



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