. On the client's knowledge of distribution, a comparison can be made with the bankruptcy scenario where similarly the claimant would not have knowledge of any unfair transfer of assets, the restoration period is still legislated as 2 years. The Law Society does not see any justification for LLPs to depart from the policy of existing legislation.

38. For the second reason on the need of more than 2 years to obtain a first instance judgment, as explained in paragraphs 26 to 28 above, section 7AI provides that the claimant can take out a clawback action even before he obtains judgment. This is thus not a valid reason.

39. The Law Society submits that if the Bills Committee considers a clawback provision must be provided in the legislation, the limitation for a person to enforce a liability under such a provision should be 2 years in line with the bankruptcy regime and other overseas LLP legislation, e.g. British Columbia, Manitoba, Nova Scotia and Saskatchewan.

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[3] British Columbia, Manitoba, Saskatchewan, Nova Scotia

Conclusion

40. In summary, the Law Society's position is as follows:

(a) it welcomes the deletion of the constructive knowledge element in section 7AC(3);

(b) it agrees to the content of the notice requirement;

(c) it is willing to issue a Law Society Practice Direction that reflects the notice requirement and any breach of the Practice Direction will subject the culpable solicitor to disciplinary sanctions;

(d) it does not support the proposed sanction of the loss of LLP status in respect of the matter for which the LLP fails to issue the required notice;

(e) in the event that the Bills Committee decides otherwise, it strongly urges the Bills Committee to remove the 30-day limit to the effect that if a client knew who the responsible partner was prior to the occurrence of the default, irrespective of whether it was within or beyond 30 days from the acceptance of instructions, the LLP status of the firm remains intact;

(f) it does not support the inclusion of an express clawback provision in the Ordinance as there is sufficient existing consumer protection without the need for any express clawback;

(g) the existing section 7AI lacks certainty and is practically unworkable;

(h) the grounds on which the Administration based to determine 6 years as the limitation period for a clawback action are invalid;

(i) the Law Society does not support the inclusion of the proposed 6 years clawback provision in the Ordinance;

(j) if the Bills Committee considers otherwise, the Law Society strongly urges the Bills Committee to include some objective bases on which to determine whether a distribution should be made and a limitation period of 2 years for the clawback action in line with other overseas LLP legislation.

The Law Society of Hong Kong
1 February 2011

Annexure 12

Submission to the Bills Committee on Draft Committee Stage Amendments to the Legal Practitioners (Amendment) Bill 2010 dated 27 May 2011

1. The Law Society has reviewed the draft committee stage amendments ("CSAs") to the Legal Practitioners (Amendment) Bill 2010 dated 27 May 2011.

Liability of "designated partner" – section 7AC(2A)(b)

2. The spirit of limited liability partnerships ("LLPs") is to modernise the legal infrastructure so that an innocent partner will not have to become jointly and severally liable for others' default solely by reason of being a partner in the same firm.

3. The Law Society acknowledges the need to strike a balance with the preservation of consumer interests. In its previous submissions, it has therefore highlighted the numerous measures adopted for consumer protection.

4. Further, the Law Society has also agreed to the latest proposal of the imposition of a notice requirement on LLPs informing their clients of the name of the responsible partner for the matter.

5. New subsection 7AC(2A)(a) of the CSAs provides that the limitation on liability does not apply unless the partnership complies (throughout the client engagement) with the procedures for designating and notifying the client of a supervising partner (called the "designated partner"). This proposal was discussed previously with the Administration and the Law Society submitted its views on the proposal in its submission dated 1 February 2011:

> *"(d) it does not support the proposed sanction of the loss of LLP status in respect of the matter for which the LLP fails to issue the required notice;*
>
> *(e) in the event that the Bills Committee decides otherwise, it strongly urges the Bills Committee to remove the 30-day limit to the effect that if a client knew who the responsible partner was prior to the occurrence of the default, irrespective of whether it was within or beyond 30 days from the acceptance of instructions, the LLP status of the firm remains intact."*

6. The Law Society will not make further submission on the new subsection 7AC(2A)(a).

7. The Law Society is however caught by surprise by the introduction, at this late stage, of the new subsection 7AC(2A)(b) which effects a fundamental change to the LLP structure.

8. New subsection 7AC(2A)(b) provides that the limitation on liability does **not** apply to the designated partner. This means that the supervising partner will **automatically** lose the entitlement to LLP protection even though he is innocent

and in the absence of any proof of negligence on his part. Unlike the proposal entailed in the new subsection 7AC(2A)(a) which at least provides a way for a law firm to avoid losing the LLP status by ensuring compliance with the notice provision, there is no way out for an innocent supervising partner to avoid losing LLP protection.

9. The Law Society takes a strong view against this fundamental change and finds it wholly unacceptable because:

   (a) It goes against the spirit and essence of LLPs which are introduced so that innocent partners will not be jointly and severally liable for others' default solely by reason of being a partner of the firm.

   (b) It goes against the principle which we have all along been adhering to - the principle that the introduction of LLPs is not intended to change the common law position with respect to the proof of negligence. Based on the proposal, the supervising partner is treated automatically the same way as a negligent partner without him being proved to be negligent in any way.

10. This is akin to a regime imposing a "scapegoat" partner for each client matter with unlimited legal liability. This harsh approach is unprecedented as it is tantamount to imposing strict liability on the designated partner concerned.

Drafting comments

11. In new section 7AI(1A), the Law Society proposes that the words "*the person proves that*" be deleted because this language permanently places the burden of proof on a partner or firm, which is unnecessary and unfair.

12. In new section 7AI(1A)(c), the reference to "doubt" as to the correctness of the assessment is very vague. The Law Society proposes that the requirement be changed to:

> *"at the time of the distribution the person did not have, or (if the person is an assignee of a partner's share in the partnership) neither did the person nor that partner know that the assessment was incorrect."*

13. The notice provisions contained in the new section 7AGA are convoluted and much more detailed and technical than necessary. There are a lot of cross references which make it very difficult to follow. The Law Society however is not in a position to redraft the entire section but would suggest that a further close examination be taken by the draftsmen to simplify and refine the provision where possible.

The Working Party on Limited Liability Partnerships
The Law Society of Hong Kong

9 June 2011

(Draft dated 27/5/2011)

Annexure 13

Legal Practitioners (Amendment) Bill 2010

Committee Stage

[**Note**: The committee stage amendments are arranged in this draft in an order that facilitates discussion. The amendments will be re-arranged to follow the usual order in the final version.]

[CSAs not concerning "designated partner"]

Clause 4	In the proposed Part IIAAA, in section 7AA(1), by deleting the definition of "business" and substituting – ""business" ( ), in relation to a limited liability partnership, means the business of the partnership in providing services as a Hong Kong firm or a foreign firm;".
Clause 4	In the proposed Part IIAAA, in section 7AA(1), by deleting the definition of "client".
Clause 4	In the proposed Part IIAAA, in section 7AA(1), by adding - ""distribution" () means, in relation to partnership property, a transfer of money or other partnership property by a partnership to a partner, whether as a share of profits, return of contributions to capital, repayment of advances or otherwise.".
Clause 4	In the proposed Part IIAAA, in section 7AC(3)(a), by deleting "or ought reasonably to have known".
Clause 4	In the proposed Part IIAAA, in section 7AG, by deleting subsection (6) and substituting – "(6) In this section "existing client" ( ), in relation

	to a law firm, means a person who retains or employs the firm at the time it becomes a limited liability partnership." In the proposed Part IIAAA, in section 7AI, by deleting subsection (1) and substituting - "(1) If a limited liability partnership makes a distribution of any of its partnership property to one or more persons (each being a partner or an assignee of a partner's share in the partnership), and immediately after the distribution – (*a*) the partnership is or will be unable to pay its partnership obligations as they become due; or (*b*) the value of the remaining partnership property is less than the partnership obligations, then each of the persons is liable as provided in subsection (2). (1A) But a person is not liable as provided in subsection (2) if the person proves that – (a) immediately before making the distribution, the limited liability partnership made a reasonable assessment that the financial position of the partnership would not be as described in subsection (1) immediately after the distribution; (b) the partnership arrived at the assessment after exercising reasonable diligence and based on information obtained for the purpose of the assessment or
Clause 4	

	otherwise available at the time of the assessment; and (c) at the time of the distribution the person did not have, or (if the person is an assignee of a partner's share in the partnership) neither the person nor that partner had, any reason to doubt the correctness of that assessment.
Clause 4	In the proposed Part IIAAA, in section 7AI, by adding after subsection (5) - "(6) No proceedings to enforce a liability under this section may be commenced later than 6 years after the date of the distribution to which the liability relates."
Clause 4	In the proposed Part IIAAA, in section 7AM(1), by deleting "continue to".

CSAs on "designated partner"

Clause 4	In the proposed Part IIAAA, in section 7AC(2), by deleting "The" and substituting "Subject to any written agreement between the partners to the contrary, the".
Clause 4	In the proposed Part IIAAA, in section 7AC, by adding after subsection (2) - "(2A) Subsection (1) has effect in relation to liability for any partnership obligation arising from a matter handled by a partnership for a client only if– (a) throughout the period during which the matter is handled by the partnership, the partnership complies with section 7AGA(1); and

	(b) the partner to be protected under subsection (1) is not a designated partner for the matter at the time of the default from which the partnership obligation arises. (2B) To avoid doubt- (a) this section does not protect a partner of a partnership from any liability for any partnership obligation (whether founded on tort, contract or otherwise) arising from the partner's own default whether or not – (i) the partner commits the default jointly or collectively with other partners; or (ii) the partner's default is attributable to or is aggravated by another partner's default; (b) the fact that a person is not a designated partner for a matter does not in any way support any inference that any liability arising from a claim in respect of the matter does not arise from the partner's default.
Clause 4	By adding after proposed section 7AG- "**7AGA. Designated partner for each matter** (1) For each matter that is handled by the partnership for a client, there must be at least one partner of the partnership acting as designated partner throughout the

	period during which the matter is handled. (2) A person is a designated partner for a matter handled by the partnership for a client only if – (a) the person is a partner of the partnership; and (b) either – (i) the person is stated in a notice that complies with subsections (6) and (7) (***designation notice***) to be a designated partner for the matter from the effective date of the notice, and the partnership complies with the conditions specified in subsection (3) (***designation conditions***); or (ii) the person is stated in a notice that complies with subsections (6) and (7) (***re-designation notice***) to be a designated partner for the matter from the effective date of the notice, and the partnership complies with the conditions specified in subsection (4) (***re-designation conditions***). (3) In relation to a designation notice, the designation conditions are – (a) the effective date of the notice must be (i) the date on which the limited liability partnership begins to act for the client in respect of the

	matter; or (ii) for a matter in respect of which the partnership has beenacting for the client before becoming a limited liability partnership, the date on which the partnership becomes a limited liability partnership; and (b) the notice is given by the partnership to the client as soon as practicable, and in any event within 30 days after the effective date of the notice. (4) In relation to a re-designation notice, the re-designation conditions are – (a) at least one person is stated in the notice as becoming, or continuing to be, a designated partner for the matter from the effective date of the notice; and (b) the notice is given by the partnership to the client as soon as practicable, and in any event within 30 days after the effective date of the notice. (5) A person who is a designated partner for a matter under subsection (2) or (8) does not cease to be such until the earlier of the following– (a) the date on which the person ceases to be a partner of the partnership; or (b) the effective date of a re-designation notice if – (i) the notice complies with

	subsections (6) and (7), and the notice states that the person ceases to be a designated partner for the matter from the effective date of the notice; and (ii) the partnership complies with the conditions specified in subsection (4). (6) A designation notice or a re-designation notice in respect of a matter– (a) must be in writing; (b) must state the effective date of the notice; (c) in the case of a designation notice, must state who is or are the person or persons that becomes or become designated partner or partners for the matter from the effective date of the notice; (d) in the case of a re-designation notice, must state - (i) who is or are the person or persons that ceases or cease to be designated partner or partners for the matter from the effective date of the notice; (ii) who is or are the person or persons that becomes or continues, or become or continue, to be designated partner or partners for the matter from the

	effective date of the notice; and (e) must state the effect of section 7AC on the liabilities in respect of the matter of the designated partner or partners as named in the notice and of other partners of the partnership. (7) Each person referred to in subsection (6)(c) or (d)(ii) must sign the notice in the person's own name and on behalf of the partnership. (8) In respect of a matter handled by a limited liability partnership for a client, a partner of the partnership is a designated partner for the matter under subsection (1), even though subsection (2)(b)(i) and (ii) is not complied with, if – (a) but for the person becoming a designated partner in respect of the matter under this subsection, the partnership would have failed to comply with subsection (1) in respect of the matter from the date of any of the following (***triggering event***) – (i) the limited liability partnership begins to act for the client in respect of the matter; (ii) for a matter in respect of which the partnership has been acting for the client before becoming a limited liability partnership, the partnership becomes a limited liability partnership; or (iii) if a person is at any time the only

	designated partner in respect of a matter under subsection (2), the person ceases to be a partner of the partnership; and (b) it is proved that – (i) the client has the requisite knowledge specified in subsection (9) at a time specified in subsection (10); and (ii) the person is a partner who is not protected under section 7AC in respect of the matter and whose identity is known to the client as mentioned in subsection (9)(b)(i) or (ii). (9) The requisite knowledge specified for the purposes of subsection (8)(b) is actual knowledge of the following matters- (a) the effect of section 7AC on the liabilities of the partners of the partnership in respect of the matter; and (b) either – (i) that a partner of the partnership is not protected under section 7AC in respect of the matter, and the partner's identity; or (ii) that two or more partners are not protected under section 7AC in respect of the matter, and the identity of one or more of those

	partners, where the knowledge is acquired from the partner whose identity is known to the client as mentioned in paragraph (b)(i) or (ii). (10) The time specified for the purposes of subsection (8)(b) is any time – (a) within 30 days after the date of the triggering event; and (b) before the occurrence of the default from which the partnership obligation mentioned in section 7AC(1) arises. (11) A person who is designated partner for a matter under subsection (8) is such from the date of the triggering event. (12) To avoid doubt, the requirement in subsection (2)(a) does not absolve a person who is not a partner of a partnership from any liability that arises from the person holding himself or herself out as a partner of the partnership and a designated partner. (13) In this section- ***effective date*** (), in relation to a designation notice or re-designation notice given by a limited liability partnership, is the date stated in the notice as the day from which a person named in the notice becomes, continues to be or ceases to be a designated partner for a matter specified in the notice.
Clause 4	In the proposed Part IIAAA, in section 7AH, by deleting "7AF and 7AG" and substituting "7AF, 7AG and 7AGA".

Clause 4	In the proposed Part IIAAA, in section 7AL(2), by deleting "of section" and substituting "of sections 7AC(2) and".

Annexure 14

Submission to the Bills Committee on LLPs

Constructive knowledge

1. In its submission to the Bills Committee dated 6 August 2010, the Law Society set out its views on the provision of constructive knowledge in section 7AC(3) of the Legal Practitioners (Amendment) Bill 2010.

2. It proposed to replace 7AC(3) with the following provision:

> *"(3) Subsection (1) does not operate to protect a partner from liability*
>
> *(a) where the partner knew of the default at the time it was committed and failed to take reasonable steps to prevent its commission, or*
>
> *(b) 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."*

3. At the Bills Committee meeting held on 17 September 2010, it was noted that there was still some concern on whether the revised provision would offer sufficient consumer protection in cases where partners deliberately avoided personal liability by not getting involved in the supervision at all.

4. Under Principle 5.17 of the Hong Kong Solicitors' Guide to Professional Conduct, Volume 1 ("Conduct Guide"), a solicitor is under a duty to keep his client properly informed and to comply with reasonable requests from the client for information concerning his affairs.

5. Commentaries 1 and 2 under Principle 5.17 provide:

> *"1. A client* should *be told the name and the status of the person responsible for the conduct of the matter on a day-to-day basis and the partner responsible for the overall supervision of the matter.*
>
> *2. If the responsibility for the conduct or the overall supervision of the whole or part of a client's matter is transferred to another person in the firm the client* should *be informed."*

6. To address any concern that partners may try to avoid personal liability by not supervising the practice, the Law Society would agree to amend the Conduct

Guide to make the obligations in Commentaries 1 and 2 under Principle 5.17 mandatory for solicitors operating as LLPs.

7. LLPs will be expressly required to inform their clients of:

   (a) the name and status of the person responsible for the conduct of the matter on a day-to-day basis;

   (b) the partner responsible for the overall supervision of the matter; and

   (c) any subsequent changes to any of the above.

   Under Commentary 1, Principle 4.10 of the Conduct Guide, a bill must be signed by a partner.

8. This express requirement, coupled with the revised section 7AC(3) set out in paragraph 2 above, is clear and certain to both clients and solicitors and offers a practical solution to the concern raised.

   (a) To a client, he will have the comfort that:

      (i) there will be a partner designated to supervise his case;

      (ii) the partner will not be able to claim innocence and enjoy LLP protection by staying away from the case because as the designated supervising partner, he is responsible for providing adequate and competent supervision.

   (b) To a solicitor in an LLP,

      (i) the requirement is sufficiently clear to enable him to ensure compliance and to have a clear understanding of his liability exposure;

      (ii) the risk of being dragged into negligence claims by clients taking a catch-all approach irrespective of merits and engaging in excessive litigation will be minimised.

9. In addition, there are existing requirements governing solicitors' conduct upon acceptance of instructions to protect consumer interest. They include:

   (a) Competence to act

      Principle 5.03 of the Conduct Guide provides that "*A solicitor must not act or continue to act in circumstances where he cannot represent the client with competence or diligence.*"

(b) Diligence, care and skill

Principle 5.12 of the Conduct Guide provides that *"A solicitor who has accepted instructions on behalf of a client is bound to carry out those instructions with diligence and must exercise reasonable care and skill."*

(c) Communicating with client

Commentaries 3 and 5 of Principle 5.12 of the Conduct Guide state:

"3. A client should be told in simple language at the outset of a matter or as soon as possible thereafter the issues raised and how they will be dealt with and in particular, the immediate steps to be taken..."

"5. A solicitor should keep his client informed of the progress of the matter, any significant development in the matter and of the reason for any serious delay which occurs."

(d) Information on work

Commentary 1 of Principle 4.01 of the Conduct Guide provides that *"A solicitor should ensure that his client or prospective client is given an explanation by a person with appropriate competence of the work which is likely to be involved in carrying out his instructions and the time which may be taken."*

(e) Information on costs

Principle 4.03 of the Conduct Guide provides that *"If no fee has been agreed or estimate given, a solicitor should tell his client how the fee will be calculated, for example, whether on the basis of an hourly rate plus any mark-up, a percentage of the value of the transaction or a combination of both, or any other proposed basis. The solicitor should tell his client what other reasonably foreseeable payments he may have to make either to his solicitor or to a third party and the stages at which they are likely to be required."*

10. Furthermore, safeguards to ensure transparency of the LLP status of a law firm are included in the Bill to ensure that the public can make an informed choice when engaging the services of a law firm. These safeguards include:

(a) The name of an LLP must include the words "Limited Liability Partnerships" or abbreviation "LLP" or "L.L.P." so that the public know that the firm operates with limited liability (section 7AE of the Bill);

(b) The name must be displayed visibly and legibly at or outside its offices and on its office documents (section 7AF of the Bill);

(c) An LLP must notify its existing clients in writing within 30 days of the fact that it has become an LLP (section 7AG(1) of the Bill);

(d) The written notice to its existing clients by an LLP, the form of which is to be specified by the Law Society, must include a statement stating how liabilities of partners of a law firm are affected by the law firm becoming an LLP (section 7AG(4) and (5) of the Bill);

(e) An LLP must give 7-day advance notice of its particulars to the Law Society (section 7AD of the Bill);

(f) The Law Society keeps a list of LLPs for public inspection free of charge (section 7AJ of the Bill).

11. Pursuant to section 7AG(4) of the Bill, the Law Society will specify the form of the written notice that an LLP sends to its existing clients. It has reviewed some samples from overseas jurisdictions, for example, the one used in Ontario, Canada, which is **attached**. It is likely that the Law Society specified form will adopt a similar approach but tailored appropriately to the standard of liability applicable to Hong Kong.

12. On top of the above requirements, consumers are effectively protected with a statutory professional indemnity scheme which provides indemnity cover of a limit of HK$10 million per claim as well as any top up indemnity insurance taken up by individual law firms.

13. The Law Society is of the strong view that all these safeguards have balanced the need to give adequate protection to consumers and to allow the modernisation of the legal infrastructure which has been moving at a snail pace to proceed at the speed it deserves to catch up with the global trend.

Distribution of partnership property

14. In its submission dated 6 August 2010, the Law Society has raised its concerns of section 7AI which regulates the distribution of partnership property.

15. At the Bills Committee meeting held on 17 September 2010, the Law Society was requested to elaborate in practical terms how the section will deter practitioners from setting up LLPs.

16. It is submitted that the section is unclear, unreasonably burdensome, and redundant without serving any useful purpose.

17. Section 7AI is unclear for the following reasons:

(a) Section 7AI(4) provides that "partnership obligation" includes both actual and contingent obligations.

(b) The meaning of "contingent" is not defined. Practitioners are left to their own judgment in figuring out when an obligation is to be included or excluded in the computation of "partnership obligation" for the purpose of section 7AI.

(c) There is so much uncertainty surrounding it that practitioners will not be able to know whether they have safely complied with the section or not:

(i) How remote an obligation has to be for it to be excluded as a "partnership obligation"?

(ii) Will all demands and claims, no matter how frivolous and vexatious they are, have to be taken into account as "partnership obligations" as soon as they are issued?

(iii) Once a demand or a claim is made, does the entire amount demanded or claimed have to be counted as partnership obligation even though the amount is out of proportion to the anticipated liability?

18. Section 7AI is unreasonably burdensome for the following reasons:

(a) Section 7AI is unlimited in time. It creates the prospect of a claim against individual partners in perpetuity, which is not only an unreasonably excessive burden but also an unworkable requirement from the practical perspective of enforcement.

(b) In reality, meritorious claims will be settled under the Professional Indemnity Scheme. Rarely does a consumer claimant have to resort to the personal assets of the culpable partner, let alone the partnership property because the statutory indemnity limit of HK$10 million per claim is already sufficient to settle the claim amount.

(c) However, in valuing "partnership obligation" for the purpose of section 7AI, an LLP is required to artificially include claims which may in fact be covered by the Professional Indemnity Scheme and the firm's own top up insurance. This unreasonably distorts the amount of surplus available for distribution to partners.

(d) In a general partnership, there is no regulation on distribution of partnership property. It is claimed by the Administration that section 7AI is included to address the concern of depletion of partnership property in an LLP.

(e) On the basis of this rationale, the "partnership obligation" in section 7AI should only cover those protected by an LLP. As currently drafted, "partnership obligation" in section 7AI unreasonably includes all obligations, even those for which every partner still personally shoulders unlimited liability.

19. Section 7AI is redundant because, as mentioned in previous submissions, in the event that the firm becomes insolvent and the partners are bankrupt, the Bankruptcy Ordinance will apply. It serves the same purpose of restoring assets that should not have been distributed out.

20. In a bankruptcy scenario, the relevant period for restoration is 2 years before presentation of bankruptcy petition where unfair preferences were given to associates of debtors and a person is an associate with whom he is in partnership under sections 50, 51, and 51B of the Bankruptcy Ordinance (Cap 6).

21. The above drawbacks in connection with the current section 7AI will deter practitioners from considering LLPs because it is not worth subjecting themselves to uncertain and unfair risks of:

(a) taking on something with which they have no idea of how to ensure compliance;

(b) having to freeze partnership surplus from distribution for no reasonable cause;

(c) shouldering in perpetuity the liability of having to return the distributions received.

Definition of "partnership obligation"

22. At its meeting on 17 September 2010, the Bills Committee requested for the views of the Law Society on the definition of "partnership obligation" in the Bill:

""partnership obligation", in relation to a partnership, means any debt, obligation, liability of the partnership, other than debts, obligations or liabilities of the partners as between themselves, or as between themselves and the partnership;"

23. The definition mainly serves to distinguish between "external" partnership obligations (i.e. those between the partnership and third parties) and "internal" partnership obligations (i.e. those between the firm and the partners and those among partners) and make it clear that LLP protection does not extend to "internal" obligations.

24. The Law Society has no comment on the legislative intent of the definition although from the drafting perspective, it looks superfluous to repeat the term being defined (which is "obligation") within the definition itself.

25. A possible solution is to amend the definition as follows:

"partnership obligation", in relation to a partnership, means any debt, obligation **(whether contractual or otherwise)** or liability of the partnership~~,~~ **owed to any third party by the partnership** other than ~~debts, obligations or liabilities of the partners as between~~ **those arising between the partners** themselves~~,~~ or as between themselves and the partnership;"

26. Alternatively, as suggested by Mr Paul Tse, the definition can be deleted in its entirety and the term "partnership obligation" be replaced with "partnership liability" whenever it appears in the Bill.

The Law Society of Hong Kong
29 September 2010

DISCLOSURE

By-law 7 contemplates that an existing general partnership may wish to continue as a limited liability partnership. In such case, section 2(1) of By-law 7 requires that the partnership disclose to each person who was a client immediately before the continuance and who remains a client after the continuance the liability of the partners of the limited liability partnership under the *Partnerships Act*.

Firms may choose to publish a notice in a local newspaper as provided in subsection 2(2) of By-law 7. Such notices should be complete and clear enough for clients to understand the nature of the limitation on the liability of the firm. **If the partnership chooses to send a written notice to clients, they are encouraged to design their own communications respecting the disclosure requirement and customize them as they see fit for their particular clients. To the extent that lawyers may find it useful, a sample letter, appearing below, may be considered an example of a communication on disclosure.**

Sample Disclosure Letter for LLPs

Dear (Client):

Effective (date), the firm of ---- has become a limited liability partnership, as permitted by the *Partnerships Act* and the *Law Society Act*. The firm is now known as ----- LLP.

As the name suggests, the partnership carries on the practice of law with a degree of limited liability. The partners in a limited liability partnership are not personally liable for the negligent acts of another partner or an employee who is directly supervised by another partner. Each partner is personally liable for his or her own actions and for the actions of those he or she directly supervises and controls. The partnership continues to be liable for the negligence of its partners, associates and employees, and accordingly there is no reduction or limitation on the liability of the partnership. All of the firm's assets remain at risk.

Liability insurance protection for the lawyers of the partnership continues, and minimum insurance requirements, as required by the *Partnerships Act*, have been established for LLPs by the Law Society. The Law Society has determined that the liability insurance coverage for an LLP is that maintained individually by the partners.

The limitation on liability is the only change to the partnership resulting from the legislative amendments and this change will not affect our firm's relationship with you as a client. We would be happy to answer any questions you have about our limited liability partnership.

Annexure 15

LC Paper No. CB(2)344/10-11(02)

Bills Committee on
Legal Practitioners (Amendment) Bill 2010 ("Bill")

Policy intent on distribution of partnership property under the proposed section 7AI

On 29 September 2010, the Law Society submitted a paper to the Bills Committee (LC Paper No. CB(2)2328/09-10(01)) incorporating, among others, its comments on the proposed section 7AI of the Bill ("**Submission**").

2. At the Bills Committee meeting held on 5 October 2010, the Administration has, in response to the relevant comments of the Law Society in its Submission, explained the policy intent of the proposed section 7AI. This paper recapitulates (and where appropriate, elaborates on) our explanations on the policy intent of the proposed section 7AI at the meeting and to discuss the practical implications of the proposed section on solicitors' practice.

Pragmatic Approach of the Bill on Distributions to LLP Partners

3. A key feature of the Bill is its pragmatic approach in balancing the practical needs of an LLP to make distributions to its partners in proper circumstances on the one hand and consumer protection on the other.

4. With regard to distributions by an LLP in similar circumstances as described in the proposed section 7AI, it is noted that many overseas jurisdictions have adopted a more restrictive approach and prohibit an LLP from making any distribution under similar circumstances (please refer to the **Annex** attached to this paper for the relevant provisions in such overseas jurisdictions). In this regard, we do not consider it conducive to the development of LLPs in Hong Kong to adopt such a restrictive approach on all LLPs generally and understand the practical needs of LLPs to make distributions to their partners in proper circumstances. The Administration has therefore adopted a pragmatic approach by providing flexibility and autonomy for each individual LLP to decide for itself whether or not it should make a distribution to its partners and not to seek a general prohibition against distributions by LLPs in the circumstances prescribed in the proposed section 7AI(1)(a) and (b) of the Bill.

5. Hence, contrary to the suggestion made by the Law Society in its Submission that the proposed section 7AI would *"freeze partnership surplus from distribution for no reasonable cause"*[1], the Bill does not prohibit distributions by LLPs in general. It remains for an LLP itself to judge whether, in a given circumstance, it would like to make a distribution to its partners after taking into account all relevant considerations including those set out in paragraphs 17(c)[2] and 18(c)[3] of the Law Society's Submission. It should be noted that the proposed section 7AI does not prohibit a distribution from being made. It is entirely an LLP's decision and judgment whether or not it should make a distribution to its partners where it has (i) a remote obligation; (ii) a frivolous and vexatious claim against it; and/or (iii) a claim, the amount that is out of proportion to the anticipated liability. Similarly, if there is a well-founded claim against an LLP, it would be entitled to decide and judge for itself whether or not it should make a distribution by reference to its insurance coverage under the Professional Indemnity Scheme and any additional top up insurance it may have at the time.

6. In providing LLPs with the autonomy as described above, however, it is also necessary to provide appropriate checks and balances against irresponsible distributions for consumer protection purposes. Accordingly, the proposed sections 7AI(1) and (2) provide as follows:

> "(1) If a limited liability partnership makes a distribution of any of its partnership property to a partner, or to an assignee of a partner's share in the partnership, as a consequence of which—
>
> (a) the partnership would be unable to pay its partnership obligations as they become due; or
>
> (b) the value of the remaining partnership property would be less than the partnership obligations,
>
> then the partner or assignee is liable as provided in subsection (2).

---

1 Paragraph 21(b) of the Submission.

2 Namely:
"(i) How remote an obligation has to be for it to be excluded as a "partnership obligation"?
(ii) Will all demands and claims, no matter how frivolous and vexatious they are, have to be taken into account as "partnership obligations" as soon as they are issued?
(iii) Once a demand or a claim is made, does the entire amount demanded or claimed have to be counted as partnership obligation even though the amount is out of proportion to anticipated liability?"

3 Namely:
"However, in valuing "partnership obligation" for the purpose of section 7AI, an LLP is required to artificially include claims which may in fact be covered by the Professional Indemnity Scheme and the firm's own top up insurance. This unreasonably distorts the amount of surplus available for distribution to partners."

(2) The partner or assignee who receives the distribution is liable to the partnership for—

(a) the value of the property received by the partner or assignee as a result of the distribution; or

(b) the amount necessary to discharge the partnership obligations at the time of the distribution,

whichever is the lesser."

7. In sum, the proposed section 7AI provides that if the liquidity test under sub-section 7AI(1)(a) or the solvency test under sub-section 7AI(1)(b) is not met after an LLP has distributed its property to a partner or an assignee, the partner or assignee is liable to return an amount equivalent to the whole or part of the value of the property received in accordance with the rules set out in the proposed section 7AI(2).

8. It should further be noted that, as provided in sub-section (5), the proposed section 7AI does not affect a payment made as reasonable compensation for current services provided by a partner to the LLP, to the extent that the payment would be reasonable if paid to a person who is an employee, but not a partner in, the LLP as compensation for similar services.

9. For reasons as explained above, we consider the policy of the Bill regarding distributions to LLP partners pragmatic and less restrictive than many other overseas jurisdictions, and we do not agree with the Law Society's submission that the proposed section 7AI is "unreasonably burdensome"[4] for LLPs.

Contingent Obligation under the Proposed Section 7AI(4)

10. The proposed section 7AI(4) of the Bill provides:

"In this section, a reference to partnership obligation is a reference to partnership obligation[5] (whether actual or contingent)." [emphasis added.]

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4 Para 16 of the Submission.

5 Under the proposed section 7AA of the Bill, "partnership obligation" is defined as "in relation to a partnership, ...any debt, obligation or liability of the partnership, other than debts, obligations or liabilities of the partners as between themselves, or as between themselves and the partnership".

11. In this respect, the Law Society has commented in its Submission that the proposed *"section 7AI is unclear"*[6] by reason that *"[t]he meaning of "contingent" is not defined"* in the Bill, and that *'[p]ractitioners are left to their own judgment in figuring out when an obligation is to be included or excluded in the computation of "partnership obligation" for the purpose of section 7AI.'*[7]

12. The Administration does not share the view of the Law Society and considers that the word "contingent" is commonly found in our legislation and its meaning is sufficiently clear to legal practitioners. For example, in the *Black's Law Dictionary*[8], "contingent liability" is defined as:

> "A liability that will occur only if a specific event happens; a liability that depends on the occurrence of a future and uncertain event. In financial statements, contingent liabilities are usu. stated in footnotes."[9]

13. A test similar to that in the proposed section 7AI is also found in section 123 of the *Insolvency Act 1986 (UK)* which also contains the term "contingent liabilities". Section 123 of the *Insolvency Act 1986 (UK)* is extracted below -

> **"123. Definition of inability to pay debts.**
> — (1) A company is deemed unable to pay its debts—
>
> ..
>
> (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.
>
> (2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities."

14. Furthermore, there are other Ordinances in Hong Kong containing references to similar terms, such as "contingent liabilities" or "contingent liability" without providing specific definitions for them and there does not appear to have caused any difficulties in practice. For

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6 Para 17 of the Submission.

7 Para. 17(b) of the Submission.

8 Ninth Edition, West (Thomson Reuters), 2009.

9 *Ibid*, at 997.

example, in the Third Schedule of the *Insurance Companies Ordinance* (Cap. 41), the term "provision" is defined as follows and the term "contingent liabilities" therein is not defined in Cap. 41:

> " ... any amount written off or retained by way of providing for depreciation, amortization, renewals or diminution in value of assets or retained by way of providing for any known liability, including liabilities in respect of expenditure contracted for and all disputed or contingent liabilities, the amount of which cannot be determined with substantial accuracy". [Emphasis added.]

15. In fact, the term "contingent" is also used in the proposed section 7AK(1)[10] of the Bill without any apparent difficulty.

Implications of the introduction of LLP and the proposed section 7AI on Solicitors' Practice – liability of partners (general partnerships vs. LLPs)

16. Innocent partners of an LLP are not, solely by reason of being a partner, liable for the default of other members of the LLP[11]. This provides significant protection for innocent partners when comparing to present solicitor practices where all partners are jointly and severally liable for all partnership obligations. However, from the perspective of a client, it means that the personal assets of innocent partners of an LLP would be ring-fenced against claims made against the firm and its other members by clients. Thus, it is necessary to balance the needs to protect innocent LLP partners on the one hand and consumers on the other hand, and the exercise is a delicate one. The proposed section 7AI aims to provide the correct balance. It provides autonomy for an LLP to make its own decision whether or not to make a distribution in

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[10] The proposed section 7AK(1) provides, among others, as follow:

"The fact that a partnership becomes, or ceases to be, a limited liability partnership-

....

(b) does not affect any of the rights and liabilities (whether actual or contingent) of the partnership, or of any person as a partner, that have been acquired, accrued or incurred before the partnership becomes, or ceases to be, a limited liability partnership." [Emphasis added.]

[11] The proposed section 7AC(1) provides:

"..., a partner in a limited liability partnership is not, solely by reason of being a partner, jointly or severally liable for any partnership obligation (whether founded on tort, contract or otherwise) that arises from a default of any other partner in the partnership, or of an employee, agent or representative of the partnership, in the course of the business of the partnership as a limited liability partnership."

any given circumstance while preserving the LLP's assets against irresponsible distributions to frustrate client's claim by requiring such distributions be clawed back to the firm's asset pool under certain circumstances[12].

17. The following example, which compares a general partnership with an LLP in meeting partnership liabilities arising from a default, explains how the proposed section 7AI would apply in practice.

Liability of partners in a general partnership solicitors' firm

18. Currently if a claim against the default of a partner in the course of the business of a general partnership solicitors' firm is substantiated, the claim amount will first be settled under the Professional Indemnity Scheme ("PIS"), which currently has a statutory indemnity limit of $10 million in respect of any one claim.[13] The liability of any remaining claim amount not covered by the PIS will be borne by the solicitors' firm and all partners in the partnership.

19. The above indemnity arrangement may be illustrated by using a general partnership solicitors' firm with, say, 5 partners as an example. If the default of one of its partners resulted in an actual liability, e.g., a judgment debt of $20 million against all partners trading as the firm, the first $10 million would be covered by the PIS. If there is money in the account of the firm, say, $5 million, that amount of money would also be used to satisfy the claim. The burden of discharging the remaining judgment debt of $5 million would fall on the 5 partners as they are jointly and severally liable for the judgment debt obtained against the firm.

20. In para 18(d) of its Submission, the Law Society argues that the proposed section 7AI is *"unreasonably burdensome"* because *"[i]n a general partnership, there is no regulation on distribution of partnership property."* Paragraphs 18 and 19 above explain why regulation on distribution of partnership property is not necessary for a general partnership, as all partners of which are personally liable for all debts and

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12 See the proposed section 7AI (1) and (2) of the Bill.

13 See paragraph 2(1) of Schedule 3 of the *Solicitors (Professional Indemnity) Rules* (Cap. 159, sub. leg. M).

obligations of the firm under section 11 of the Partnership Ordinance (Cap. 38).

Liability of partners in an LLP solicitors' firm

21. If the solicitors' firm in the above example is an LLP, the judgment debt of $20 million would be imposed against the LLP and the defaulting partner. The first $10 million of the judgment debt would still be covered by the PIS, followed by $5 million from the account of the LLP. The defaulting LLP partner would be the only person personally liable to discharge the remaining $5 million due to the claimant, and the 4 innocent partners would not be personally liable for the judgment debt.[14]

22. However, if the LLP is unable to pay its partnership obligations as they become due (or the value of the remaining partnership property would be less than the partnership obligations) as a consequence of a distribution to the 4 innocent partners (who are given LLP protection), the distribution made to them shall be liable to be clawed back in the circumstances stated in the proposed section 7AI(1) and (2).

Department of Justice
November 2010

#358425-v8A

[14] See the proposed section 7AC(1) in n11 above.

Annex

Extracts of overseas LLP statutes containing provisions prohibiting distribution of partnership property from an LLP

1. United States – California - *California Corporations Code*

Section 16957(a)

"*No distribution shall be made* by a registered limited liability partnership if, after giving effect to the distribution:

(1) The registered limited liability partnership would not be able to pay its debts as they become due in the usual course of business.

(2) The registered limited liability partnership's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the registered limited liability partnership were to be dissolved at the time of the distribution, to satisfy the preferential rights of other partners upon dissolution that are superior to the rights of the partners receiving the distribution."

[Emphasis added]

Section 16957(c)

"A distribution for purposes of this section means the transfer of money or property by a registered limited liability partnership to its partners without consideration."

2. Canada – British Columbia – *British Columbia Partnership Act*

Section 94

"In this Part: …

"distribution" means a transfer by a partnership of some or all of the partnership property to a partner or to an assignee of a partner's share in the partnership;

…"

Section 112(1)

"A limited liability partnership

(a) *must not make a distribution* in connection with winding up its affairs or after it has ceased to carry on business unless all partnership obligations have been paid or satisfactory provision for their payment has been made, and

(b) in circumstances other than in connection with winding up its affairs, *must not make a distribution* if the limited liability partnership would, after the distribution, be unable to pay its partnership obligations as they come due in the ordinary course of business."
[Emphasis added]

Section 112(2)

"Despite subsection (1) (a), if a partner has expended money for the benefit of a limited liability partnership or has made a loan to the partnership, other than for or in relation to an acquisition by the partner of an interest in the partnership, the partner is entitled to receive a prorated payment with all other creditors of the same class of the limited liability partnership."

Section 112(3)

"Subsection (1) does not prohibit a payment made as reasonable compensation for current services provided by a partner to the limited liability partnership."

Section 113(1)

"A partner in a limited liability partnership who receives a distribution contrary to section 112 (1) is liable to the limited liability partnership for the positive difference between

(a) the lesser of

(i) the value of the partnership property received by the partner, and

(ii) the amount necessary to discharge partnership obligations that existed at the time of the distribution, and

(b) the amount the partner is entitled to receive under section 112 (2) or (3), as the case may be."

Section 113(2)

"Partners in a limited liability partnership who authorize a distribution contrary to section 112 (1) are jointly and severally liable to the limited liability partnership for any amount for which the partner who received the distribution is liable under subsection (1) of this section, to the extent that the amount is not recovered from that partner."

Section 113(3)

"Proceedings to enforce a liability under this section may be brought by the limited liability partnership, any partner in the limited liability partnership or any person to whom the limited liability partnership was obligated at the time of the distribution to which the liability relates."

3. Canada – Manitoba – *Manitoba Partnership Act*

Section 67

"In this Part,
"distribution", in relation to partnership property, means a transfer of money or other partnership property by a partnership to a partner or an assignee of a partner's share in the partnership, whether as a share of profits, return of contributions to capital, repayment of advances or otherwise; ···"

Section 85(1)

"A Manitoba limited liability partnership *must not make a distribution* of partnership property in connection with the winding up of its affairs unless all partnership obligations have been paid or satisfactory provision for their payment has been made." [Emphasis added]

Section 85(2)

"In circumstances other than in connection with the winding up of its affairs, a Manitoba limited liability partnership *must not make a distribution* of partnership property if there are reasonable grounds to believe that after the distribution

(a) the partnership would be unable to pay its partnership obligations as they come due; or

(b) the value of the partnership property would be less than the partnership obligations."[Emphasis added]

Section 85(3)

"Subsection (1) does not prohibit a payment on account of a partnership obligation if a partner receives a prorated payment with all other creditors of the partnership of the same class."

Section 85(4)

"Subsections (1) and (2) do not prohibit a payment made as reasonable compensation for current services provided by a partner to the partnership, to the extent that the payment would be reasonable if paid to an employee who was not a partner as compensation for similar services."

Section 85(5)

"A Manitoba limited liability partnership may base its determination of whether a distribution is prohibited by subsection (2)

(a) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;

(b) on a fair valuation; or

(c) on another method that is reasonable in the circumstances."

Section 86(1)

"A partner in a Manitoba limited liability partnership who receives a distribution in contravention of section 85 is liable to the partnership for the lesser of

(a) the value of the property received by the partner; and

(b) the amount necessary to discharge the partnership obligations that existed at the time of the distribution."

Section 86(2)

"A partner in a Manitoba limited liability partnership who authorizes a distribution in contravention of section 85 is jointly and severally liable to the partnership for any amount for which a recipient is liable under subsection (1), to the extent that the amount is not recovered from the recipient."

Section 86(3)

"Proceedings to enforce a liability under this section may be brought by the Manitoba limited liability partnership, any partner in the partnership or any person to whom the partnership was obligated at the time of the distribution to which the liability relates."

4. Canada –Saskatchewan – *Saskatchewan Partnership Act*

Section 78

"In this Part:

(a) **"distribution"** means, in relation to the partnership property, a transfer of money or other partnership property by a partnership to a partner or an assignee of a partner's share in the partnership, whether as a share of profits, return of contributions to capital, repayment of advances or otherwise; ..."

Section 83(1)

"A limited liability partnership *shall not make a distribution* of partnership property in connection with the winding up of its affairs unless all partnership obligations have been paid or satisfactory provision for their payment has been made." [Emphasis added]

Section 83(2)

"In circumstances other than in connection with the winding up of its affairs, a limited liability partnership *shall not make a distribution* of partnership property if there are reasonable grounds to believe that after the distribution:

(a) the partnership would be unable to pay its partnership obligations as they come due; or
(b) the value of the partnership property would be less than the partnership obligations."[Emphasis added]

Section 83(3)

"Subsection (1) does not prohibit a payment on account of any partnership obligation where a partner receives a prorated payment with all other creditors of the same class of the limited liability partnership."

Section 83(4)

"Subsections (1) and (2) do not prohibit a payment made as reasonable compensation for current services provided by a partner to the limited liability partnership, to the extent that the payment would be reasonable if paid to an employee who was not a partner as compensation for similar services."

Section 83(5)

"A limited liability partnership may base its determination of whether a distribution is prohibited by subsection (2):

(a) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;

(b) on a fair valuation; or

(c) on another method that is reasonable in the circumstances."

Section 84(1)

"A partner in a limited liability partnership who receives a distribution contrary to section 83 is liable to the partnership for the lesser of:

(a) the value of the property received by the partner; and

(b) the amount necessary to discharge partnership obligations that existed at the time of the distribution."

Section 84(2)

"Any partners in a limited liability partnership who authorize a distribution contrary to section 83 are jointly and severally liable to the partnership for any amount for which a recipient is liable pursuant to subsection (1), to the extent that the amount is not recovered from the recipient."

Section 84(3)

"Proceedings to enforce a liability pursuant to this section may be brought by the limited liability partnership, any partner in the partnership or any person to whom the partnership was obligated at the time of the distribution to which the liability relates."

Annexure 16

LC Paper No. CB(2)344/10-11(01)

Response to Law Society's Submission

At the third Bills Committee meeting of 5 October 2010 ("**BC Meeting**"), the Bills Committee requested the Administration to provide a written response to the Law Society's "Submission to the Bills Committee on LLPs" dated 29 September 2010 ("**Submission**"). Accordingly, we are writing to respond to the various issues highlighted in the Submission below.

Constructive knowledge

2. The proposed section 7AC(3) of the Bill provides as follows –

> "Subsection (1) does not protect a partner from liability if the partner –
>
> (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."

3. The Administration has explained in paragraphs 16 to 18 of our Paper, LC Paper No. CB(2)2233/09-10(02), our concerns over the Law Society's proposal to replace the proposed section 7AC(3) of the Bill with the following ("**Revised section 7AC(3)**") –

> "Subsection (1) does not operate to protect a partner from liability
>
> (a) where the partner knew of the default at the time it was committed and failed to take responsible steps to prevent its commission; or
>
> (b) 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."

4. In the Submission, the Law Society stated its view that the Revised section 7AC(3) coupled with the following would be sufficient to address the Administration's concerns –

(a) The following current principles in the Hong Kong Solicitors' Guide to Professional Conduct, Volume 1 ("**Conduct Guide**"):
   i. Commentaries 1 and 2 under Principle 5.17[1] ;
   ii. Commentary 1, Principle 4.10[2] ;
   iii. Principle 5.03[3] ;
   iv. Principle 5.12[4] ;
   v. Commentaries 3 and 5 of Principle 5.12[5] ;
   vi. Commentary 1 of Principle 4.01[6];
   vii. Principle 4.03[7] .

(b) The requirements in the proposed sections 7AE, 7AF, 7AG(1), 7AG(4) and (5), 7AD, and 7AJ of the Bill.[8]

(c) The current statutory professional indemnity scheme which provides indemnity cover up to HK$ 10 million per claim and any top up insurance taken out by an individual firm.[9]

5. A key policy intent of the Bill is to strike a suitable balance between protecting innocent LLP partners on the one hand and consumers of legal services on the other hand. The proposal for the Revised section 7AC(3) will deny consumers the right to pursue against LLP partners who are not "innocent" in the sense that they ought reasonably to have known of a default by other members of his firm but failed to exercise reasonable diligence to prevent its occurrence. As such, the Revised section 7AC(3) should be considered carefully based on the policy intent as outlined above.

6. The principles of the Conduct Guide as mentioned in paragraph 4(a) above (with the exception of the Law Society's latest proposal to make Commentaries 1 and 2 under Principle 5.17 mandatory) [10] and the statutory professional indemnity scheme as mentioned in paragraph 4(c) above are existing requirements for

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1 see paragraphs 4 to 6 of the Submission for details. It should be noted that the Law Society is also proposing to make the requirements in these commentaries mandatory for solicitors operating as LLPs.
2 see paragraph 7 of the Submission.
3 see paragraph 9(a) of the Submission.
4 see paragraph 9(b) of the Submission.
5 see paragraph 9(c) of the Submission.
6 see paragraph 9(d) of the Submission.
7 see paragraph 9(e) of the Submission.
8 see paragraph 10 of the Submission.
9 see paragraph 12 of the Submission.
10 see paragraph 7 below.

solicitors. They are not additional measures targeted for consumer protection in relation to LLPs. The proposed sections of the Bill as mentioned in paragraph 4(b) above are existing provisions in the Bill (principally to ensure that a consumer is aware that the firm he engages is an LLP) in its current form. In other words, all the provisions as mentioned in paragraph 4 are not additional safeguards for consumer protection to justify removing the constructive knowledge element from the proposed section 7AC(3)(a) of the Bill.

7. That said, the Administration welcomes the Law Society's latest proposal to make the obligations in Commentaries 1 and 2 under Principle 5.17 of the Conduct Guide (as referred to in paragraph 4(a)(i) above) mandatory for solicitor firms operating as LLPs. That will help avoid the possibility that no partner can be identified as being responsible for a case. However, as we indicated at the third BC Meeting, we would like to clarify and discuss with the Law Society on a number of issues before we can reach any specific conclusion on its proposal. In particular, we would like to discuss with the Law Society about the possibility of developing its proposal regarding Commentaries 1 and 2 under Principle 5.17 of the Conduct Guide into more concrete measures, such as requiring an LLP to provide a prior written notification confirming the identities of its responsible handling solicitor and supervising partner before it accepts instructions from a client.

8. In this respect, we have met with the Law Society to discuss, among others, about the issues mentioned in paragraph 7 above on 16 November 2010. At the meeting, the Law Society was receptive to the proposal of an LLP providing a written notification to its client confirming the identity of its responsible supervising partner in respect of each matter/case the firm handles. The Administration and the Law Society would require more time to discuss on certain related issues on the proposal, including in particular, the consequences of failing to issue the notice. The Administration will continue to keep the Bills Committee informed of any further progress on this issue.

Distribution of Partnership Property

9. In the Submission, the Law Society expressed the views that "*Section 7AI is "unclear"* [11] by reason that *"[t]he meaning of "contingent" is not defined"* in the Bill, and that *"Practitioners are left to their own judgment in figuring out when an obligation is to be included*

[11] paragraph 17 of the Submission.

or excluded in the computation of "partnership obligation" for the purpose of section 7AI".[12]

10. In connection with the above, we have set out our comments in paragraphs 10 to 15 of our Paper, "Policy intent on distribution of partnership property under the proposed section 7AI".

11. In the Submission, the Law Society also raised the following questions which, according to the Law Society, would hinder practitioners from knowing whether they have safely complied with the proposed section 7AI –

> "(i) How remote an obligation has to be for it to be excluded as a "partnership obligation"?
>
> (ii) Will all demands and claims, no matter how frivolous and vexatious they are, have to be taken into account as "partnership obligations" as soon as they are issued?
>
> (iii) Once a demand or a claim is made, does the entire amount demanded or claimed have to be counted as partnership obligation even though the amount is out of proportion to the anticipated liability?"[13]

12. In connection with the above, we have explained in paragraph 5 of our Paper, "Policy intent on distribution of partnership property under the proposed section 7AI" that the proposed section 7AI does not prohibit a distribution from being made, and that it is entirely the LLP's decision and judgment whether or not it should make a distribution to its partners where it has (i) a remote obligation; (ii) a frivolous and vexatious claim against it; and/or (iii) a claim, the amount that is out of proportion to the anticipated liability. Proposed section 7AI is more lenient than various Canadian precedents in that, under the Canadian precedents, a partner who authorises a distribution of partnership assets while the LLP is insolvent will be liable for the assets distributed if they cannot be recovered from the partner who receives the assets.[14]

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[12] paragraph 17(b) of the Submission.

[13] paragraph 17(c) of the Submission.

[14] Relevant sections in the Partnership Acts of the jurisdictions concerned are as follows -
British Columbia, s.113(2)
Manitoba, s.86(2)
Nova Scotia, s.68(2)
Newfoundland & Labrador, s.53(2)
Saskatchewan, s.84(2)

13. In the Submission, the Law Society also expressed the view that *"Section 7AI is unreasonably burdensome"* [15] based on the following reasons –

(a) *"Section 7AI is unlimited in time"*[16].

(b) *"statutory indemnity limit of HK$ 10 million per claim is already sufficient to settle the claim amount"*[17].

(c) *"This [requirement of Section 7AI] unreasonably distorts the amount of surplus available for distribution to partners"*[18].

(d) *"In a general partnership, there is no regulation on distribution of partnership property"*[19].

14. We would like to respond to the Law Society's comments in paragraph 13 above in the following –

(a) In response to the request made by the Law Society on this issue, the Administration would propose a limitation period of 2 years from the date the claimant discovered the distribution made or could with reasonable diligence have discovered it for the proceedings under the proposed section 7AI(3). The Administration considers this proposal apt to balance the conflicting needs of protecting innocent LLP partners and consumers.

(b) Whether or not the existing statutory professional insurance indemnity of HK$ 10 million per claim is appropriate for LLPs is still being examined by the Bills Committee. Furthermore, as acknowledged at the AJLS meeting of 25 May 2009, professional insurance scheme is a complicated issue which should be considered in a separate context.[20]

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15 paragraph 18 of the Submission.

16 paragraph 18(a) of the Submission.

17 paragraph 18(b) of the Submission.

18 paragraph 18(c) of the Submission

19 paragraph 18(d) of the Submission

20 paragraph 12 (c) of the minutes of meeting of the Panel on Administration of Justice and Legal Services of 25 May 2009. For Members' background information –

(a) In Canada, the Rules of the Law Society of Alberta, in Rule 159.4, and Manitoba Law Society Rules, in Rule 3-48, contain special requirements for LLPs.

(b) Under the (UK) Solicitors' Indemnity Insurance Rules 2009 and the Minimum Terms and Conditions, LLPs (as recognised bodies) are required to obtain cover complying with the

(c) As explained in paragraph 5 of our Paper, "Policy intent on distribution of partnership property under the proposed section 7AI", there is no restriction in the proposed section 7AI of the Bill against distributions by an LLP.

(d) We have pointed out in paragraph 20 of our Paper, "Policy intent on distribution of partnership property under the proposed section 7AI" that since all partners of a general partnership are personally liable for all debts and obligations of the firm under section 11 of the Partnership Ordinance (Cap. 38), there is no need to put in place a regulation on distribution of partnership property for general partnerships.

15. In the Submission, the Law Society expressed the view that *"Section 7AI is redundant because .. in the event that the firm becomes insolvent and the partners are bankrupt, the Bankruptcy Ordinance will apply. It serves the same purpose of restoring assets that should not have been distributed out"*[21]. It also mentioned that *"In a bankruptcy scenario, the relevant period for restoration is 2 years before presentation of bankruptcy petition where unfair preferences were given to associates of debtors and a person is an associate with whom he is in partnership under sections 50, 51 and 51B of the Bankruptcy Ordinance (Cap 6)."*[22]

16. The Bankruptcy Ordinance (Cap. 6) ("**BO**") provides the following –

(a) that in respect of a transaction which is at an undervalue entered into by a debtor[23] (who is later adjudged bankrupt) within 5 years before presentation of the bankruptcy petition against him[24], the court can make an order to restore the position to what it would have been without the transaction[25].

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minimum terms and conditions and with a sum insured of £3 million, rather than £2 million for other Firms.

(c) In Singapore, the insurance cover required for a solicitor in an LLP firm is twice the amount of that practising in general partnership. In addition, the LLP firm needs to take out insurance for itself. (s.4(1)(ba) & (d) of the Legal Profession (Professional Indemnity Insurance) Rules (Singapore))

21 paragraph 19 of the Submission.

22 paragraph 20 of the Submission.

23 section 49(1) of the Bankruptcy Ordinance.

24 section 51(a) of the Bankruptcy Ordinance.

25 section 49(2) of the Bankruptcy Ordinance.

(b) that where a debtor (who is later adjudged bankrupt), has within 2 years before presentation of the bankruptcy petition against him[26] given an unfair preference (which is not a transaction at an undervalue) to a person who is an associate of the debtor[27], the court can make an order to restore the position to what it would have been had the debtor not given the unfair preference[28].

17. Subject to the Law Society's further clarification, the Administration does not agree that the provisions against unfair preferences or transactions at an undervalue in the BO can achieve the objective of the proposed section 7AI for the following reasons –

(a) Under section 50(3) of the BO[29], a bankrupt debtor gives an unfair preference to a person if that person is one of the **debtor's creditors** or a **surety** or **guarantor** for any of his debts or other liabilities. It is clear that a partner having received property from an LLP is not a "person" that would trigger the operation of section 50(3).

(b) Under section 49(3) of the BO[30], a "transaction at an undervalue" involves passing of property by a bankrupt debtor to another person for no or undervalued consideration. Distributing partnership assets and profits to partners does not fall within sub-paragraphs (a), (b) or (c) of section 49(3) and thus is not a "transaction at an undervalue".

18. By reasons as explained in paragraph 17 above, we do not consider the proposed section 7AI redundant. Instead, given the

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26 section 51(1)(b) of the Bankruptcy Ordinance.

27 section 51(1)(b) of the Bankruptcy Ordinance.

28 sections 50(1) and (2) of the Bankruptcy Ordinance.

29 Under section 50(3) of the BO, a debtor gives an unfair preference to a person if (a) that person is one of the debtor's creditors or a surety or guarantor for any of his debts or other liabilities; and (b) the debtor does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the debtor's bankruptcy, will be better than the position he would have been in if that thing had not been done.

30 Section 49(3) of the BO provides:
"For the purposes of this section and sections 51 and 51A, a debtor enters into a transaction with a person at an undervalue if –
(a) he makes a gift to that person or he otherwise enters into a transaction with that person on terms that provide for him to receive no consideration;
(b) he enters into a transaction with that person in consideration of marriage; or
(c) he enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the debtor."

inadequacy of the BO provisions for such purpose, we consider the proposed section 7AI necessary for consumer protection.

Partnership Obligation

19. Paragraph 26 of the Submission suggests the definition of "partnership obligation" can be deleted. The Administration does not agree for the following reasons –

(a) We have explained in the Administration's Response on "partnership obligation" and "debts, obligations and liabilities" (LC Paper No. CB(2)2233/09-10(01)) that the proposed Part IIAAA operates against the background of the Partnership Ordinance (Cap. 38) and that the existing sections 11 to 14 of the Partnership Ordinance use those three terms. If the proposed Part IIAAA only protects an innocent partner from "partnership obligations" without defining that term to mean not just "obligations" but also "debts" and "liabilities", doubts will arise as to whether the protection given to an "innocent" partner cover "debts" and "liabilities".

(b) As noted by the Law Society (paragraph 23 of the Submission), the definition of "partnership obligation" in the Bill serves to distinguish debts, obligations and liabilities that are *external* from those that are *internal*, and makes it clear that a reference to "partnership obligation" does not extend to the internal debts, obligations and liabilities. If the definition were deleted, problems of interpretation may arise. For example, there may be disputes as to whether *internal* debts, obligations and liabilities are relevant in assessing a partnership's solvency under the proposed section 7AI.

20. Paragraph 24 of the Submission states that it looks superfluous to repeat "obligation" within the definition itself. The Administration considers it necessary to repeat "obligation" in the definition. The reasons are as follows –

(a) The definition of "partnership obligation" in our Bill is the same as that in the *Model Limited Liability Partnership Act* adopted and recommended by the Uniform Law Conference

of Canada[31]. Some Canadian jurisdictions have adopted the same definition.[32]

(b) If the defined term were "obligation" alone, the reference to "obligation" may be omitted and the definition may read – "obligation" includes debt and liability.

(c) However, in the Bill, the term defined is "partnership obligation", *not* "obligation" alone. The definition is to make it clear that "partnership obligation" does *not* cover obligations, debts or liabilities that are *internal*. In order to achieve this purpose, the definition says what "partnership obligation" means, instead of saying what "partnership obligation" includes. Given that the word "means" is used, it would be wrong to omit the reference to "obligation" from the definition. The policy intent is that "partnership obligation" means debt, obligation or liability that is external.[33]

21. Paragraph 25 of the Submission proposes an alternative definition as a "solution" to the alleged "problem" –

> "partnership obligation" (合夥義務), in relation to a partnership, means any debt, obligation (whether contractual or otherwise) or liability of the partnership, owed to any third party by the partnership other than ~~debts, obligations or liabilities~~ those arising between the partners ~~of the partners as between~~ themselves, or as between themselves and the partnership;

22. The Administration has the following observations on the alternative definition –

(a) It is not clear how the alternative definition is a "solution" to the alleged "problem". Still, the alternative definition includes "obligation".

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[31] The work of the Uniform Law Conference of Canada is done by delegates appointed by member governments (i.e. the various provincial and territorial governments of Canada). The ULCC considers areas in which provincial and territorial laws would benefit from harmonization and adopts or recommends model laws for the member governments.

[32] For example, section 94 of the *Partnership Act of British Columbia*, Canada and section 102.1 of the *Partnership Act of the Northwest Territories*, Canada.

[33] For a discussion on the function of definitions, see G.C. Thornton, Legislative Drafting (4th Edition), pages 145 - 147.

(b) It is not clear why "(whether contractual or otherwise)" is added. Since the bracketed phrase is added after "obligation", it is not clear whether the bracketed phrase is intended not to apply to "liability".

(c) Introducing the term "third party" seems to be an attempt to shorten the definition, but the meaning of "third party" is not clear –

(i) It seems that the reference to "third party" is intended to convey the idea of *external* debts, obligations and liabilities.

(ii) However, as if the drafter is unsure that "third party" conveys clearly the "external" sense, the drafter retains "other than those arising between the partners themselves or as between themselves and the partnership".

(iii) But if "third party" means a party that is neither "the partners" nor the partnership, the passage beginning with "other than" is superfluous.

(iv) With the passage beginning with "other than" retained, the reader may be puzzled as to what is meant by "third party" and what the alternative definition as a whole means.

Department of Justice
November 2010

#358613 v8A

Annexure 17

LC Paper No. CB(2)888/10-11(01)

Bills Committee on
Legal Practitioners (Amendment) Bill 2010 ("Bill")

The Administration's Policy Position on

(a) the constructive knowledge element of the proposed section 7AC(3)(a), and

(b) the limitation period for clawback actions under the proposed section 7AI

Background

The proposed sections 7AC(3), 7AI(1) and (2) of the Bill provide respectively as follows –

The proposed section 7AC(3)

"Subsection (1) does not protect a partner from liability if the partner –

(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."

The proposed sections 7AI(1) and (2)

"(1) If a limited liability partnership makes a distribution of any of its partnership property to a partner, or to an assignee of a partner's share in the partnership, as a consequence of which—

(a) the partnership would be unable to pay its partnership obligations as they become due; or

(b) the value of the remaining partnership property would be less than the partnership obligations,

then the partner or assignee is liable as provided in subsection (2).

(2) The partner or assignee who receives the distribution is liable to the partnership for—

(a) the value of the property received by the partner or assignee as a result of the distribution; or

(b) the amount necessary to discharge the partnership obligations at the time of the distribution,

whichever is the lesser."

2. At the 4th Bills Committee meeting held on 25 November 2010, the Administration reported that we had met with the Law Society to discuss the following[1]:-

(a) the Law Society's request for removing the words "or ought reasonably to have known of" **("Constructive Knowledge Element")** from the proposed section 7AC(3)(a), and the proposal (**"Proposal"**) to replace the Constructive Knowledge Element with a requirement for an LLP to serve a written notification confirming the identities of its responsible handling solicitor and supervising partner for a matter before the firm accepts instructions in respect of the matter from a client (**"Notification Requirement"**)[2]; and

(b) the Law Society's concern that "Section 7AI is unlimited in time"[3].

3. At the 4th Bills Committee meeting, the Bills Committee requested the Administration to further discuss with the Law Society and submit a paper to the Bills Committee on the Administration's policy position on each of the issues as mentioned in paragraph 2 above before the 5th Bills Committee meeting scheduled on 27 January 2011.

4. Since the 4th Bills Committee meeting, the Administration has held two further meetings with the Law Society to discuss the issues respectively on 14 December 2010 and 13 January 2011. As requested, the following sets out and explains the Administration's current policy position on each issue.

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1 The Administration had two meetings with the Law Society on 16th and 24th of November 2010 respectively.

2 For the background of the discussion of the Proposal with the Law Society, please see paras 7 and 8 of the Administration's previous paper submitted to the Bills Committee in November 2010 (LC Paper No. CB(2)344/10-11(01)).

3 Para 18(a) of the Law Society's "Submission to the Bills Committee on LLPs" dated 29 September 2010 (LC Paper No. CB(2)2328/09-10(01)).

The Constructive Knowledge Element in the proposed section 7AC(3)(a)

Consequence of breach of the Notification Requirement

5. A key issue and focus of our recent discussions with the Law Society about the Proposal is to determine the appropriate sanction against an LLP which fails to comply with the Notification Requirement. On this issue, the Administration's current policy stance is that all partners of an LLP should be barred from relying on the proposed sesction 7AC(1) for protection in the particular case where the LLP had failed to comply with the Notification Requirement ("**Loss of LLP Protection**"). The following sets out the principal reasons for our position:

(a) the Notification Requirement is a simple procedural step to comply with, and it would not be unduly burdensome, in our view, for the management of an LLP to put in place a system to ensure the compliance with the Notification Requirement, e.g. a checklist system; and

(b) a principal objective of the Notification Requirement is to provide certainty to a client by informing him of the name of the responsible LLP partner(s) for his case before there is default on the part of the LLP. This will help eliminate the uncertainty in establishing whether an LLP partner has constructive knowledge of the default after its occurrence. In order to achieve the above objective, it is necessary to provide an effective deterrent to prevent an LLP from breaching the Notification Requirement. In our view, the Loss of LLP Protection sanction would provide a powerful deterrent to prevent LLPs from breaching the Notification Requirement.

6. In addition, taking into account practical considerations for the implementation of the Notification Requirement, we would propose to provide an exception to the Loss of LLP Protection sanction as described in paragraph 5 above. In the event that an LLP can prove that a client has **actual** knowledge of the identity of the responsible partner(s)(a) prior to the occurrence of the default and (b) within 30 days from the firm's acceptance of instructions in respect of his matter, all other partners of the LLP should continue to be allowed to rely on the proposed s 7AC(1) for protection in the particular case concerned even if the Notification

Requirement was not observed by the LLP. This is justified as the aggrieved consumer in that case knows the responsible partner(s) for his matter. As such, it would be inappropriate to hold all other LLP partners liable in such a case.

Proposed requirements in respect of the notice

7. In terms of the form and contents of the notice to clients, the Administration proposes that the notice must:

(a) be in writing;

(b) name the responsible partner(s) for the matter;

(c) be signed by the responsible partner(s) on behalf of the LLP;

(d) be given as soon as practicable, and in any event not later than 30 days after the LLP accepts instructions in respect of the matter; and

(e) contain an undertaking by the LLP to inform the client of any subsequent changes of the responsible partner(s).

Time Limit for Clawback Actions under the proposed section 7AI

8. We mentioned in paragraph 14(a) of our paper entitled "Response to Law Society's Submission" issued in November 2010, LC Paper No CB(2)344/10-11(01) that the Administration would propose a limitation period of two years from the date the claimant discovered the distribution made or could with reasonable diligence have discovered it for the proceedings under the proposed section 7AI(3) in response to the Law Society's concern that *"Section 7AI is unlimited in time"*.

9. The Law Society did not agree with the above proposal on the basis that the effective limitation period for clawback actions would be uncertain. The limitation period would not end until two years from the date the claimant finds out or could reasonably have found out that the distribution was in contravention of the liquidity test and/or solvency test in the proposed section 7AI(1).

10. Having taken into account the Law Society's views, the Administration would propose that the limitation period shall be six years from the date of distribution. The following are our reasons:

(a) section 4(1) of the Limitation Ordinance (Cap. 347) provides, inter alia, that "actions to recover any sum recoverable by virtue of any Ordinance...., other than a penalty or forfeiture or sum by way of penalty or forfeiture" shall not be brought after the expiration of six years from the date on which the cause of action accrued. We intend to set out this rule in the Bill; and

(b) a six years' limitation period from distribution would provide a longer period than the two years' limitation period proposed by the Law Society and therefore better protection to the consumers. We object to the Law Society's proposal of two years' limitation period for two reasons: (a) clients are not privy to information about distribution of profits and assets by an LLP to its partners; and (b) it usually takes more than two years for a client to obtain a first instance judgment on his claim for negligence against a law firm before he is in a position to enforce the judgment debt.

11. In sum, we consider that, as compared with the proposal by the Law Society, a six years' limitation period from distribution would strike a better balance between protecting consumer interest and the interest of LLP partners regarding clawback actions under the proposed section 7AI.

Department of Justice
January 2011

#360404 v6A

Previous Provision | Next Provision | 中文
Back to List of Enactments

Annexure 18

Contents of Section

Chapter:	347	Title:	LIMITATION ORDINANCE	Gazette Number:	
Section:	4	Heading:	**Limitation of actions of contract and tort, and certain other actions**	Version Date:	30/06/1997

Actions of contract and tort and certain other actions

(1) The following actions shall not be brought after the expiration of 6 years from the date on which the cause of action accrued, that is to say-

(a) actions founded on simple contract or on tort;
(b) actions to enforce a recognizance;
(c) actions to enforce an award, where the submission is not by an instrument under seal;
(d) actions to recover any sum recoverable by virtue of any Ordinance or imperial enactment, other than a penalty or forfeiture or sum by way of penalty or forfeiture:

Provided that-

(i) (Repealed 31 of 1991 s. 4)
(ii) nothing in this subsection shall be taken to refer to any action to which section 6 applies.

(2) An action for an account shall not be brought in respect of any matter which arose more than 6 years before the commencement of the action.
(3) An action upon a specialty shall not be brought after the expiration of 12 years from the date on which the cause of action accrued:
Provided that this subsection shall not affect any action for which a shorter period of limitation is prescribed by any other provision of this Ordinance.
(4) An action shall not be brought upon any judgment after the expiration of 12 years from the date on which the judgment became enforceable, and no arrears of interest in respect of any judgment debt shall be recovered after the expiration of 6 years from the date on which the interest became due.
(5) An action to recover any penalty or forfeiture, or sum by way of penalty or forfeiture, recoverable by virtue of any Ordinance or imperial enactment shall not be brought after the expiration of 2 years from the date on which the cause of action accrued:
Provided that for the purposes of this subsection the expression "penalty" (罰金) shall not include a fine to which any person is liable on conviction of a criminal offence.
(6) Subsection (1) shall apply to an action to recover seamen's wages, but save as aforesaid this section shall not apply to any cause of action within the Admiralty jurisdiction of the High Court which is enforceable in rem.
(7) This section shall not apply to any claim for specific performance of a contract or for an injunction or for other equitable relief, except in so far as any provision thereof may be applied by the court by analogy in like manner as the corresponding enactment contained in the Limitation Act 1980 (1980 c. 58 U.K.) is applied in the English Courts. (Amended 31 of 1991 s. 4)
(8) (Repealed 31 of 1991 s. 4)

[cf. 1939 c. 21 s. 2 U.K.; 1954 c. 36 s. 2(1) U.K.]

Annexure 19

Individual Section Mode

Contents of Section

Chapter:	6	Title:	BANKRUPTCY ORDINANCE	Gazette Number:	L.N. 158 of 1998
Section:	**50**	Heading:	**Unfair preferences**	Version Date:	01/04/1998

(1) Subject to this section and sections 51 and 51A, where a debtor is adjudged bankrupt and he has at a relevant time (defined in section 51) given an unfair preference to any person, the trustee may apply to the court for an order under this section.
(2) The court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if that debtor had not given that unfair preference.
(3) For the purposes of this section and sections 51 and 51A, a debtor gives an unfair preference to a person if-

(a) that person is one of the debtor's creditors or a surety or guarantor for any of his debts or other liabilities; and
(b) the debtor does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the debtor's bankruptcy, will be better than the position he would have been in if that thing had not been done.

(4) The court shall not make an order under this section in respect of an unfair preference given to any person unless the debtor who gave the unfair preference was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (3)(b).
(5) A debtor who has given an unfair preference to a person who, at the time the unfair preference was given, was an associate of his (otherwise than by reason only of being his employee) is presumed, unless the contrary is shown, to have been influenced in deciding to give it by such a desire as is mentioned in subsection (4).
(6) The fact that something has been done in pursuance of the order of a court does not, without more, prevent the doing or suffering of that thing from constituting the giving of an unfair preference.

(Replaced 76 of 1996 s. 36)

Previous Provision | Next Provision | 中文 | Past Versions
Back to List of Enactments

Contents of Section

Chapter:	6	Title:	BANKRUPTCY ORDINANCE	Gazette Number:	L.N. 158 of 1998
Section:	**51**	Heading:	**"Relevant time" under sections 49 and 50**	Version Date:	01/04/1998

(1) Subject to subsections (2) and (3), the time at which a debtor enters into a transaction at an undervalue or gives an unfair preference is a relevant time if the transaction is entered into or the unfair preference given-

(a) in the case of a transaction at an undervalue, at a time in the period of 5 years ending with the day of the presentation of the bankruptcy petition on which the debtor is adjudged bankrupt;
(b) in the case of an unfair preference which is not a transaction at an undervalue and is given to a person who is an associate of the debtor (otherwise than by reason only of being his employee), at a time in the period of 2 years ending with that day; and
(c) in any other case of an unfair preference which is not a transaction at an undervalue, at a time in the period of 6 months ending with that day.

(2) Where a debtor enters into a transaction at an undervalue or gives an unfair preference at a time mentioned in subsection (1)(a), (b) or (c) (not being, in the case of a transaction at an undervalue, a time less than 2 years before the end of the period mentioned in subsection (1)(a)), that time is not a relevant time for the purposes of sections 49 and 50 unless the debtor-

(a) is insolvent at that time; or
(b) becomes insolvent in consequence of the transaction or preference,

but the requirements of this subsection are presumed to be satisfied, unless the contrary is shown, in relation to any transaction at an undervalue which is entered into by a debtor with a person who is an associate of his (otherwise than by reason only of being his employee).
(3) For the purposes of subsection (2), a debtor is insolvent if-

(a) he is unable to pay his debts as they fall due; or
(b) the value of his assets is less than the amount of his liabilities, taking into account his contingent and prospective liabilities.

(Replaced 76 of 1996 s. 36)

Previous Provision | Next Provision | 中文 | Past Versions
Back to List of Enactments

Previous Provision | Next Provision | 中文 | Past Versions
Back to List of Enactments

Contents of Section

Chapter:	6	Title:	BANKRUPTCY ORDINANCE	Gazette Number:	L.N. 158 of 1998
Section:	**51B**	Heading:	**Meaning of "associate"**	Version Date:	01/04/1998

Expanded Cross Reference:

49, 49A, 50, 51, 51A

(1) For the purposes of sections 49 to 51A, any question whether a person is an associate of another person shall be determined in accordance with this section. <* Note - Exp. X-Ref.: Sections 49, 49A, 50, 51, 51A *>
(2) A person is an associate of a debtor if that person is the debtor's spouse, or is a relative, or the spouse of a relative of the debtor or his spouse.
(3) A person is an associate of a debtor with whom he is in partnership, and of the spouse or a relative of any debtor with whom he is in partnership.
(4) A person is an associate of a debtor whom he employs or by whom he is employed and for this purpose, any director or other officer of a company shall be treated as employed by that company.
(5) A person in his capacity as trustee of a trust is an associate of a debtor if the beneficiaries of the trust include, or the terms of the trust confer a power that may be exercised for the benefit of, that debtor or an associate of that debtor.
(6) A company is an associate of a debtor if that debtor has control of it or if that debtor and persons who are his associates together have control of it.
(7) For the purposes of this section, a person is a relative of a debtor if he is that debtor's brother, sister, uncle, aunt, nephew, niece, lineal ancestor or lineal descendant, treating-

> (a) any relationship of the half blood as a relationship of the whole blood and the step child or adopted child of any person as his child; and
> (b) an illegitimate child as the legitimate child of his mother and reputed father,

and references in this section to a spouse shall include a former spouse.
(8) For the purposes of this section, a debtor shall be taken to have control of a company if-

> (a) the directors of the company or of another company which has control of it (or any of them) are accustomed to act in accordance with his directions or instructions, but a debtor shall not be considered to have control of a company by reason only that the directors act on advice given by him in a professional capacity; or
> (b) he is entitled to exercise, or control the exercise of, 1/3 or more of the voting power at any general meeting of the company or of another company which has control of it,

and where 2 or more persons together satisfy either of the above conditions, they shall be taken to have control of the company.
(9) In this section, "company" (公司) includes any body corporate (whether incorporated in Hong Kong or elsewhere); and references to directors and other officers of a company and to voting power at any general meeting of a company shall have effect with any necessary modifications.

(Added 76 of 1996 s. 36)

Annexure 20

Submission on the Legal Practitioners (Amendment) Bill 2010 and the Committee Stage Amendments to the Bill

The Law Society is not in a position to support the Legal Practitioners (Amendment) Bill 2010 ("Bill") as amended by the currently drafted Committee Stage Amendments.

Objectives

1. The Law Society's aim in proposing the introduction of limited liability partnerships ("LLPs") for solicitors is to make available to its members an additional choice of a mode of practice that:

   (a) allows Hong Kong to catch up with the global trend as most jurisdictions including international financial centres like New York, London and Singapore have all adopted LLPs;

   (b) addresses the unfairness to law firm partners who have to shoulder personal liability even in cases where they are not at fault;

   (c) combines the features of limited liability to be offered by solicitor corporations and the culture of operating in a partnership that has traditionally been treasured by the profession;

   (d) offers an attractive form of business organisation to those solicitors who wish to expand their operation by forming a larger partnership with partners who possess expertise in different practice areas thereby:

      (i) facilitating a diversification of the scope of practice areas and legal services on offer in the same firm to meet the different needs of a client;

      (ii) cultivating the concept of a one-stop shop making available a wide range of services for consumers' convenience;

      (iii) expanding the scale of operation leading to an economy of scale that benefits both the law firms and the consumers; and

   (e) is simple and straightforward to implement.

2. LLPs are not intended to create new "privileges" to solicitors. Being a common mode of operation around the world, the introduction of LLPs is intended as a minor innovation to ensure that Hong Kong, being an international financial centre, is keeping itself abreast with the global modernisation of the law and the legal infrastructure.

Pace

3. The Law Society completed the LLP proposal in 2004. The issue was brought to the attention of the Panel on Administration of Justice and Legal Services of the Legislative Council in June 2004.

4. Meetings were held among stakeholders and research studies were carried out. In June 2005, the Law Society was given assurances by the then Solicitor General that the Administration had given priority to the preparation of a paper for the Policy Group to consider the LLP proposal. Suddenly, in March 2006, the Administration informed the Law Society that no further work would be carried out in respect of LLPs for the remaining term of the Chief Executive (until the end of June 2007).

5. The Law Society raised the LLP issue at its meeting with the Secretary for Justice in April 2007. The Administration resumed discussion with the Law Society in August 2008.

6. Since 2008, there were numerous exchanges between the Law Society with the Administration.

7. Finally, the Administration gazetted the Legal Practitioners (Amendment) Bill 2010 in June 2010.

8. Seven years have elapsed since the Law Society submitted its proposal in 2004. Nearly a decade of precious time has been lost for the legal profession in Hong Kong to catch up with the global development and the process is still not completed.

Major Modifications

Initial proposal - 2004

9. The salient features of the Law Society's initial LLP proposal were as follows:

   (a) It operates in the form of a partnership.

   (b) It is a full shield model, that is, all partners of an LLP are protected from all personal liability subject to the proviso that a partner is responsible for his own negligence.

   (c) A partner is not required to indemnify the firm or other partners in respect of debts or obligations of the LLP for which a partner is not liable under the full shield model.

   (d) The name of an LLP must include "LLP" or "Limited Liability Partnership".

(e) This new form of practice should apply to everyone by way of a new Limited Liability Partnership Ordinance, a draft of which was prepared by the Law Society.

No stand alone Ordinance

10. In November 2008, the then Solicitor General proposed to implement the proposal by amending the Legal Practitioners Ordinance as it was the Administration's proposal to restrict the application to solicitors' firms only.

11. To avoid further delay, the Law Society agreed and urged the Administration to proceed with the drafting work quickly.

No full shield

12. A major modification by the Administration of the Law Society's initial proposal is to change it from a full shield model to a partial shield model, that is, partners are only protected from personal liability in relation to liabilities arising from negligent or wrongful acts or omissions only. This effectively means that the partners of an LLP will still be jointly and severally liable for the operational cost of the business of a law firm.

13. For ease of reference, the following major jurisdictions do offer a full shield model:

(a) New York, US;

(b) Ontario and British Columbia, Canada;

(c) UK (corporate model);

(d) Singapore (corporate model) ;

(e) India (corporate model).

14. Limited liability of solicitor partners on the operational cost of the business of a law firm has never been a cause of concern as law firms may carry out the necessary administrative functions in connection with the running of the practice through service companies.

15. The introduction of LLPs is a convenient opportunity to simplify the artificial structure of routing the engagement of administrative services through service companies. No useful purpose is served by requiring LLPs to artificially complicate their structure at additional cost to form service companies to achieve the same result.

16. It complicates the operation of law firms by forcing them to incur extra cost and administrative work, and yet the extra burden imposed on law firms does not result in any added protection to consumers. The Law Society finds the absurdity of insisting on such a lose-lose outcome incomprehensible.

17. The Law Society has spent considerable time in explaining its viewpoints to the Administration. It has also made previous submissions to the Panel on Administration of Justice and Legal Services on this issue. However, as currently drafted, the Bill only affords LLP protection to liabilities arising from negligent or wrongful acts or omission.

Allocation of liability to innocent partners

18. One of the objectives of the introduction of LLPs is to address the unfairness to law firm partners who have to shoulder personal liability even in cases where they are not at fault.

19. The issue of supervision was discussed back in 2008. The Administration was concerned that partners would avoid supervision in order to escape personal liability. It then proposed a default rule whereby all partners were required to share liability equally if no partner was found to be negligent.

20. The Law Society took the view that the proposed default rule distorted the basic objective of the law of tort which was to identify the responsible party and allocate responsibility accordingly. It created a perverse disincentive against seeking to identify the partner who was properly responsible.

21. In response, the Law Society objected to the proposed default rule and made its position clear - whether a partner is negligent in a case is a matter for the court to decide based on the particular facts of the case and any default rule attempting to allocate responsibility automatically in the absence of any proof of negligence is not acceptable.

22. The Administration subsequently proposed to include a constructive knowledge provision whereby a partner would lose LLP protection if he ought reasonably to have known of the default at the time of its occurrence and failed to exercise reasonable diligence to prevent its occurrence.

23. Such a proposal sparked off another lengthy discussion between the Law Society and the Administration.

24. The Law Society has explained at length that there was absolutely no cause for concern that partners in an LLP would abandon proper supervision. Even if there was such a concern, which the Law Society submitted was an unnecessary concern, expressly legislating on the attachment of liability to constructive knowledge would not resolve the issue.

25. It would simply invite claimants to adopt a catch-all approach by easily relying on such an express provision to include all partners as defendants on the basis that being partners in the same firm, they all ought to have known of the default. This defeated the purpose of the introduction of limited liability partnerships. Innocent partners would unreasonably and unnecessarily be dragged into negligence claims.

26. To address the Administration's concern that partners might deliberately avoid personal liability by not getting involved in the supervision at all, the Law Society proposed that LLPs be required in the Conduct Guide to inform their clients of the name and status of the person responsible for the conduct of the matter on a day-to-day basis; the partner responsible for the overall supervision of the matter and any subsequent changes.

27. The Administration insisted on imposing the notice requirement in the legislation providing for the loss of LLP protection for the firm in respect of that matter should the LLP fail to issue the written notice, unless the client knew who the responsible partner was prior to the default and within 30 days from the firm's acceptance of instructions in respect of that matter.

28. The Law Society objected to the suggested sanction. Providing for the stripping of a firm's LLP status (albeit only in respect of a particular matter) on the basis of a failure to comply with a mere formality of issuing a written notice renders the LLP status a sham.

29. In late May 2011, to the surprise of the Law Society, the Administration introduced by way of committee stage amendments, one further drastic distortion of the LLP model.

30. A new section was included to provide that the limitation on liability does not apply to the partner designated in the notice. This means that the supervising partner will automatically lose the entitlement to LLP protection even though he may be innocent and in the absence of any proof of negligence on his part. If so, it would have the unintended consequence of creating a general partnership between the designated partner and the negligent partner within the LLP. This is conceptually problematic.

31. This is akin to a regime imposing a "scapegoat" partner for each client matter with unlimited legal liability. This harsh approach is unprecedented as it is tantamount to imposing strict liability on the designated partner concerned.

Clawback of a distribution of partnership property

32. The Law Society understands the concern that consumers will be exposed to the risk of not being sufficiently compensated in a claim as a result of the exclusion of the personal assets of the innocent partners in an LLP.

33. However, this concern is greatly exaggerated. As stated in a previous submission, from 1994/95 indemnity year to July 2009, only 1.6% of the claims on the Fund have sought HK$10 million or more and out of these claims, only one claim was brought by an individual who was paid HK$10 million (including defence cost but less the indemnified's deductible).

34. Rarely does a claimant have to resort to the personal assets of the culpable partner, let alone the partnership assets because the statutory indemnity limit of HK$10 million is already sufficient to settle the claim amount of an individual claimant.

35. On the basis of the claims history, the operation in the form of an LLP or a general partnership does not make much real practical difference with respect to the sufficiency of indemnity protection to consumers.

36. Looking at LLP provisions around the world, claw back provisions are uncommon.

37. Most other major jurisdictions like UK, Singapore or New York simply rely on the general insolvency or fraudulent transfers provisions that apply to all business organisations including LLPs.

38. The Law Society has submitted before and it reiterates its position that on the premise that consumers will not be disadvantaged, Hong Kong should be in line with most other jurisdictions in designing its LLP legislation so that it can truly achieve the objective of enhancing Hong Kong's competitiveness through a modernisation of its legal infrastructure that is comparable to other jurisdictions. Consumers will not be disadvantaged without clawback because:

    (a) the mandatory Professional Indemnity Scheme has proven to be sufficient protection based on past claims experience;

    (b) the Bankruptcy Ordinance will apply to claw back assets that should not have been transferred out in the event that the firm becomes insolvent and the partners are bankrupt;

    (c) the general remedy of Mareva injunction will apply should there be any risk of dissipation of the firm's assets.

39. The committee stage amendments proposing to include a 6-year limit for a claimant to enforce a liability for a claw back and a defence to a partner who received a distribution based on a "reasonable assessment" that the distribution would not result in the distribution being "wrongful" did not address the Law Society's concern over uncertainty and unpredictability at all.

40. The Law Society's suggestion of adopting more specific objective criteria as in some Canadian provisions were not adopted. As currently drafted, neither practitioners nor the public will be able to know for certain what will be accepted as having satisfied the "reasonable assessment" test. The question of uncertainty and unpredictability still remains unresolved. As such, the "reasonable assessment" test is unworkable in the absence of defined criteria and would unnecessarily complicate even the routine distributions in the form of partnership drawings.

Sufficient safeguards

41. The Law Society is fully conscious of the importance of consumer protection. It takes the view that the existing safeguards in the proposed LLP framework are already sufficient:

(a) The name of an LLP must include the words "Limited Liability Partnerships" or abbreviation "LLP" or "L.L.P." so that the public know that the firm operates with limited liability;

(b) The name must be displayed visibly and legibly at or outside its offices and on its office documents;

(c) An LLP must notify its existing clients in writing within 30 days of the fact that it has become an LLP;

(d) The written notice to its existing clients by an LLP, the form of which is to be specified by the Law Society, must include a statement stating how liabilities of partners of a law firm are affected by the law firm becoming an LLP;

(e) An LLP must give 7-day advance notice of its particulars to the Law Society;

(f) The Law Society must keep a list of LLPs for public inspection free of charge.

42. On top of the above requirements, consumers are effectively protected with a statutory professional indemnity scheme which provides indemnity cover of a limit of HK$10 million per claim as well as any top up indemnity insurance taken up by individual law firms.

43. In a negligence claim, a claimant will normally first sue against the firm and at this level, the claimant is already covered by the statutory professional indemnity limit of $10 million plus top up insurance cover, if any.

44. The Law Society is of the strong view that all these safeguards have balanced the need to give adequate protection to consumers and to allow the modernisation of the legal infrastructure which has been moving at a snail pace to proceed at the speed it deserves to catch up with the global trend.

45. The LLP status of a firm and the effect on the liabilities of partners are made fully transparent to consumers to ensure that they can make an informed choice as to whether to engage the services of an LLP.

Final product unacceptable

46. However, the series of imposed modifications to the LLP model has distorted the Law Society's initial LLP proposal to a point where the LLP structure no longer achieves the objectives for which it was initially introduced. This alternative mode of practice no longer serves as an additional choice because it has become wholly unattractive to the legal profession.

47. Unless the Committee Stage Amendments are revised as set out in paragraph 48, the Law Society will not render its support for the Bill and it will advise its members of its position accordingly.

48. The Law Society takes the view that with respect to the Committee Stage Amendments, the following should be revised:

(a) Take out all proposed amendments in relation to the regulation of liability of the "designated partner".

This will translate into the deletion of new section 7AC (2A) and new section 7AGA(1) in their entirety and of the proposed amendment to sections 7AC(2) and 7AL(2).

(b) Take out all proposed amendments in relation to the notice requirement of the "designated partner" which is tied in with the regulation of liability of such a partner.

This will translate into the deletion of new section 7AGA(2) to (10). As a consequential amendment to the deletion, the reference to section 7AGA in section 7AH should also be deleted.

(c) Redraft a simple provision requiring an LLP to notify clients of the name of the supervising partner for every matter and any subsequent change.

(d) Delete the proposed amendment to section 7AC(2B) as it is a restatement of the law and wholly unnecessary.

(e) Delete section 7AI in its entirety unless the following amendments are made:

(i) Delete "will be" in section 7AI(1)(a) because the assessment of the ability of the partnership to repay its partnership obligations as they become due should be current and hence only present tense "is" should be used.

(ii) Amend section 7AI(1A) by deleting the last four words in the preamble "the person proves that" and by amending subsection (a) as follows:

"immediately before making the distribution, the limited liability partnership made an assessment that the financial position of the partnership would not be as described in subsection (1) immediately after the distribution on the basis of:

(a) financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;

(b) a fair valuation; or

(c) *any other method that is reasonable in the circumstances."*

(iii) Delete section 7AI(1A)(b) and (c) as they will not be necessary if section 7AI(1A)(a) is amended as above.

(iv) Change "6 years" to "2 years" in section 7AI(6).

The Law Society of Hong Kong
29 June 2011

Annexure 21

Members' Forum of the Law Society on Limited Liability Partnerships

Proposal on the requirements of "supervising partner(s)" for limited liability partnerships ("LLPs")

Introduction

This note sets out the key elements of the latest proposal of the Department of Justice on the requirements relating to "supervising partner(s)" for incorporation into the Legal Practitioners (Amendment) Bill 2010 ("Bill"). It is subject to the provisions of the final LLP legislation.

The Latest Proposal

All the previous proposals regarding designated partners (in the form of draft Committee Stage Amendments) will be replaced by the following requirements to be inserted in the Bill:-

(a) Each client matter of an LLP must be supervised by a partner.

(b) An LLP shall keep the client informed of the identity of at least one partner who is responsible for the overall supervision of a client matter ("the **Supervising Partner**").

(c) Failure of an LLP to keep the client so informed under (b) will result in loss of LLP protection for all partners in respect of that particular client matter.

(d) The Supervising Partner shall, within 30 days of a request of the client, provide the client with a list of partners who, to the best knowledge of the Supervising Partner, are or were (as appropriate) responsible for the supervision of the whole or a particular part of the client's matter.

Department of Justice
10 February 2012

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