

Corporate Commercial

Limited Liability Partnership (LLP) Conversion Issues and Checklist A client's guide



LINDER MYERS
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1. Introduction

1.1 A limited liability partnership ("LLP") is a relatively new form of business entity (Limited Liability Partnerships Act 2000). The partner or 'members' of the LLP have limited liability. An LLP is a corporate entity with its own legal personality separate from that of its members. Unlike a company, there is no distinction in the internal structure of an LLP between the roles of the owners of the business (shareholders) and managers (directors).

1.2 This checklist is designed to give a brief introduction to LLPs and to highlight a range of issues which should be considered at the outset. Professional advice (including tax advice) should always be taken when considering your own personal circumstances. Please note that not all the issues referred to below will be relevant in all circumstances. The principal aim of this checklist is to help identify issues before commencing drafting any of the following agreements (as appropriate) in order that any arrangements adopted will be specifically tailored to suit individual circumstances:

1.2.1 an LLP agreement entered into by all members of the LLP to regulate the relationship between members in connection with the LLP's affairs (this agreement, like a traditional partnership agreement, is not required to be disclosed to the outside world);

1.2.2 a transfer agreement entered into by the partners of the old partnership (or previous trading entity) and the LLP whereby certain assets (including goodwill, equipment, contracts, stock etc.) are transferred to the LLP;

1.2.3 other ancillary documentation such as new employment contracts for the employees of the LLP, assignments of intellectual property and assignment/transfer of property etc.

1.3 If you require any further information please contact the Corporate Commercial department.

2. Why change to an LLP?

2.1 One of the main reasons for setting up an LLP is to enable members of an LLP to limit their liability.

2.2 In a normal partnership:

- 2.2.1 every partner is liable jointly with his other partners for all the debts and obligations of the partnership incurred during his membership; and
- 2.2.2 every partner is jointly and severally liable for

any loss or damage arising from the wrongful acts and omissions of any of the partners (including that partner's own acts and omissions) which were done in the ordinary course of the partnership's business or with the authority of the partners. This means that an injured person may sue one or more of the partners or all of them together at this option.

- 2.3 Increasingly the unlimited liability of partners in a normal partnership has become a cause of concern for various reasons:
 - 2.3.1 the size of the partnership is growing, meaning that partners in large (and especially in international) partnerships will not know each other, this also arises where partnerships merge;
 - 2.3.2 there is an increase in the amount of claims being made for professional negligence and the size of claims is growing; and
 - 2.3.3 concern that there is a risk to partners' personal assets if a claim were to exceed the assets and insurance cover of the partnership

3. Conversion to an LLP

3.1 Advantages

- 3.1.1 Limitation of liability of members
- 3.1.2 Treatment as a partnership for tax purposes (i.e. members are assessed to income tax in the same way as a normal partnership)

3.2 Disadvantages

- 3.2.1 Publicity requirements. The accounting provisions of the Companies Act apply which means that the LLP is required to file accounts and an annual return. The accounting provisions require the disclosure of the highest paid member's profits.

3.3 Other aspects for consideration

3.3.1 Assuming that it is intended that the existing partnership contracts with clients will continue then these agreements require assignment and novation to the LLP. If they are not novated, and the existing business is run-off, then partners (who are also members of the LLP) who are continuing to provide services under the old partnership contracts must take care to ensure that their clients fully understand that the partners are acting in two different capacities (i.e. with unlimited liability in respect of the contracts being run-off and as members with limited liability in relation to any new contracts between that client and the LLP).

3.3.2 Transfers of employees from the old partnership to the LLP and the application of Transfer of Undertakings Protection of Employment Regulations 2000 will need to be considered. New employment contracts between the employees and the LLP will be needed.

3.3.3 Transfers of the assets to the LLP, in the case of leased property. This will include obtaining the consent of the landlord to the assignment of a lease and the release of Partners from their obligations.

3.3.4 Transfer (assignment/novation) of contracts with suppliers of the old partnership (IT contracts, services etc) to the LLP.

3.3.5 Indemnity insurance issues. To cover the ongoing obligations of the old partnership during its run-off and any claims which could be brought after the run-off in respect of the old partnership's activities. Are there any annuities payable to retired partners? Consider also cover for the LLP.

3.3.6 Change of stationery to reflect the fact that the business is trading through the new LLP.

3.3.7 If any of the Partnership assets are located abroad consider the legal and tax implications of the transfer in the relevant jurisdictions, consents, registrations, tax consequence.

3.3.8 Change in banking arrangements, including the provision of security over assets of the LLP, if required.

4. Professional partnerships converting to LLP

4.1 A professional partnership considering a conversion to an LLP will need to review the requirements of the regulatory system that applies to that profession. In these circumstances any required approval of the conversion by the relevant regulatory body may take a number of weeks. Therefore the timing of obtaining any necessary approval will have to be taken into account in the planning timetable.

5. Other timing issues

5.1 Any plan to convert to an LLP should consider the cost savings that can be achieved in synchronising the conversion with the accounting year end and insurance arrangements year end.

6. CHECKLIST

6.1 Members

- 6.1.1 Who are they?
- 6.1.2 Will each member bear their own costs in relation to the transaction? If not, what are the arrangements for payment of costs (including if the matter aborts)?

6.2 Preliminary

- 6.2.1 Is a feasibility or other preliminary study (e.g. market survey) required and if so, has it been carried out? If not, who will carry out/pay for it?
- 6.2.2 Has a business plan been prepared?
- 6.2.3 Have the proposed members entered into any preliminary agreement and, if not do they wish/need to do so (e.g. heads of agreement/confidentiality/exclusivity)?

6.3 Business

- 6.3.1 Nature/description of LLP business?
- 6.3.2 Is it a specific (single project/time limited) venture or of indefinite duration? Is it intended to be a trading entity or an investment entity?
- 6.3.3 Location - where will the business be carried out?
- 6.3.4 Regulatory issues - are there any particular requirements for statutory (or other) licences, permissions etc?

6.4 LLP

- 6.4.1 Will the activities be carried out in the same LLP or through a series of limited liability entities?
- 6.4.2 If the latter, will the entities be private limited companies or another kind of LLP?
- 6.4.3 Has the LLP already been incorporated and if so, has it traded or acquired any assets liabilities?
- 6.4.4 Capital Contributions - proportionate split between members or contributions paid up front, or in tranches when called for? By way of cash or assets?
- 6.4.5 Proposed name of LLP
- 6.4.6 Members and designated members details needed (e.g. DOB, home address)
- 6.4.7 Auditors
- 6.4.8 Accounting reference date
- 6.4.9 Registered office address
- 6.4.10 VAT registration - who will do it? What are the administrative arrangements?

6.5 Finance

- 6.5.1 What is the initial funding required? Met by capital contributions/loans, from members/third party borrowing or a mixture?
- 6.5.2 Who will provide funding and in what proportions?

- 6.5.3 Consider also future funding requirements
- 6.5.4 Funding to be by way of cash or other assets?
- 6.5.5 Has any member already provided funds or other value (e.g. assets/services/facilities) and if so what (if any)? Is credit to be given for this by way of equity contributions etc?
- 6.5.6 Profits and losses to be shared equally or in proportion
- 6.5.7 Limit on borrowings?
- 6.5.8 Business plan - does this include cashflow projections in order to establish working capital requirements? Does it need to be reviewed/updated?

6.6 Transfer of Assets to LLP

- 6.6.1 Consider LLP's premises – will there be an outright transfer of licence/lease?
- 6.6.2 Stamp duty/other tax issues?
- 6.6.3 Valuation of assets being transferred.
- 6.6.4 Requirement for third party consents and time implications?
- 6.6.5 Due diligence/warranties from seller?

6.7 Membership Issues

- 6.7.1 Will any capital shares carry any “weighted” or other special voting rights (for example rights of veto on key decisions)
- 6.7.2 What protection is to be provided to minority members by rights of veto (including class rights)? Will members have a right to petition for unfair prejudice?
- 6.7.3 Members meetings/designated members meetings consider location, frequency and notice/quorum requirements
- 6.7.4 What restrictions (including pre-emption rights) will apply on the introduction of new capital into the LLP, on the transfer of interests by the members and on exit routes?
- 6.7.5 Key man insurance/life insurance?

6.8 Required Returns on Investment

- 6.8.1 Drawings?
- 6.8.2 Timing of payments (interim/final/periodic)?

6.9 Disputes and Resolution

- 6.9.1 Arbitration can work well when applied to specific issues such as valuation of members' interests in the LLP on exit. In the circumstance the parties can't agree a value, then the matter can be referred to an independent chartered accountant.
- 6.9.2 Can deadlock arise on every issue, any issue which a member decides is a deadlock issue when it arises, or only those issues defined as a deadlock issues in the LLP agreement?
- 6.9.3 Can deadlock be resolved by reference to managing

directors chairman of corporate members, chairman's casting vote or arbitration/expert determination?

- 6.9.4 Consequence of a deadlock could be to have a cooling off period, or to wind up the LLP or to provide that one member buys the other out.

6.10 Intellectual Property Issues

- 6.10.1 What IP Rights are required by LLP and who owns them at present?
- 6.10.2 Will LLP acquire IP rights outright or only on licence? Can members validly transfer/licence IP rights to LLP?
- 6.10.3 Will other members acquire any IP rights?
- 6.10.4 Who will own IP developed by LLP and/or members (including improvements to original IP)?
- 6.10.5 What will happen to IP rights on termination of LLP?
- 6.10.6 Will any member need a licence of IP rights following winding up?

6.11 Employees

- 6.11.1 Which employees will LLP need?
- 6.11.2 Will the LLP acquire employees by operation of law (e.g. TUPE)?
- 6.11.3 Will consent of employees (or existing employers) be required?
- 6.11.4 New employment contracts between employees and LLP required?
- 6.11.5 Pension/share option incentive issues?
- 6.11.6 Will any staff be temporarily seconded to LLP by members (or third parties)?

6.12 Transfers of LLP interests and exits

- 6.12.1 Initial lock-in period?
- 6.12.2 If transfers of membership interests are restricted, will there be categories of permitted transfer (to which pre-emption rights do not apply) e.g. within a group of companies or to families/family trusts of individual members?
- 6.12.3 How will capital interests be valued for transfer purposes?
- 6.12.4 Rights/obligations of outgoing members regarding repayment of loans, return of assets?

6.13 Involvement of Members

- 6.13.1 Will members be obliged to provide LLP with premises and/or other services or facilities (e.g. training staff, accounting/treasury functions, access to computer systems etc)?
- 6.13.2 Will LLP trade with it's members/group/company of member in relation to supply of raw materials good/services. Distribution/agency agreements?

- 6.13.3 Do any of the above arrangements affect profit shares, responsibility for losses, risks and liabilities borne by members or control/independence of LLP?
- 6.13.4 Accounting/reporting/information issues?
- 6.13.5 Management information/business plans/budgets

6.14 Restrictions

- 6.14.1 Non-complete covenants including duration and geographical scope of such restriction
- 6.14.2 Breach of LLP agreement: Consequences?
- 6.14.3 Confidentiality issues?

6.15 Winding up

- 6.15.1 Will the business of the LLP be fixed term or indefinite?
- 6.15.2 Do certain events cause automatic winding up (e.g. insolvency/bankruptcy of member, transfer of capital interests, change of control of member, loss of assets/licences)?
- 6.15.3 Do members have a right to wind up LLP where there is a change of control, material breach of LLP agreement or on notice?
- 6.15.4 Consequence of winding up. Consider performance of outstanding contractual obligations of LLP, responsibility for other liabilities of LLP, rights to assets of LLP, repayment of debts/return of assets by/to LLP parties and capital contribution on winding-up to LLP or between members.

Contact us

For further information and specialised advice please contact our Corporate Commercial team. The above is to be used as a guide only.



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