The Practitioner Perspective (1)
Issues that arise in partner & member exits

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What we are going to look at today

- An overview of exiting partners/members.
- How do expulsion and compulsory retirement differ?
- Is compulsory retirement an unfettered right to remove? Do you need to give &/or have reasons?
- Is there a right to be heard?
- How does good faith apply in the context of exits?
- How might *Braganza* principles apply to partner/member exits?
- A quick look at what the legal consequences of an invalid exit might be?

Terminology

- Expulsion cf compulsory retirement of partners or members (nb not employees - the position is very different for employees (not covered in this talk))
- Establish first whether you are dealing with a partner/member or an employee (nb you cannot be a partner and an employee (see *Cowell v Quilter Goodison Co* [1989] IRLR 392 (CA)), nor a member and an employee: see *Reinhard v Ondra LLP* [2016] 2 BCLC 571(Ch) and *Bates van Winkelhof v Clyde & Co LLP* [2014] 1 W.L.R. 2047).
- Distinguish between:
  - a power to terminate for cause (usually called 'a power of expulsion')
  - a power to terminate without cause, but simply on the expiry of a given period of notice (usually called 'compulsory retirement'); usually the service of such a notice needs to be approved in advance by a given majority of members (often 75% or more).

YOU NEED THE POWER!

- Cannot expel or compulsorily retire without an express power in the partnership or LLP agreement to do so (see s.25 PA 1890 and LLP Regulations 2001 Regulation 8 and *Eaton v Caulfield & others* (2011) BCC 386)

- There must express/actually agreement (nb beware drunken train journeys!)

Construing the Clause

- Both an expulsion clause and a compulsory retirement clause are seen as expropriatory
- The Court will approach the clause strictly and, in so far as there is an ambiguity, it will be construed against the person(s) seeking to exercise the power
- But there are sensible limits to the strictness (see *Hitchman v Crouch Butler Savage Associates* (1983) 127 SJ 441).

What if there is no power?

- If there is no power then choices are limited
- Try and negotiate a deal with the partner or member who the firm want to part company with
- If no deal can be done then dissolution (for a partnership) or winding up (for an LLP) may be the only option, BUT this is not to be undertaken lightly. You cannot just re-form without the individual. A full account is needed and there are huge potential consequences and complications (regulation, insurance, staff, bank loans/guarantees called, client retainers etc etc)

Attacking an Expulsion or Compulsory Retirement

- Essentially one can attack an expulsion or compulsory retirement on these bases:
  - the ground is not made out (in the case of expulsion alone); or
  - the proper procedure was not followed; or
  - discrimination (see especially Equality Act 2010, s.44 and 45); or
  - the expulsion or compulsory retirement is vitiated by bad faith or ulterior/improper motive; or
  - (perhaps) decision was irrational/*Wednesbury* unreasonable – see *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661 (discussed further below)

Is the Ground Made Out?

- The clearest type of grounds
- Serious or persistent breach
- Does it warrant expulsion even if it is a breach?
- How might that be carried into legal effect?
- What about poor performance?

A Closer Look at Bad Faith (1)

- Bad faith is not easy to establish (for a good example of bad faith see *Blisset v Daniel* (1853) 10 Hare 493.)
- In *Blisset*, the Court found that the expulsion notice had been "clandestinely obtained", that the notice was given "not having been bona fide exercised on the judgment of all the partners" and that the removal was "to gratify one partner only, and not on the judgment of the other two [partners]". The Court regarded the conduct as being "a fraud upon the Plaintiff"

A Closer Look at Bad Faith (2)

- The Court will not strike down an expulsion or compulsory retirement merely because the judge would have reached a different decision
- Acting honestly, genuinely and for the relevant purpose?
- A possible test is to ask whether the decision reached was one which no reasonable group of partners or members truly acting in the best interests of the partnership or LLP could in good faith have reached (based on *Voaden v Voaden* [unrep 21.2.1997])
- In the context of LLPs perhaps import company law principles – is the power being exercised bona fide for the benefit of /in the best interests of the LLP as a whole? (see by analogy company cases on companies like *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656)

‘Rubber stamping’

- in the recent Canadian case of *Tim Ludwig Professional Corp v BDO Canada LLP* 2016 ONSC 2225 and on appeal 2017 ONCA 292 the court found that the decision to expel has been made earlier by the CEO and that the decision of the Policy Board (who ought to have made the decision whether to expel) was mere rubber stamping of the CEO’s earlier decision
- This was described as the Policy Board abdicating its powers, not a valid determination and a breach of contract
- Whether this is a species of bad faith, a procedural breach, irrationality, or a wholly separate basis of attack is semantics

Braganza

- Impact of *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661?
- Implied term where decision maker has potential conflict of interest.
- Introduces *Wednesbury* style test – potentially both limbs of that test:
  - Process;
  - Outcome.

Wednesbury unreasonableness

Provincial Picture Houses Ltd v Wednesbury Corpn [1948] 1 KB 223*:*

"The court is entitled to investigate the action of the local authority with a view to seeing whether **[1]** they have taken into account matters which they ought not to take into account, or conversely, have refused to take into account or neglected to take into account matters which they ought to take into account. **[2]** Once that question is answered in favour of the local authority, it may still be possible to say that, although the local authority have kept within the four corners of the matters which they ought to consider they have nevertheless come to a conclusion so unreasonable that no reasonable authority could ever have come to it" per Lord Greene MR" [*Numbering added*].

Not all decisions caught

Distinction drawn in some cases between:

- Making an assessment or choosing from a range of options, taking into account the interests of both parties [Caught by 2 stage test] versus
- A simple decision whether or not to exercise an absolute contractual right such as a right to terminate a contract following a breach [Not caught].

See:

•*Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* [2013] EWCA Civ 200

•*Monk v Largo Foods Ltd* [2016] EWHC 1837 (Comm)

•*Shurbanova v Forex Capital Markets Ltd* [2017] EWHC 2133 (QB)

•*Property Action Group Ltd v RBS plc* [2018] 2 BCLC 322

•*UBS AG v Rose Capital Ventures Ltd* [2018] EWHC 3137 (Ch)

- ***Query: how far will the Braganza principles be applied to partnerships and LLPs? In the context of exits or at all?***

Procedure

- If a partnership or LLP wishes to expel or compulsorily retire it must follow the procedures in the agreement with care
- Procedural breach may well mean that the power has not been validly exercised (including necessary notice periods, quorate votes etc)

A right to be heard?

- The orthodox legal position seems to be that, absent a contractual entitlement, there is no right for the 'accused' to respond (see *Green v Howell* [1910] 1 Ch 495 and *Mullins v Laughton* [2003] Ch *250* at para 95) to any allegation for which expulsion /compulsory retirement is proposed
- Nevertheless this approach is questionable and it is usually sensible to offer a managed right of explanation/response to the 'accused':
  - natural justice?
  - the Kangaroo Court – may 'feed' the impression of bad faith or irrationality
  - See by analogy Companies Act 2006 s.168-9

A Closer Focus on Compulsory Retirement

- The weapon of choice for the firm – often recommend to firms to include one in their agreement/deed!
- Often used for under performance
- Do you need a reason? Is it carte blanche?
- Circulating information and documentation before a vote
- Should you give reasons?
- The firm should consider preparing a memorandum with the information/data attached which the decision makers are being invited to consider (allow the ‘target’ partner/member to see this information? And respond?)

What Test Should be Applied?

- Similar to bad faith test, ie no reasonable group of partners or members truly acting in the best interests of the partnership or LLP could in good faith have reached
- Again query the effect of *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661?

What are the Consequences? (1)

- If an expulsion or compulsory retirement is successfully challenged the ‘orthodox’ view of the result is that the action of the firm is invalid and the partner/member is to be put back into the position he would have been had he not been (invalidly) ‘removed’ (see Lindley & Banks on Partnership Edn 20 at para 10-150)
- But there is a strong countervailing view in the recent Canadian case of *Tim Ludwig Professional Corp v BDO Canada LLP* 2016 ONSC 2225 and on appeal 2017 ONCA 292 in which damages (on an expectation and aggravated basis) were awarded

What are the Consequences? (2)

- Damages may also, even if the wrongful act is treated as void, in some circumstances be recoverable for career disruption or loss of reputation (see *Mullins v Laughton* [2003] Ch 250)
- The decision in *IBM UK Holdings Ltd v Dalgleish* [2015] EWHC 389 (Ch) suggests that the wrongful act may be voidable (not void) and therefore is it open to the innocent partner/member to choose whether to accept the wrongful act as terminating the partnership and sue for damages?
- Query would that now work in the light of *Flanagan v Liontrust Investment Partners LLP* [2015] EWHC 2171 (Ch)?

Hopefully we have covered....

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