Square pegs and round holes: why company insolvency law is a bad fit for partnerships and LLPs

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1 Introduction

General and limited partnership insolvency is governed not by the Partnership Act 1890 or the Limited Partnerships Act 1907, which regulate other matters of general and limited partnership law, but by the Insolvent Partnerships Order 1994 (IPO).[1] The IPO applies to partnerships almost the full range of company and individual insolvency procedures set out in the Insolvency Act 1986 (IA 1986) - partnership voluntary arrangements (PVAs), administration, compulsory (but not voluntary) winding up and, for general partnerships, joint bankruptcy of all partners. It also provides options for partnership winding up to be accompanied by the winding up of corporate partners and/or the bankruptcy of individual partners. Unfortunately, the IPO is acknowledged by the courts[2] and leading commentators on partnership law[3] to be an exceptionally and unnecessarily complicated piece of legislation which is, as a result, barely usable.

LLP insolvency is governed by the Limited Liability Partnerships Regulations 2001[4] (LLP Regulations), which supplement the Limited Liability Partnerships Act 2000 and apply the full range of company procedures from IA 1986 - LLP voluntary arrangements (LLPVAs), administration, and both voluntary and compulsory winding up. They also introduced a new provision into IA 1986. Section s214A enables the court to 'clawback' a contribution to the LLP's assets from an LLP member in certain circumstances and has recently been examined by the court in *Milne (Liquidator of Premier Housewares) Scotland) LLP) v Rashid*[5] (discussed below). Like the IPO, albeit to a lesser extent, the insolvency provisions of the LLP Regulations are unnecessarily complex and inaccessible.

This article will examine the reasons for the unsatisfactory state of partnership and LLP insolvency laws, the nature and extent of the problem, and a range of possible solutions.

2 Why are partnership and LLP insolvency laws in a mess?

The extensive problems with the laws governing insolvent partnerships and LLPs result from their being based on IA 1986 which is designed for companies and individuals. Partnerships and LLPs differ significantly from companies or individuals, and therefore require different legislative solutions to those provided by IA 1986. Partners and LLP members own and manage the business,[6] so their roles and decisionmaking differ in law from company directors or members. Further, partnerships – unlike companies or individuals (or indeed LLPs) - have no separate legal personality to their partners, and partners are personally liable

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[1] SI 1994/2421.

[2] *Official Receiver v Hollens* [2007] EWHC 753 (Ch) [2007] Bus LR 1402 [29].

[3] Roderick I'Anson Banks, *Lindley & Banks on Partnership* (20th edn, Sweet and Maxwell, 2017) para 27-01, Mark Blackett-Ord and Sarah Haren, *Partnership Law* (5th edn, Bloomsbury 2015) para 22.2, David Milman, *Personal Insolvency Law, Regulation and Policy* (Ashgate 2005) 11, Geoffrey Morse, *Partnership and LLP Law* (8th edn, OUP 2015) para 8.02 and Elspeth Berry and Rebecca Parry, *The Law of Insolvent Partnerships and Limited Liability Partnerships* (2015 Wildy, Simmonds & Hill) para at para 1.

[4] SI 2001/1090.

[5] [2018] CSOH 23.

[6] Partnership Act, s 1(1) and the Limited Liability Partnerships Act 2000, s 2(1).

for the debts of the business.[7] It is therefore unsurprising that the application of substantive company and individual insolvency legislation to them produces significant problems, examples of which are discussed below.

These differences also mean that the theories developed to underpin company insolvency law do not work when transposed to partnership or even LLP insolvency law. For example, theories which stress that the role of insolvency law is to protect creditors[8] fail to take account of partners' personal liability for partnership debts, while theories which reflect the existence of other stakeholders in the business such as employees and clients[9] fail to recognise that partners and LLP members themselves are the most significant stakeholders. Partnership and LLP insolvency law would more appropriately be underpinned by a multiple values approach such as the Cork Report's statement of aims,[10] which would allow the differences between them and companies or individuals to be fully reflected. For example, those aims include the protection of the insolvent, creditors and other stakeholders; prevention of conflicts between creditors; efficient realisation and fair distribution of the assets; the protection of viable businesses; and - as the DTI[11] and the Company Law Review Steering Group[12] (CLRSG) also acknowledged in the wider corporate context - commanding universal respect and achieving a system that is simple and efficient. However, as will be discussed, the current legislation fails to fulfil these aims.

Given all of this, it must be questioned why partnerships and LLPs should be subject to the IA 1986 regime. Partnership law has its own solutions to the problems which IA 1986 solves for companies, and these aspects of the IPO are not merely redundant but often harmful because of their ambiguities, omissions and overall complexity. While LLP law provides few alternatives to the IA 1986 regime, and therefore the insolvency provisions of the LLP Regulations cannot be entirely redundant, they are often harmful for similar reasons to the IPO.

3 The nature and extent of the problem

In order to demonstrate the problem, a number of key areas will be considered: the structure of the legislation itself, the way in which it transposes company law concepts, its provisions on decisionmaking, and the effectiveness of the rescue provisions and those facilitating the break up of a business.

a) The structure of the legislation

Although the IPO includes in full the text of modified IA 1986 provisions, it does not include the text of unmodified provisions. The reader must therefore repeatedly cross refer to IA 1986, a process made more difficult by the fact that the IPO fails to make it clear exactly which IA 1986 provisions apply.[13] This was an issue in *Re Newton's Coaches*,[14] in which the court had to determine whether s216 IA 1986 applied to partnerships (and concluded that it did not). The LLP Regulations are even worse, because they do not set out the modified sections in full, but only list words or phrases inserted or deleted. Further, the separation of secondary partnership and LLP insolvency legislation from the primary IA 1986

[7] Partnership Act, s9
[8] Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17(2) OJLS 227, 230-234 and Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (4th edn, Jordans, 2017) 25-26.
[9] Finch n8, 236-238 and Keay and Walton n8, 27-30.
[10] Insolvency Law and Practice: Report of the Review Committee (Cmnd 8588, 1992).
[11] DTI, 'Modern Company Law for a Competitive Economy: Consultation Paper' (March 1998.
[12] The Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy' at xi and paras 1.15-1.22.
[13] *Official Receiver v Hollens* n2 para 29.
[14] [2008] EWHC 835, [2017] BCC 34; see further Elspeth Berry, 'Interpreting the Insolvency Act 1986 in the partnership context: *Paul Newton and Brian Newton v Upon Notice to: The Secretary of State for Business, Energy and Industrial Strategy* (Case Comment) (2017) 30(3) Insolv Intell 42.

means it is rarely made clear how, or even if, amendments to IA 1986 apply to partnerships and LLPs. The result is that partnership and LLP insolvency laws are unnecessarily complicated and inaccessible.[15] It is unclear why the legislature chose to apply IA 1986 by statutory instrument and why, having taken this approach, it chose to make the secondary legislation substantially (and incomprehensibly) cross-referential rather than providing a fully standalone option.

b) Transposition of company concepts

The differences between partnerships or LLPs, and companies, are unfortunately not reflected in a careful adaptation of company law concepts to them, and it is therefore often unclear how particular concepts apply. For example, it is impossible to know exactly who in a partnership will be subject to the equivalent duties and liabilities to a director since the IPO does not define the term 'director' in the partnership context. It provides that expressions appropriate to companies are to be construed as references to the corresponding persons appropriate to a partnership,[16] and so 'directors' must therefore include partners. However, although the IPO defines a member of a partnership as both a partner[17] and a person held out as such[18] (together referred to in this article as 'partners' in order to avoid confusion with LLP members),[19] and it is unclear whether the term 'director' also includes the latter since, by definition, they are not actually partners and are thus unlikely to have a management role analogous to directors.

Equivalent problems result from the failure of the LLP Regulations to define 'members' of an LLP;[20] from the IPO's wide definition of an 'officer' of a partnership[21] which seemingly extends IA 1986 beyond partners despite the definition of an officer of an LLP as (only) including an LLP member;[22] and from the treatment of partnerships as 'unregistered companies' for some purposes but not for others.[23] The term 'contributory' is also problematic for both partnerships and LLPs: it is redundant in the partnership context but the IPO does not make this clear, and the definition in the LLP Regulations is misleading because it would in fact be unusual for an LLP member to satisfy the definition by entering into an agreement to contribute to the LLP's assets on winding-up, or for a former member to satisfy it by the obligations arising from such an agreement surviving his departure from the LLP.[24]

c) Internal decisionmaking procedures

Another problem with both the IPO and the LLP Regulations is that they often fail to specify how decisions in an insolvency are to be taken by partners, LLP members, or the LLP. For example, where decisions are required to be taken by a specified proportion of partners/LLP members/contributories by reference to their value or voting rights, it is unclear how this value is to be assessed and, to the extent that they may include persons held out as partners, or former partners or

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[15] See further Elspeth Deards [E. Berry], 'Partnerships: when the view is no longer of profit' (1995) 4(2) Nott LJ 165.
[16] IPO, Art 3.
[17] Partnership Act, s1.
[18] Partnership Act, s14.
[19] IPO, Art 2.
[20] See further *Clyde & Co LLP and another v Bates van Winkelhof* [2014] UKSC 32, [2014] 1 WLR 2047, discussed in Elspeth Berry, 'When Is a Partner/LLP Member *Not* a Partnership/LLP member? The Interface with Employment and Worker Status' (2017) 46(3) Ind LJ 309.
[21] IPO, Art 2.
[22] LLP Regulations, Reg 4(1)(g).
[23] See further *Re Newton's Coaches* n13 and Berry, 'Interpreting the Insolvency Act 1986 in the partnership context' n13.
[24] IA 1986, ss74 and 79, as modified by the LLP Regulations, Sch 3, and John Whittaker and John Machell, *The Law of Limited Liability Partnerships* (4th edn, 2016 Bloomsbury) 31.21.

LLP members, it is unlikely that any internal agreement will confer voting rights on them. Equally, where decisions are to be taken by partners/LLP members/the LLP, it is unclear whether this requires unanimity or merely a majority. In *Patley Wood Farm LLP v Brake and another*[25] the court held that since Parliament had provided expressly for majority action by directors in relation to administration[26] but had explicitly excluded the same provision from partnerships and LLPs,[27] unanimity was required. However, this reasoning is limited to administration, and in any event conflicts with the common law rule of majority decisionmaking by corporate bodies,[28] which could apply to LLPs (which are corporate bodies[29]) since the LLP Regulations provide that the mutual rights and duties of the LLP and its members are determined 'subject to the provisions of the general law'.[30] Further, partnership and LLP law both include the default rule that 'ordinary matters' are decided by a majority but unanimity is required in order to take the more extraordinary decisions of admitting a new partner/LLP member or changing the nature of the firm's business.[31] On this basis, a decision to invoke insolvency proceedings would presumably be extraordinary and require unanimity,[32] whereas subsequent administrative decisions would be ordinary and therefore only require a majority; but no such distinction is made by the insolvency legislation.

d) Ineffectiveness of the rescue procedures

There are a number of problems with the way in which the company voluntary arrangement (CVA) procedures are applied to partnerships. For example, despite the fact that partners are jointly and severally liability for the debts of the partnership,[33] a PVA only applies to partnership assets and not to partners' assets. Similarly, although an administration moratorium protects the partnership assets, partners' personal liability means that their private assets may still be subject to proceedings by creditors. In both cases the IPO could easily provide for linked individual or company voluntary arrangements (IVAs or CVAs) or company administration but does not do so. The moratorium also seemingly fails to prevent a dissenting partner in a partnership 'at will' (i.e. where the partners have not agreed a fixed duration) from giving notice and thereby triggering dissolution and potentially sabotaging the administration.[34] Even more fundamentally, the IPO makes administration less likely to happen at all, because it does not allow a partnership to petition the court on the ground that the partnership is likely to – but has not yet - become unable to pay its debts,[35] even though companies and LLPs may invoke this ground.

e) Ineffectiveness of the break up procedures

The problem of legislative structure is particularly acute in relation to partnership winding up, and the IPO provisions are virtually unusable because not only do they provide four separate routes to partnership winding up, but two of these involve concurrent petitions against the partners and import separate versions of

[25] [2016] EWHC 1688 (Ch), [2017] 1 WLR 343.
[26] IA 1986, Sch B1, para 105.
[27] IPO, Sch 2, para 39 and the LLP Regulations, Sch 3.
[28] *Merchants of the Staple of England v Governors of the Bank of England* (1887) 21 QBD 160 (CA) 165.
[29] Limited Liability Partnerships Act 2000, s1(2).
[30] LLP Regulations, Reg 7; see further John Whittaker and John Machell n24 paras 17.12 and 17.15.
[31] Partnership Act, s 24 and the LLP Regulations, Reg 7.
[32] Geoffrey Morse n3 para 5.23, Roderick I'Anson Banks n3 paras 27-155 and notes 674 and 741, and Mark Blackett-Ord and Sarah Haren n3 para 22.75.
[33] Partnership Act, s9 and Civil Liability (Contribution) Act 1978, s3.
[34] Partnership Act, s 26; see further Elspeth Berry, 'Limited partners behaving badly: insolvency procedures and other options for general partners when limited partners default' (2009) 24(11) BJIBFL 660.
[35] IA 1986, Sch B1, para 11 as modified by the IPO, Sch 2, para 5.

IA 1986 for the petitions against the partnership, against corporate partners, and against individual partners. Thus, merely identifying the relevant provisions in any winding up scenario is difficult. There are also many inconsistencies and ambiguities. For example, leave of the court is required for a petition without concurrent petitions if the partnership consists of less than eight partners,[36] which is arbitrary and unnecessarily restrictive.

The government's new approach to insolvency forms, which is to set out the required content in the Insolvency Rules rather than prescribing a statutory form (although templates for certain forms are provided), casts doubt on whether the forms set out in the IPO remain valid. Further, despite both the IPO and the LLP Regulations omitting certain necessary forms, the government has not set out the required content or templates for these forms. The Insolvency Service Guidance suggests that both partnerships and LLPs can be wound up in the same way as a company and refers to the company winding up form (Comp 1); its only acknowledgement that adaptions are required is the statement that applicants to wind up a partnership will need the to ask the court to wind it up as an unregistered company.[37] However, use of Comp 1 would require considerable variations for either a partnership or an LLP and it is disappointing that it was not explicitly made adaptable for partnerships and LLPs, or separate templates provided for them.

As to the two partnership bankruptcy procedures - joint bankruptcy of all partners, and partner bankruptcy concurrently with partnership winding up - their rehabilitative potential is reduced because the IPO does not apply the IA 1986 provisions on debt relief.[38] There is also an inherent tension between consolidating proceedings in order that the entirety of the property owned by the partners is administered jointly, and the different priorities for the payment of joint and separate debts.[39] For example, the IPO's definition of a partner's estate is confused;[40] and while it refers separately to the partnership's and the partners' estates,[41] the unmodified IA 1986 sections which apply refer only to the debtor's estate - and the debtors are the partners, not the partnership, and so it is often unclear which provision applies to which estate.

4 Possible solutions

a) Revision of the current partnership and LLP insolvency legislation

Some of the problems with the IPO and the insolvency provisions of the LLP Regulations could be addressed relatively easily by amending them. For example, problems with the adaptation of company terminology could be solved by providing more comprehensive and particularised definitions for the partnership and LLP contexts or, in some instances, by omitting company terms from the IPO or LLP Regulations.

However, many other problems are not so easily addressed and, in any event, the necessary legislative reforms are unlikely. The government proposed to substantially reform the IPO as long ago as 2005[42] but has still not done so, while

[36] IA 1986, s221A(1) and (2), as inserted by the IPO, Sch 5, para 2.
[37] The Insolvency Service, 'Guidance: How to wind up an insolvent partnership' <https://www.gov.uk/government/publications/how-to-wind-up-an-insolvent-partnership/how-to-wind-up-an-insolvent-partnership> accessed 5 March 2018.
[38] IA 1986, Part VIIA 1986, which makes provision for debt relief orders is not applied by the IPO, Arts 8, 10 or 11.
[39] IA 1986, s328–328D, as modified by the IPO, Sch 7, para 21.
[40] IA 1986, s283 as modified by the IPO, Sch 4, Pt II, para 28 and Sch 7, para 7.
[41] For example, IA 1986, s290(3) as modified by the IPO, Sch 7, para 9 and.
[42] Select Committee on the Merits of Statutory Instruments, 7th report (2005), App 4.

the LLP Regulations have been amended constantly since their inception[43] yet the problems discussed above have not been addressed. Together with the different nature of partnerships and LLPs as compared to companies and individuals, and the consequent difficulties in applying IA 1986 to them, this means that alternatives to the piecemeal reform of the existing legislation must be considered.

b) Repeal the current legislation but re-enact in standalone statutory provisions

The IPO and the insolvency provisions of the LLP Regulations could be replaced with self-contained partnership and LLP insolvency statutes or separate codified chapters within IA 1986. Either would improve accessibility, reduce the likelihood of the legislation failing to address areas of difference between partnerships or LLPs as compared to companies or individuals, and make it easier to give partners and LLP members discretion to address as many issues as possible in their internal agreement. The case for this is stronger for partnerships, which are not generally subject to company law and are more flexible vehicles, but it could also benefit LLPs.

c) Repeal the current legislation without re-enacting similar provisions

More radically, the IPO and the insolvency provisions of the LLP Regulations could be repealed, and not - or at least not wholly - re-enacted, thereby disapplying some or all of IA 1986.[44]

The aims of insolvency law according to the Cork Report include preserving viable businesses,[45] and of course rescue procedures are of considerable importance to partners in particular because of their personal liability. Neither the Partnership Act nor the LLP legislation provides formal mechanisms to assist a firm which finds itself in temporary financial difficulties and so it is desirable to continue to apply IA 1986 rescue procedures to partnerships and LLPs.

However, the application of IA 1986 break up procedures, at least to partnerships, is unnecessary. Consolidation of bankruptcy proceedings is consistent with the Cork Report aims of efficiency, and fairness between creditors, but IA 1986 as amended by the IPO also enables a court to consolidate proceedings where a bankruptcy (or winding up) petition is presented against a single partner,[46] and this means that the problematic IPO provisions on joint or concurrent bankruptcy can be avoided. The application of IA 1986 winding up procedures is even less defensible since a partnership may be wound up under the Partnership Act by the partners themselves.[47] Combined with partners' personal liability, this can protect creditors without the need for the more expensive and complex intervention of insolvency law.[48] Creditors would still be

[43] Most recently by the Insolvency (Miscellaneous Amendments) Regulations 2017 (SI/1119).
[44] The IPO and the LLP Regulations also apply the Company Directors Disqualification Act 1986 (CDDA 1986) disqualification regime to partnerships and LLPs, and substantial problems arise from this application. In particular, although disqualification can deter the abuse of limited liability by LLP members, partners have no limited liability to abuse and disqualification should not be applied to them.
[45] n10 para 198.
[46] IA 1986, ss128(5A)-(5C) and 303(2A)-(2C) as inserted by IPO, Art 14; see further *Official Receiver v Hollens* n2 and Stuart J Frith, 'Avoiding the Insolvent Partnerships Order: Part 1: Consolidating individual bankruptcies (1991) 4(2) Insolv Int 9-11.
[47] Partnership Act, ss38-39; for a recent example, see *Campbell v Campbell* [2017] EWHC 182 (Ch). A limited partnership's affairs are wound up by its general partners unless the court orders otherwise (Partnership Act, s6(3) (or unless it is a private fund limited partnership (PFLP)).
[48] Justice, 'Insolvency law: An agenda for reform' (1994) para 1.16 and Milman n3 140.

able to use IA 1986 to bankrupt or wind up partners[49] and the court could still consolidate proceedings,[50] but the complications caused by the IPO would not arise. The IPO provisions on winding up should therefore be repealed.

These arguments do not apply to LLPs; unless members have agreed to contribute to its assets on a winding up, creditors can only force them to do so if IA 1986 sanctions apply. Indeed, the LLP Regulations create an additional sanction against LLP members which is not applicable to directors and which can benefit creditors, the so-called 'clawback' under s214A IA 1986. This enables the court to order a member to contribute if he 1) withdrew LLP property within two years before the commencement of the winding up , 2) knew or had reasonable grounds to believe that the LLP was at the time of the withdrawal unable to pay its debts within the meaning of s123 IA 1986 or would become so unable after that withdrawal, and 3) knew or ought to have concluded that after the withdrawal there was no reasonable prospect of the LLP avoiding insolvent liquidation. However, this test sets a very high threshold and the value of the sanction is accordingly diminished. For example, in *Milne (Liquidator of Premier Housewares) Scotland) LLP) v Rashid*,[51] the court refused to order a contribution, even though it was undisputed that limb 1) was met and it held that limb 2) was also met, because although s123(2) deemed an LLP to be unable to pay its debts if its assets were less than its prospective and contingent liabilities, and this required not merely its liabilities to exceed its assets at a particular point in time, but that it could not reasonably be expected to meet its debts falling due in the near future.[52] On this basis, the respondent member had reasonable grounds to believe that the LLP was unable to pay its debts. However, the court held that limb 3) was not met, because there was a reasonable prospect of the LLP avoiding insolvent liquidation and so the respondent could not have known, nor be expected to have concluded, that there was no such prospect.

It is therefore necessary to retain the option of LLP winding up under IA 1986, in order to protect creditors.

5 Conclusion

The partnership medium allows those who take on personal liability to operate their businesses with maximum informality and flexibility. Extensive regulation such as the IPO can only be justified if it is accessible and confers substantial benefits. The rescue procedures are therefore justified, as they have the potential to protect businesses as going concerns and so benefit creditors, partners or LLP members, and other stakeholders, although they require reform in order to improve their effectiveness. However, the break up procedures for partnerships are neither accessible nor, given that alternatives are available, substantially beneficial. The IPO therefore requires at least partial repeal or, preferably, complete repeal with re-enactment of the (reformed) rescue provisions in the form of a standalone statute or chapter of IA 1986.

In contrast, the limited liability of LLP members justifies greater regulation, and necessitates creditor protection though the application of the IA 1986 winding up procedures although, as with the IPO, the insolvency provisions of the LLP Regulations require substantial reforms to improve their accessibility and should be reformed and re-enacted in standalone form.

[49] IPO, Art 19(5) confirms that the IPO does not affect this.
[50] IA 1986, ss128(5A)-(5C) and 303(2A)-(2C) as inserted by IPO, Art 14.
[51] n5.
[52] *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc* [2013] UKSC 28, [2013] 1 WLR 1408.