Partnerships & Professional Practices
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LLP + no LLP members' agreement = litigation

The recent case of *Eaton v Caulfield & others* (an unfair prejudice petition brought under *section 994 of the Companies Act 2006*, coupled with a just and equitable winding up petition under *section 122(1)(g) Insolvency Act 1986*) highlights the difficulties faced by LLP members who do not have an LLP members' agreement setting out their rights and obligations.

All too often parties who wish to enter into business together incorporate an LLP, but are in such a rush to get started that they don't think about or finish thinking about the precise basis on which they wish to do business together. They plunge into a business project only to find some time later that issues emerge, perhaps issues that were always there but had not been identified. By then the business has taken wing, there is considerable client/customer goodwill and/or considerable profits have been made, and essentially the business is worth fighting over.

Typically, one or more parties decide that it would be better for them to be doing business on their own or to the exclusion of one or more of the other participants, and they look for ways to exit the people they can no longer work with, or to walk away themselves, taking their capital and business connections with them.

Unfortunately, the default rules (contained in the *Limited Liability Partnerships Regulations 2001*) that govern the relationship between the parties in the absence of agreed terms are minimal and usually inadequate to deal with the sort of issues that often arise. In many cases where there is no LLP members' agreement the participants discover that they cannot lawfully do what they want to do.

In the *Eaton* case the parties found themselves at trial arguing over whether one party had been entitled to expel the other and whether certain verbal exchanges were sufficient to override the default rule that in the absence of contrary agreement the profits and capital are to be shared equally.

The difficulty with not writing down the precise terms on which you are going to be in business together, and making it a term of that agreement that all variations have to be in writing and signed by the parties, is that the law recognises oral agreements and oral variations of written agreements.

So in the *Eaton* case the (no doubt very expensive) trial was concerned with what was said about expulsion in a management meeting and during an argumentative drinking session on a train journey, and what terms as to profit-sharing and ownership of capital were agreed in an exchange of emails.

It is always difficult in such cases to pull a clear statement as to what was agreed out of a morass of conversation and often casually-expressed correspondence.

The outcome was that it was found that there was no agreement permitting the expulsion of a member, so that Mr Eaton, by being "dismissed", had been unfairly prejudiced and was entitled to wind up the LLP and receive an equal share of any surplus value in the business.

This outcome may well have been a disaster for all concerned, including the "winner", as the value of any business's goodwill would be bound to be severely damaged by entry into liquidation and consequent ceasing to trade. In such a case the parties may try to do a hurried deal to salvage such value as they can, that is if they can bring themselves at that point in time to negotiate with one another.

In effect in such cases the Judge writes the parties' agreement for them, but the cost of that can typically be at least 100 times greater than the cost of taking professional advice at the outset.

Those who wish to use an LLP as their business vehicle should ensure that they have an LLP members' agreement in place, before they open their doors for business. Those who have omitted to do so should put one in place as soon as they can, before the honeymoon period is over.

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