

# Guide to: LLP Agreements

Limited liability partnerships (“LLPs”) are a relatively modern creation (the LLP Act is from 2000) and are intended to bridge the gap between traditional partnerships and limited companies.

In a traditional partnership, the partners are all personally liable and the business cannot enter into contracts in its own right. An LLP is treated similarly to a partnership for tax purposes, but the key difference is that it is a legal entity in its own right (like a limited company) and as a general rule, its partners (known as “members”) have no liability for its debts or other obligations.

## What’s the problem?

Parliament assumed that LLPs would almost always have a written agreement between the members, governing how the LLP should be run, how profits should be shared, how new members should be introduced and what should happen if a member leaves. The statutory framework is therefore very brief, with just enough basic default rules to ensure that LLPs can still function without a written agreement, but not covering many of the points that LLP members are likely to want to consider.

Some examples are set out below: –

### **New members**

The LLP Act states that any person may become a member “by and in accordance with an agreement with the existing members”. Without a written agreement, this effectively means that all members must always consent to a new member. While this is often the case anyway, this will need to be overridden if you want to allow new members to join with the consent of, say, 75% of the existing members.

### **Retirement or expulsion of members**

What happens if one of your members is fundamentally dishonest or incompetent and the other members want to remove him? A member can only be removed “in accordance with an agreement with the other members”. A written agreement will normally state the circumstances in which a member can be expelled, and what percentage of the other members are required to approve the expulsion. Without a written agreement, you are stuck with that disruptive member unless he or she leaves voluntarily (which is perhaps unlikely).

A written agreement will normally set out notice provisions governing the retirement of a member. Retirement is often disruptive and you’ll want to ensure you have enough notice to recruit and prepare – you might even want to require retirement to take effect on an account’s year-end to simplify the calculation of any exit or goodwill payments. Without a written agreement, any member can simply retire by giving “reasonable notice” (which is vague and unhelpful).

## Payments to outgoing members

An LLP is different to a limited company in that there are no shares to sell to the other members. When a member leaves, he or she simply surrenders their right to any further share in capital or profits. Without an agreement, an outgoing member is entitled to no payment whatsoever (other than undrawn profits). It is however often the case that you will want outgoing members (or their spouses on death) to receive some compensation for the value in the business that they are surrendering (usually paid by the LLP rather than the members). This often takes the form of a return of capital plus a goodwill payment. A written agreement can set out detailed rules for how this payment will be calculated and when it will be paid.

## Capital and profits

Without a written agreement to the contrary, all members are entitled to share equally in the capital and profits of the LLP. It is common for different members to receive different proportions and a written agreement can set this out.

## Decision making

It is often the case that you will want certain decisions to be subject to a simple majority decision and others to require a higher threshold, or even unanimity. The default statutory provisions state that “any difference arising as to ordinary matters connected with the business of the limited liability partnership may be decided by a majority of the members, but no change may be made in the nature of the business of the limited liability partnership without the consent of all the members.” This is again quite vague (what are “ordinary matters”?) and a written agreement can set out explicitly the different types of decision that require an elevated level of consent.

## Duties of members to each other and the LLP

The statutory framework provides little in the way of duties of members and does not, for example, explicitly state that members must act in good faith to each other and the LLP. A written agreement can set out detailed obligations and duties. This can also help where you want to expel a member as you may be able to demonstrate a material breach of those obligations and duties (which is usually one of the grounds for expulsion).

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