Legal Update

Aldermore Bank plc and another v Austin Law and others [2014] EWHC 2175 (Ch)

The third defendant had been a sole practitioner solicitor but successfully applied for SRA recognition of a partnership law firm, the first defendant in this case. The second claimant, Kuits, then paid money to the law firm on behalf of the first claimant, the bank, for the purpose of enabling completion of a remortgage by a remortgagor for whom the law firm acted. As a result of fraud the money was diverted to individuals who had no right to receive it. Kuits reported this to the SRA which intervened in the law firm's practice.

The claimants sought repayment from the law firm and from the partners in it on the basis of undertakings given by it to complete the transaction within three days of the transfer of the money or return the money. The second defendant disputed liability on the ground that she had subsequently left the firm. The third defendant disputed liability on the ground that she had not been a partner but only an employee.

As to the second defendant, the court noted that undertakings given by solicitors were strictly enforced, and that a solicitor would not normally be released from the undertaking other than with the consent of the beneficiary of it (*Re Coolgardie Goldfields Limited* [1900] 1 Ch 475). The undertakings here had not been released and the fact that the second defendant had resigned from the firm or it had dissolved before the payment of the advance was irrelevant. Even if that were incorrect, no notice of her resignation had been given to the claimants and they were thus entitled to rely on s36 of the Partnership Act 1890, which provided that a person who dealt with a firm after a change in its constitution was entitled to rely on all apparent partners of the old firm as still being partners of it until he had notice of the change.

The court also held that the third defendant had been a partner in the firm. The documentary evidence was limited, but she had received SRA correspondence which referred to her as the nominated compliance officer for the firm and had not attempted to correct the implication that she was to be a partner. Other SRA correspondence indicated her extensive involvement in the future of the firm which suggested that she was to be a partner. Further, she had sent texts after the partnership was recognised which referred to her becoming a partner and receiving a promotion which, given that she was already a salaried partner in the third defendant's sole practice, must refer to her becoming a partner in the full sense of that word.

Other evidence also indicated that she was a partner. First, Kuits' executive partner had been told that the firm was controlled by two partners including the third defendant. Second, she was an authorised signatory on the client account. Third, she did not object to the second defendant handing a letter of resignation to her or to the second defendant describing her in that letter as being the supervising partner. Fourth, there was some evidence that she worked longer hours than the fixed part time hours that she had claimed, and although she had received a salary rather than a profit share, the fact that the SRA intervention occurred only a month after the partnership had been recognised meant that there had been no time for a profit

Elspeth Berry, Reader in Law, Nottingham Law School, Nottingham Trent University

sharing arrangement to take effect. Although she had been described as a salaried partner to the bank when the account was opened, this had taken place before regulatory approval of the partnership had been given and was therefore of limited significance. The court considered that, on the balance of probabilities, there was a partnership between the second and third defendants from the date when regulatory approval of the partnership was received,.

The court concluded that the second and third defendants were each liable on the undertakings to return the money.

Comment

This judgment provides useful examples of the features of partnership as opposed to employment status, features which are frequently subject to scrutiny by the courts in relation to salaried partners and which have assumed a higher profile in the light of recent cases concerning the related issue of the employment status of LLP members.

Lie v Mohile [2014] EWHC 3709 (Ch)

Lie and Mohile were general medical practitioners who had practiced under a partnership agreement. Both the agreement and their contract with the primary care trust required the practice to be carried on from specified premises. The freehold title to the premises was owned by Mohile, who granted a tenancy to himself and Lie in order to carry on the practice.

After relations between them deteriorated, Mohile purported to give notice of dissolution and terminated the tenancy, although he subsequently accepted that the notice of dissolution was invalid. Lie was granted an injunction restraining Mohile from excluding him from the premises pending determination of his application for the grant of a new tenancy. This application was unsuccessful and the proprietary basis of the injunction thereby fell away but the court, citing *Harrison-Broadley v Smith* [1964] 1 WLR 456 (a case notable also for the description by Harman LJ of accountants as 'the witchdoctors of the modern world…willing to turn their hands to any kind of magic'), held that it was well established that in order to give effect to the partnership the partner who owned the premises from which the business was carried on must be taken to have granted a licence to the other partner to enter them for the purpose of the business. In the present case the injunction has therefore been continued in order to give effect to this licence

Mohile applied to discharge the order. The court held that although it was clear from the terms of the order that it would expire on the making of the order at the trial of the dissolution proceedings, the licence itself did not expire. The partnership business was not terminated by the order for dissolution but continued for purpose of winding up and possibly to preserve goodwill, and each partner had a right to participate in the business which was being wound up unless and until the court appointed a receiver on the application of any partner. Thus the implied licence continued while the partnership business continued to be carried on at those premises. In addition, an appeal court might grant an injunction enforcing that entitlement pending the hearing of the appeal.

Although neither of these arguments required the court to grant an injunction in favour of Lie, and the exercise of its discretion depended on all the circumstances of the case, the court held that on balance the order should be continued. First Mohile had acted precipitately in informing the staff immediately after the dissolution judgment that Lie was not to be allowed into the premises and that the police should be called if he attempted to do so. Second, he continued to practice there and had had to employ locums to replace Lie. Third, the medical practice was a partnership asset and Lie and Mohile remained jointly and severally liable to provide the services contracted for. Although requiring partners who had fallen out so badly to work together under one roof could be damaging for the practice and for the winding up of the business, they had already managed to carry on the business for three years since the breakdown of their relationship without any detriment to the patients.

The court also concluded that there was no basis to discharge the part of the order requiring Mohile not to disable Lie's NHS smartcard, or that requiring Mohile to restore Lie's professional subscriptions since Mohile's continued to be paid. Although the requirement to pay Lie's drawings could be dealt with instead as part of the account, Mohile had made drawings and incurred expenditure to pay locums and the payments to Lie would in any event come into the final account, and the court therefore concluded that that part of the order should also be continued.

Comment

The emphasis on the implied licence given to partners to enter the premises for the purpose of the business is of particular note here, as is the fact that it is not determined by the dissolution of the partnership but only on the conclusion of its winding up.

LEGAL UPDATE CONTINUED...

The Connaught Income Fund, Series 1 (in liquidation) v Capital Financial Managers Limited and Blue Gate Capital Limited [2014] EWHC 3619 (Comm)

The claimant was an unregulated investment scheme set up as a limited partnership and operated at various times by each of the defendants. The claimant alleged that the defendants unlawfully promoted it to investors who became partners in it, in breach of the Financial Services and Markets Act 2000 (FSMA), and were responsible for misleading promotional literature. It sued as assignee of those investors who had suffered losses. The defendant claimed that the assignments were invalid and the proceedings were a nullity.

The court held, first, that the authority of the partners under s38 of the Partnership Act 1890 to wind up a dissolved partnership was not relevant because the action was not brought by the former partners in the claimant but the liquidators on behalf of the claimant.

Second, the claimant did not lack personality and capacity to sue, since it was an insolvent partnership acting through its liquidator in the name of the firm or the names of the partners. The proceedings were therefore not a nullity.

Third, the fact that the claimant was an assignee of the claims did not, without more, make it a fiduciary or someone acting in a representative capacity and so the restrictions under the FSMA on rights of action by such persons did not apply. Nor was the general right to assign restricted by the FSMA.

Finally, the liquidators had not exceeded their statutory powers under IA 1986, Sch 4. They had the power to bring or defend any legal proceedings with the sanction of the liquidation committee (which had been given here), the power to do all such other things as may be necessary for the winding up of its affairs and distributing its assets, and the power to do all acts and execute in the name and on behalf of the partnership or any partner all deeds and other documents. The latter was a self standing and not an ancillary power, and accepting a gratuitous asset and taking legal steps to protect it were actions which the liquidators could properly deem to be necessary.

The court concluded that the claimant should succeed, and could bring claims on the basis of the assignments.

Comment
Insolvent partnerships, whether general or limited, can be wound up informally under the Partnership Act (as in *Lie v Mohile* above) or under IA 1986, which is applied to partnerships by the Insolvent Partnerships Order 1994. It is worth remembering that the Order makes significant modifications to IA 1986 albeit not in relation to the powers of the liquidator.

The Queen on the application of Kerman & Co LLP v Legal Ombudsman [2014] EWHC 3726 (Admin)

Levy, a sole practitioner solicitor, provided services to a will trust as trustee. He subsequently entered into a merger agreement with the claimant firm. A complaint arising out of his provision of those trustee services was directed by the defendant legal ombudsman to the claimant firm, on the basis that it was the successor firm to Levy's sole practice and was thus responsible for dealing with the complaint.

The court accepted that the fact that the claimant was the successor firm for insurance purposes did not necessarily mean it took Levy's place for regulatory purposes or the purposes of being a respondent to the complaint. However the ombudsman scheme rules referred to in the Legal Services Act 2007 provided that where an authorised person ceased to exist and another person succeeded to the whole or substantially the whole of its business, complaints already outstanding against the former became complaints against the latter. Both the Act and the rules gave a broad description of the term 'person' and did not restrict it to an individual human being. Indeed the authorisation regime under the Solicitors Regulatory Authority Practising Regulations subjected the sole practitioner's firm – as distinct from the individual human being - to the solicitor's regulatory regime. The reference to 'ceases to exist' also did not refer to an individual but to the cessation of the firm or legal entity subject to the regulatory regime. Further, the possible outcomes of a complaint under the ombudsman scheme - an apology, limitation of fees, payment of compensation, rectification of any error at the respondent's expense or any other action at the respondents expense – all, with the exception of the apology, assumed that the respondent remained an authorised person and would make little sense in relation to a

LEGAL UPDATE CONTINUED...

retired sole practitioner. There was no doubt that the claimant acquired all or most of Levy's business and that the sole practice ceased to exist, which was the end of that particular authorised person.

The existence of Levy as an individual after that date did not affect the finding that the claimant was the proper respondent, since it received the benefit and goodwill of the business and therefore it was not unfair it they had to accept the burden.

The court concluded that the defendant ombudsman had jurisdiction to proceed to investigate the complaint in which the claimant was the appropriate respondent.

Comment

The differentiation of a sole practice from the person who was the sole practitioner might at first sight seem surprising, but the result – that the successor practice also succeeds to the complaint against the former firm- is not, being entirely consistent with the ombudsman scheme rules.

Fennell v Halliwells LLP [2014] EWHC 2744 (Ch)

Fennell and eight others fixed share members in Halliwells LLP resigned before it went into administration and then into compulsory liquidation. The liquidators sought to recover drawings made by them on account of profits which were never made.

Clause 7.2 of the LLP deed provided that drawings which subsequently proved to have exceeded a member's share of profits for the relevant period must be refunded to the LLP. However, the fixed share members had entered into retirement deeds with the LLP. Clause 3.2 provided that the LLP guaranteed to pay the retiring member monthly drawings until his cessation date at the same rate and on the same date that they were paid prior to the service of his notice of retirement, and to credit his tax reserve account amounts equal to its reasonable estimate of his tax liability up to his cessation date. Clause 3.2 further provided that the LLP undertook not to reduce, reclaim, claw back or set off against any drawings which were to be paid in full without deduction, and clause 10.3 provided that the LLP would not seek to claim, reduce, extinguish or delay the payment of any sum payable to the retiring member under the retirement deed or the LLP deed.

The court held that the language and meaning of the retirement deed were clear. Clause 3.2 did not state, as it could have done, that the drawings would be paid on the same basis as they had previously been paid, which would have allowed for the recovery provisions in clause 7.2 of the LLP deed to be applied. This provided that drawings which subsequently proved to have exceeded a member's share of profits for the relevant period must be refunded to the LLP.

The undertaking and agreement in clauses 3.2 and 10.3 not to reduce or reclaim the drawings were not expressed, as they could have been, to be subject to clause 7.2 of the LLP Deed. Nor were they expressed, as they could have been, to be subject to any temporal limitation. The LLP had waived and released any claim to pursue the retiring fixed share members for any overpaid drawings or tax. Leave to appeal was refused.

Comment

This judgment may prove to be a pyrrhic victory for the fixed share members if the liquidators' claim by under s238 of the Insolvency Act 1986, which the parties agreed to deal with in a separate application, is successful. The liquidators argued that if the effect of the retirement deed was that the LLP had agreed to make payments to the fixed share members and to HMRC on their behalf regardless of whether the LLP made profits – which is what the court concluded in this judgment - then it had entered into a transaction at an undervalue contrary to s238 of the Insolvency Act 1986, since the fixed share partners had provided consideration which was worth significantly less than that provided by the LLP - indeed no consideration at all - at a time at which it was heavily insolvent. If the s238 claim succeeds, the court may make such order as it sees fit for restoring the position to what it would have been if the LLP had not entered into that transaction – and may thus order repayment of the drawings and the tax (see further s241).

Dinesh Kotak v Jagdish Kotak [2014] EWHC 3121 (Ch), judgment of 2 October 2014

The parties were brothers who had been in partnership together. The relationship between them had broken down and the partnership subsisted only for the purposes of winding up. The court had previously ordered, inter alia, that the two properties owned by the partnership be sold at open market value by private treaty and that both partners had permission to bid or submit an offer to buy the properties.

However, one of the partners, D, sought a pre-emptive sale order in favour of a company owned by him and his son in relation to one of the properties. The offer was for £3.4 million and the property had previously been valued at £3.71 million if marketed for up to a year, or £2.7 million if only marketed for 6 months.

The partners owed their bank £11 million, secured by charges on both properties, and the partnership had an annual shortfall of £162,000. The partnership therefore appeared to be unable to pay its debts as they fell due. D argued that the partnership debts would be met from his personal assets and that his reputation as a businessman would suffer, whereas J had no assets. J argued that D had acquired the purchase money wrongfully taking money out of the partnership, and that he had forged J's signatures on the loan and charge documentation. The court noted that in any event D would have been able to bind J as his partner under s5 of the partnership Act 1890 unless the bank was aware that the signatures were forged, and that as the bank had not been made a party to the proceedings and there had been no allegations that it was not entitled to enforce its loans and securities against the properties, the case should proceed on the basis that it was able to enforcement them.

The court stated that it had initially considered that the assets of the partnership should be sold for the purposes of winding up and that since CPR 40.16 gave it the power to order a sale of land and PD 40D paras 2 and 3 gave it wide powers as to the conduct of the sale, including authorising a party to bid, it could therefore sanction a particular sale to occur immediately even if that sale was to a party. Nonetheless, as this was a 'draconian' sanction (at para 29 of the judgment) it should be held over until independent solicitors and estate agents had been appointed and an attempt made to assess the present market. However, after the hearing and before judgment was given, the offer price was increased to £3.7 million. The court considered that this was unlikely to be bettered and noted that although the bank would still suffer a considerable loss on the sale, it must have considered it to be a good price or it would not have agreed to release its security over the property.

The court therefore directed a further hearing to be held at which it was minded to sanction D's offer unless cogent evidence suggested a major change in the true market value of the property over and above the offer, and at which it would give directions for the conduct of the allegations currently made by J against D and would consider whether the bank should be joined in to the proceedings. The court also noted that the present Part 8 claim form needed to be changed to a true partnership action to allow for the taking of accounts and other partnership matters to be dealt with. It concluded by directing that PD 40E paras 2.3-2.9 should not apply, so that the judgment would not be confidential in the period between its circulation to the parties and its formal handing down, on the ground that it was important that the bank and the solicitors and estate agents should know about it and be able to act upon it.

Walsh and others v Needleman Treon (A Firm) and others [2014] EWHC 2554 (Ch), judgment of 25 July 2014

The claimants appealed against a summary judgment finding that one of the defendants, Prior, was not a partner in the defendant firm of solicitors, and had not been held out as such under s14 of the Partnership Act 1890. The appeal was dismissed, the court finding that the judge had been entitled to reach the conclusions that he did.

The court held, first, that Prior was not a partner but an employee. The original offer letter from the partnership to Prior was clearly one of employment, notwithstanding that part of the remuneration package was a bonus based on a percentage of profit costs. Although labels were not determinative, the letter referred consistently to "employment". It also referred to a requirement to agree holiday times with a partner, which was to be expected of an offer of employment as distinct from any other relationship, and the terms and conditions were unequivocally indicativee of an employment relationship. The proceedings for unfair dismissal which Prior had

LEGAL UPDATE CONTINUED...

brought against the defendant firm had proceeded on the fundamental premise that Prior was an employee, and the court pointed out "as is common ground, status as an employee is inconsistent with true partnership" (at para 20). The fact that the fee for Prior's practising certificate was charged at the partner rate reflected the fact that the SRA charged this rate for those held out as a partner and was not inconsistent with employment status.

The court also held that Prior had not incurred liability to the claimants under s14 of the Partnership Act. Section 14 provides that anyone who represents himself, or knowingly suffers himself to be represented, as a partner in a particular firm, is liable as a partner to anyone who has on the faith of such representation given credit to the firm. Prior had sought and been granted partner status from the outset of his employment, was described as such on the firm's notepaper and was introduced to other employees as a partner,. The claimants were clearly aware of this holding out since the first claimant had been a client of the firm and so would have seen the notepaper, and his wife had been an employee of the firm while Prior worked there. However, the claimants had not produced evidence that they had relied on this representation; in fact, they had advanced funds to the firm both before and after Prior had been involved in it.

Comment

The case is noteworthy not only for the issues of partnership law, but also because of the parallel apparently drawn with partnership law by s4(4) of the LLP Act. The position of salaried LLP members has been under considerable scrutiny recently, both by the tax authorities and by the courts in *Clyde v Bates van Winkelhof*. In the light of the comment of Lady Hale in Clyde that the challenge by counsel to the traditional legal position that employee status is inconsistent with true partner status was a "serious" one, it is interesting that the court in Walsh asserted with confidence and without debate that traditional position.

Catch a Ride Limited, Rachel Rees and William Rees v Gardner, Carville and Hallmark Chauffeur Services LLP [2014] EWHC 1220 (Ch), judgment of 23 January 2014

The parties had conducted a joint venture through the medium of an LLP which had previously been set up by Gardner and Carville but in which the Reeses, were subsequently been registered as members. The Reeses alleged that they, together with Catch A Ride Limited which was ultimately owned by Rachel Rees, were members in the LLP.

Gardner and Carville accepted that the claimants had some economic interest in the LLP by way of resulting or constructive trust, but denied that they were members. They changed the locks on the LLP's premises, refused to provide any information about it to the claimants, and ran it for their own benefit.

The claimants initially sought, and received, undertakings that Gardner and Carville would not prevent them accessing the LLP's premises, destroy LLP information or deal with its assets without their consent. However, the parties subsequently agreed that the undertakings had not worked. In the light of this, the court held that it was unlikely that injunctive relief would be successful. This left it with the stark choice between awarding no relief at all or appointing a receiver.

The court noted that the granting of interim relief in partnership actions and quasi-partnership companies was common in an attempt to maintain the status quo pending the final resolution of the dispute. This was because monetary compensation was related to the value of the business which was in dispute, and it was therefore important to preserve its value pending its realisation. The court therefore "unhesitatingly" decided to appoint a receiver of the business and gave the following directions;

- the receiver must confirm the appointment of the current general manager of the LLP for the discharge of his existing duties,
- it was the function of the receiver and manager to undertake, or procure at modest cost, the conduct of the business,
- the receiver was to be a co-signatory on all LLP bank accounts
- the receiver was at liberty to enter into a management and trading agreement with Gardner and Clarke, who was another current manager of the business, to whom the task of supervising the day to day business could be delegated,
- no salary should be paid to any of the individual alleged LLP members
- the committal proceedings commenced by the Reeses in relation to alleged breaches of the undertakings by Gardner should be stayed,
- the claimants' claim form should be served but the proceedings stayed for three months pending mediation, and
- the receivership should take effect until a specified deadline or until the expenses amounted to £10000, at which time the claimants could apply for a continuation or alternative relief, and the receivership and any management and trading arrangement should continue until that application had been disposed of.

LEGAL UPDATE CONTINUED...

Comment

It appears from this judgment that registration as an LLP member is not conclusive of membership, at least for internal purposes such as management and information rights and financial entitlements.

The APP Christmas quiz **Answers:**

1. John Grisham 2. Inner Temple 3. Honolulu, Hawaii 4. Gringotts Wizarding Bank, from the Harry Potter books 5. 1880 6. An accountant 7. Hilary Clinton 8. Ebenezer Scrooge 9. They all studied accounting. 10. Aristotle

APP Arbitration and Mediation Directory

For further information on those listed below please visit the Directory on the APP Website http://www.app.org.uk.

Berry, Christopher	Edwin Coe LLP	Arbitrator	Solicitor
Blackett-Ord, Mark	5 Stone Buildings	Arbitrator	Barrister
Djanogly FCIArb FCA MAE, Daniel	Daniel Djanogly	Arbitrator	Arbitration and Forensic Accounting
Furst, David	Powell & Gilbert LLP	Mediator	Chartered Accountant
Garry, Peter	Keystone Law	Mediator	Solicitor
Haywood, Jennifer	Serle Court	Mediator	Barrister
Haywood, Jennifer	Serle Court	Arbitrator	Barrister
Hennessey, Angela	Angela Hennessey FCA FCIArb	Arbitrator	Chartered Accountant
Howell-Richardson, Phillip	Independent Mediators	Mediator	Mediator and Consultant in ADR
I'Anson Banks, Roderick	Partnership Counsel, 48 Bedford Row	Arbitrator	Barrister
I'Anson Banks, Roderick	Partnership Counsel, 48 Bedford Row	Mediator	Barrister
Jones, Professor Grant	Arbitral Ltd.	Arbitrator	Chartered Accountant, solicitor, barrister (non-practising), New York attorney, licensed insolvency practitioner, arbitrator & special professor of law at Nottingham University
Jump, Graeme	Weightmans LLP	Mediator	Solicitor
Lockhart-Mirams, Andrew	Lockharts	Arbitrator	Solicitor
Maher, Martha	St. John's Chambers	Mediator	Barrister
Ralph, Stephen	Keystone Law	Arbitrator	Solicitor/Insolvency Practitioner
Whittell, Mark	Gunnercooke LLP	Mediator	Solicitor
Williams, Tony	Jomati Consultants LLP	Mediator	Consultant - non-practising solicitor

APP Committee Members

Contributions

Any member who wishes to contribute in any way to the APP by, for example organising, speaking at or suggesting topics for workshops, contributing to the newsletter, participating in the Working Parties, providing a venue for APP events, or suggesting other APP initiatives, should contact the Administrator.

Contact
Jayne Ford
Administrator, APP
116 Watchouse Road
Galleywood, Chelmsford
Essex, CM2 8NH

Tel/Fax: 01245 471 262
Ford@adminapp.fsbusiness.co.uk

www.app.org.uk