



21 April 2017

Reform of UK Limited Partnership Law

The Government has been considering updating UK limited partnership law for some time and, following a consultation period, has introduced reforms with a view to simplifying the pre-existing law, reducing uncertainty and administrative costs and burdens, and ensuring that the UK remains an attractive and competitive location for private investment funds in comparison to other jurisdictions.

INTRODUCTION

WHEN DO THE CHANGES TAKE EFFECT?

The reforms were introduced on 6 April, 2017.

WHICH LIMITED PARTNERSHIPS ARE AFFECTED?

The Government's intention was that the reforms should apply only to limited partnerships (both Scottish and English limited partnerships) that are used as private investment funds. Accordingly, the reforms apply only to a limited partnership that is "designated" as a "Private Fund Limited Partnership" ("**PFLP**"). The pre-existing law continues to apply to all other English and Scottish limited partnerships.

A PFLP is a limited partnership that satisfies the following two conditions:

- (i) It is constituted by an agreement in writing; and
- (ii) It is a "collective investment scheme" within the meaning of section 235 of the UK Financial Services Markets Act 2000 ("**FSMA**") but ignoring any exemptions pursuant to section 235 (5) of the FSMA (for example, the "group" exemption).

Most private investment funds (such as private equity and venture capital funds and their related vehicles such co-investment vehicles, and feeder funds) will fulfil these conditions. However, some private investment funds may not satisfy these conditions (for example, if investors have significant influence over their investment fund).

TRIVERS SMITH

IS THE NEW REGIME MANDATORY?

The new regime is not mandatory. A limited partnership that satisfies the conditions to qualify as a PFLP, must apply to the Registrar of Limited Partnerships to be designated as a PFLP in order for the new regime to apply to it. It is open to a limited partnership that satisfies the conditions to be a PFLP to choose not to apply to be designated as a PFLP, in which case the pre-existing limited partnership law will continue to apply to it.

CAN ANY LIMITED PARTNERSHIP THAT QUALIFIES AS A PFLP BE DESIGNATED AS A PFLP?

Any limited partnership that satisfies the conditions to be a PFLP may apply at any time on or after 6 April, 2017 to be designated as a PFLP and, upon being so designated the new regime will apply to it, subject to some transitional rules in the case of a limited partnership that was registered before 6 April, 2017 (discussed below). But once a limited partnership has been designated as a PFLP, it may not elect to terminate its designation as a PFLP.

WHAT CHANGES HAVE BEEN INTRODUCED?

The changes fall into the following five main categories:

"WHITE LIST" ACTIVITIES

Limited partners in private investment funds expect the management of the fund to be in the hands of the partnership's general partner or manager, but it is common for them to be given some involvement either directly or through an advisory committee or similar body. The white list provides a large measure of comfort to limited partners that participating in a number of matters in which they commonly have a role will not jeopardise their limited liability status. Details of the "white list" of activities are set out in the Appendix.

PARTNERSHIP CAPITAL

Under pre-existing law, limited partners were required to contribute capital to a UK limited partnership upon becoming a limited partner, were not permitted to withdraw capital during the life of the partnership and, if they withdrew capital during the life of the partnership, they were liable for the liabilities of the partnership up to the amount of the capital withdrawn. These rules resulted in administrative complexity at the time a limited partner was admitted to the partnership, and to the split of funding provided by a limited partner between a small amount of capital and the balance as loans (enabling a limited partner to be repaid almost all of its funding in the form of the repayment of the loans without creating liability concerns).

These rules have been abolished in relation to a limited partnership designated as a PLFP and there is no requirement for a limited partner in a PLFP to contribute any capital to the partnership at any time. Accordingly, the entire funding to be contributed by a limited partner to a PFLP can be in the form of capital which can be contributed and repaid at any time without affecting the extent of the liability of a limited partner. This removes the need for the customary capital/loan split which should simplify the drafting of limited partnership agreements and remove an aspect of UK limited partnership agreements that was confusing to those who were unfamiliar with the concept.

WINDING UP

Under the pre-existing law, a limited partnership was required to be wound up by its general partner unless a Court ordered otherwise. This caused complexities where there was no general partner (for example, if the general partner had been removed). Under the new regime, subject to any agreement between the partners,

- (a) where a limited partnership designated as a PFLP is dissolved at a time when the partnership has no general partner, the partnership must be wound up by a person appointed by the limited partners who is not a limited partner; and
- (b) where it is dissolved at a time when the partnership has a general partner, the partnership must be wound up by the general partner.

TRAVERS SMITH

The white list (see above) states that appointing a person to wind up a limited partnership where there is no general partner is not to be treated as taking part in the management of the business of a limited partnership, and so will not prejudice the limited liability of the limited partners who participate in that appointment. It would be open to limited partners to agree that, on the dissolution of a limited partnership, the limited partners could appoint a person to wind up the partnership even if there was a general partner. Although the white list does not expressly refer to such a case, presumably limited partners participating in such an appointment would also not be treated as taking part in the management of the partnership business.

This reform will simplify the situation where someone other than the general partner is to wind up a limited partnership that is designated as a PFLP, including where there is no general partner, where the limited partners do not wish to have the general partner winding up the partnership, or the person winding up the limited partnership needs to have appropriate regulatory authorisations or to be an insolvency practitioner.

FILING/ADVERTISING REQUIREMENTS

There is no longer any obligation on the registration of a limited partnership which is designated a PFLP to provide details of the general nature of the partnership business, the amount of capital contributed by each limited partner, or the term of the limited partnership. There is also no longer any obligation in respect of such a partnership to notify any changes to any of these details.

The obligation under UK limited partnership law to advertise in the London Gazette (or Edinburgh Gazette for Scottish limited partnerships) any transfer of a limited partner's interest in the partnership gave rise a number of complications, principally due to concerns that the transfer was not fully effective until the advertisement appeared. But this obligation has now been removed in the case of a limited partnership designated as a PFLP. Additionally, the statutory right of a person dealing with a limited partnership after a change in its limited partners to continue to treat a retiring limited partner as still being a limited partner until he has notice of the change has been removed in the case of a limited partnership designated as a PFLP.

The requirement to advertise in the relevant Gazette if a general partner becomes a limited partner remains, but the time such change takes effect is not affected by when the advertisement appears in the Gazette. However, a person dealing with the limited partnership is entitled to continue to treat the person ceasing to be the general partner as still being the general partner until he has notice of the change. An advertisement in the relevant Gazette is deemed to be notice of the change for these purposes.

MISCELLANEOUS CHANGES

Partners in a limited partnership have been subject to duties to render to other partners accounts and information in relation to the partnership and not to compete with the partnership. These duties are applied by statute unless disapplied by agreement between the partners. Since the role of limited partners in a private fund limited partnership is largely passive and the limited partners may have interests in many other investment funds or investments, some of which may be in competition, these duties are not thought to be appropriate for such limited partners. Therefore, these duties have been commonly disapplied in the partnership agreement of a private investment fund limited partnership.

The reforms recognise this and have exempted limited partners in a limited partnership designated as a PFLP from these duties.

ARE THERE ANY DISADVANTAGES TO BEING DESIGNATED AS A PFLP?

There do not appear to be any commercial disadvantages to be designated as a PFLP. The PFLP regime has introduced considerable clarity as to what limited partners may do without risking the loss of their limited liability status. Additionally, the other reforms have reduced complexity and administrative burdens for limited partnerships designated as PFLPs.

It is unclear whether HMRC's Memorandum of Understanding with the BVCA (the "**MOU**") will apply to PFLPs that do not follow the split loan/capital funding structure, and whether HMRC requires an "all capital"

PFLP to be structured in any particular manner in order to benefit under the MOU. But we assume that this will not give rise to any issues because the MOU currently recognises that limited partnership structures governed by laws other than UK law may not have the split loan/capital structure. Further, it would seem counter-productive if UK tax uncertainty or an unfavourable tax treatment of an all capital structure resulted in PFLPs being unable to move away from the split loan/capital structure.

The use of an all capital structure may result in higher stamp taxes on transfers of limited partner interests in the secondary market, although the precise stamp taxes analysis depends on a number of factors including the nature of the underlying assets, so this would need to be considered on a case-by case basis.

SHOULD EXISTING FUNDS OPT TO BE DESIGNATED AS PFLPS?

An existing limited partnership that qualifies as a PFLP can apply to be designated as a PFLP at any time. This is a simple procedure involving the completion and submission to the Registrar by the general partner of a Form LP8 providing basic details of the limited partnership and a confirmation by the general partner that the limited partnership meets the conditions to be a PFLP. The issue by the Registrar of a certificate of designation is conclusive evidence that the partnership was designated as a PFLP on the date of designation.

It is worth noting that there is a difference between the treatment of partnership capital in the case where an existing limited partnership becomes designated as a PFLP depending on whether the partnership was registered before the date of the introduction of the reforms (6 April, 2017). If the limited partnership was registered before 6 April, 2017 and is designated as a PFLP, capital contributions made prior to it being designated as a PFLP will be covered by the old regime (and so may not be withdrawn and, if withdrawn, results in the limited partner being liable for the debts and obligations of the partnership up to the amount so withdrawn). Any withdrawal of capital by a limited partner that reduces its the capital contributed below the amount contributed at the date of designation as a PFLP will need to be notified to the Registrar. If the limited partnership was registered after 5th April 2017 and became a PFLP, all capital contributed will be covered by the new regime irrespective of when it was contributed.

Some tax advice is likely to be needed on conversion to a PFLP: subject to this, we do not consider that, in legal terms, there are any disadvantages in "converting" to a PFLP. The main issues are likely to be any costs and administrative requirements arising out of the partnership agreement and related documentation. As each fund has its own bespoke documentation, it will be necessary for each fund to review its own documentation in the light of any proposal to become designated as a PFLP to check, in particular, whether any limited partner/advisory committee consents or notifications are required or whether any amendments need to be made to the partnership documentation. An existing partnership with a split loan/capital structure can retain that structure but there may be provisions in the existing documentation that ideally should be altered to reflect the application of the new regime such as any contractual provisions concerning the extent of the liability of limited partners and the permitted activities of limited partners, and the notification, advertisement and winding up provisions.

Therefore, any decision to opt into the new regime is likely to involve some costs and administration so it will be necessary for sponsors/managers to weigh up the advantages against any disadvantages.

SHOULD UK PRIVATE FUND LIMITED PARTNERSHIPS FORMED AFTER 5 APRIL, 2017 BE ESTABLISHED AS PFLPS?

It is a simple procedure to designate a limited partnership as a PFLP at the time of its initial registration. This involves the completion and submission to the Registrar of Limited Partnerships of Form LP7 which provides the limited information required on initial registration and the confirmation by the general partner that the limited partnership meets the conditions to qualify as a PFLP.

Some tax advice is likely to be needed on conversion to a PFLP: subject to this, we do not consider there are any disadvantages in new funds being set up as designated PFLPs. Whether the sponsor of the fund will wish to take advantage of all of the reforms will depend on a number of circumstances. For example, a sponsor may not wish to move from a split loan/capital structure to an all capital structure in view of the familiarity of its investors with the existing documentation and the desire to avoid additional costs. But there may be pressure

from investors worried about their limited liability status to adopt PFLP status and possibly to take more advantage of the opportunities that the reforms offer them to increase their involvement in the fund's affairs.

FURTHER REFORM OF PARTNERSHIP LAW IN THE FUTURE?

The limited partnership law updates discussed in this briefing are welcome but the government has in the past considered a wider reform of UK partnership law. In particular, the Department for Business, Enterprise and Regulatory Reform consulted in 2008 on wide ranging reforms to UK partnership law following the review of partnership law undertaken by the Law Commission and the Scottish Law Commission and summarised in their report in 2003.

That earlier consultation did not result in a radical overhaul of UK partnership law and the proposals were largely shelved in view of the extent of the responses received. However, in its consultation in July, 2015, the Government stated it remained committed to exploring the possibility of allowing funds outside Scotland to elect to have separate legal personality. Further, in its response in March, 2016 to the consultation process the Government stated in the context of its decision not to implement its earlier proposal for the introduction of a procedure for removing PFLPs from the Register of Limited Partnerships that it will explore "wider options" and consider the possibility of consequent proposals in due course.

More recently, in January, 2017, the Department for Business, Energy and Industrial Strategy (the "**BEIS**") issued a Call for Evidence following concerns that limited partnerships (particularly those registered in Scotland) might be being used for criminal activity. In that paper the BEIS focussed mainly on areas that might encourage or inhibit criminal activity such as transparency issues and the "emigration" of limited partnerships. But the paper also referred to the earlier consultations on reforming limited partnership law and stated that "now may be the time to look again to see whether Limited Partnerships need reform". Therefore, it is possible that further reforms affecting limited partnerships will be brought forward.

APPENDIX

"WHITE LIST" ACTIVITIES

- Under UK limited partnership law, a limited partner becomes fully liable for the debts and obligations of the limited partnership if it "takes part in the management of the partnership business". The Limited Partnerships Act 1907 (the "**LPA 1907**") did not state what activities might constitute taking part in the management of a partnership's business and there is little authority as to how those words should be interpreted. This has created uncertainty as to what may amount to "taking part in the management of the business of the partnership" which has caused concerns for limited partners in private investment funds who do not wish to risk their limited partner status.
- The reforms introduce a "white list" of activities that will not be regarded as taking part in the management of the partnership's business for the purposes of the LPA 1907 and so can be undertaken by a limited partner without jeopardising its limited liability. The intention of the government was to provide limited partners with the ability to monitor and assess the performance of investments and to approve actions of the general partner/manager, but not to act on behalf of the partnership or be involved in the selection or making of investments.
- The list is not exhaustive and is not to be regarded as creating adverse presumptions either as to what other activities do not constitute taking part in the management of the business of a PFLP, or as to what activities do or do not constitute taking part in the management of the business of a limited partnership that is not a PFLP. It is worth noting that the reforms do not give limited partners the right to undertake any of the activities on the white list, and so any entitlement of limited partners remains a matter to be agreed in the limited partnership documentation.

The activities on the white list are in some cases drafted in general terms and the following activities on the white list are likely to provide particular comfort to limited partners:

- (i) Appointing or nominating a person to represent a limited partner on a fund's committee. This is particularly relevant in the context of advisory committees which are very common in private equity funds. Authorising such a person to take any action as a member of such a committee that would not involve taking part in management of the partnership's business is also on the white list. Therefore, it remains important to ensure that the members of any such committee do not do things that amount to taking part in management of the business.
- (ii) Taking part in a decision authorising or approving an action proposed to be taken by the person managing the partnership including: the acquisition or disposal by the partnership of all or part of its business or the acquisition of a business, the acquisition or disposal by the partnership of a particular investment or type of investment, or the incurring, extension, variation or discharge of debt or any other obligation by the partnership, or the exercise of the partnership's rights in respect of an investment. Private investment funds commonly give either the advisory committee or limited partners the right to consent to a particular investment or class of investments being made that would otherwise breach an investment restriction or fall outside the investment policy of the fund, or to incur debt or other obligations that would not otherwise be permitted. This makes it clear that participating in such consents or waivers will not prejudice the limited liability of the limited partners.
- (iii) Taking part in a decision as to how the partnership exercises any right as an investor in another collective investment scheme (provided the partnership's exercise of the right would not cause it to be liable for the liabilities of the investee scheme beyond the amount the partnership agreed to contribute to the investee scheme). This is helpful in the case of a feeder fund where the limited partners in the feeder fund are given the right to participate in how the feeder fund exercises its rights in the master fund.
- (iv) Taking part in a decision about the variation of, or waiver of, a term of the partnership agreement or associated documents, whether the general nature of the partnership business should change, or

TRAVERS SMITH

whether the partnership should end or its term be extended, or whether a person should become or cease to be a partner. The advisory committee or limited partners in private investment funds are commonly given powers to agree an extension of the life of the fund or to agree to the winding up of the fund and limited partners commonly have the right to participate in alterations to the limited partnership agreement or other documents such as a management agreement.

- (v) Taking part in a decision regarding changes in the persons responsible for the day-to-day management of the partnership. This reduces uncertainty where limited partners or the advisory committee are involved in any "key person" procedures including approving any replacement "key person" or in a change to the general partner.
- (vi) Reviewing or approving a valuation of the partnership's assets and approving the accounts of the partnership. Approving valuations of the partnership's assets and reviewing accounts is sometimes a role performed by an advisory committee or even by limited partners.
- (vii) Acting, or authorising a representative to act, as a director, member, employee, officer or agent of, or shareholder in, the general partner or the manager or adviser of the partnership, provided this does not involve the limited partner taking part in the management of the partnership business or authorising a representative to take any action that would, if taken by a limited partner, involve taking part in management of the partnership business. This clarifies that the mere fact that a limited partner is, or appoints a representative to be, a director, employee etc. of a person who is involved in managing the partnership's business will not, of itself, prejudice the limited liability of the limited partner. This is intended to provide comfort, in particular, to individuals who are employees etc of the manager/adviser but who also invest in the fund as limited partners.

TRIVERS SMITH

For further information about the issues discussed in this briefing, please contact one of the partners in our Investment Funds group, or your usual contact at Travers Smith.

Travers Smith

April 2017

FOR FURTHER INFORMATION, PLEASE CONTACT

10 Snow Hill
London EC1A 2AL
T: +44 (0) 20 7295 3000
F: +44 (0) 20 7295 3500
www.traverssmith.com



Sam Kay

Partner, Investment Funds

E: sam.kay@traverssmith.com
T: +44 (0) 20 7295 3334



Emily Clark

Partner, Tax

E: emily.clark@traverssmith.com
T: +44 (0) 20 7295 3393



Aaron Stocks

Partner, Investment Funds

E: aaron.stocks@traverssmith.com
T: +44 (0) 20 7295 3319



Elena Rowlands

Partner, Tax

E: elena.rowlands@traverssmith.com
T: +44 (0) 20 7295 3491



Jeremy Elmore

Partner, Investment Funds

E: jeremy.elmore@traverssmith.com
T: +44 (0) 20 7295 3453



Jane Tuckley

Partner, Financial Services & Markets

E: jane.tuckley@traverssmith.com
T: +44 (0) 20 7295 3238



Will Normand

Partner, Investment Funds

E: will.normand@traverssmith.com
T: +44 (0) 20 7295 3169



Tim Lewis

Partner, Financial Services & Markets

E: tim.lewis@traverssmith.com
T: +44 (0) 20 7295 3321



Rick Stratton

Partner, Tax

E: richard.stratton@traverssmith.com
T: +44 (0) 20 7295 3219



Phil Bartram

Partner, Financial Services and Markets

E: phil.bartram@traverssmith.com
T: +44 (0) 20 7295 3437



Anthony McWhirter

Consultant, Investment Funds

E: anthony.mcwhirter@traverssmith.com
T: +44 (0) 20 7295 3629



Stephanie Biggs

Partner, Financial Services & Markets

E: stephanie.biggs@traverssmith.com
T: +44 (0) 20 7295 3433