

The Return of Limited Partnership Law Reform

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SUMMARY

- The UK Government is revisiting proposals for limited partnership law reform to bolster the position of UK limited partnerships as a preferred vehicle for private equity and other funds.
- The proposed changes, if adopted, will modernise limited partnership administration for private funds in a number of respects. They will also provide much-needed clarity on the extent to which limited partners can have consent or consultation rights without jeopardising their limited liability status.
- However, it will be important to ensure that the right fund vehicles do qualify for the new regime and that the proposals do not cause new issues for fund managers.



INTRODUCTION

HM Treasury has published a consultation which outlines proposed changes to UK partnership legislation, with a view to modernising limited partnerships for private equity fund structures. The changes are intended to remove a number of uncertainties and inconveniences in existing UK limited partnership law in order to ensure that the UK limited partnership remains the preferred structure for European private equity and venture capital funds. The changes will be made by a Legislative Reform Order.

The proposed changes would only apply to qualifying, "private fund limited partnerships" and include:

- an ability for Companies House to remove inactive private fund limited partnerships from the register;
- a "white list" of permitted activities for limited partners in private fund limited partnerships which will not amount to taking part in the management of the limited partnership business;
- the removal of:
 - the requirement for limited partners in private funds to make a capital contribution; and
 - the liability of limited partners in private funds to repay capital contributions that have been withdrawn;
- the removal of some of the details that must be specified when a private fund established as a limited partnership is registered (including the amount of capital contributed), and when such details change;
- the removal of the requirement for the advertisement in the Gazette of transfers of limited partnership interests; and
- the removal of partners' duties to render accounts and information and to account for profits made in competing businesses.

Although the consultation refers specifically to private equity and venture capital funds, limited partnerships (in the UK and elsewhere) are also commonly used for investment in a range of other asset classes, including real estate and infrastructure. The proposals have the potential to benefit joint ventures and managers of funds and managed accounts in these asset classes as well, provided the conditions to be treated as a private fund limited partnership can be satisfied.

A number of the changes were first proposed in 2008 as part of a slightly wider-ranging review of limited partnership law. The responses to that consultation led the Government not to proceed with the proposed reforms in full, but they felt that there was support for a number of the key proposals that have now been put forward again.

Meanwhile, over recent years several other jurisdictions such as Jersey and Luxembourg have modified their limited partnership offerings, including by creating different types of limited partnership with and without separate legal personality. These proposals do not go that far and Scottish limited partnerships (which, unlike English limited partnerships, have their own legal personality) will still be needed for "tiered" partnership structures and other situations where separate legal personality is required. HM Treasury has stated that it believes introducing a new form of limited partnership with separate legal personality outside Scotland would be too fundamental a change to the nature of limited partnerships to be dealt with by the Legislative Reform Order process.

WHAT IS A PRIVATE FUND LIMITED PARTNERSHIP?

The new rules will only apply to private fund limited partnerships, with the existing regime staying in place for other limited partnerships. In order to qualify as a private fund limited partnership, a limited partnership would need to be (i) constituted by a written agreement and (ii) a collective investment scheme under the Financial Services and Markets Act 2000, or an arrangement that would be a collective investment scheme were it not that each of the limited partners is a body corporate in the same group as the general partner (the "**group exemption**"). The application for registration as a limited partnership (the current Form LP5) must also request designation as a private fund limited partnership and be accompanied by a solicitor's certificate that the conditions above have been met.

The requirement that a private fund limited partnership is a "collective investment scheme" is based on the assumption that most funds are collective investment schemes. However, depending on their terms, single investor vehicles, master funds and some joint ventures (which are all commonly used in private fund structures) could fall outside the definition of "collective investment scheme". It is difficult to see why a single investor fund or managed account should not be treated under the same regime as classic multi-investor funds as far as limited partnership law is concerned. Indeed, an investor in a "fund for one" may expect more involvement in the partnership's investment activities and is therefore more likely to need the clarity provided by the white list. Unless the definition of private fund limited partnership is widened, fund structuring lawyers will need to take particular care that the relevant entities qualify as collective investment schemes. This may in turn have unhelpful consequences, such as the need to appoint an FCA-authorised operator of any limited partnership that is a collective investment scheme.

Particular care will be important when setting up limited partnerships, given the need to satisfy the conditions from the date of application for registration. It is standard practice to establish a fund limited partnership in advance of the first closing at which external investors are admitted, with the general partner and a single limited partner that is affiliated in some manner to the manager/general partner as the initial partners. Under these proposals, that initial limited partner

would most likely need to be a body corporate in the same group as the general partner.

Limited partnerships that have been registered before the effective date of the new rules, but which meet the conditions for private fund limited partnerships, will be able to benefit from the changes provided they apply to Companies House within 12 months of the date of the Legislative Reform Order. Otherwise, there is no ability to opt in or out of the regime, so fund managers and advisers will need to review existing limited partnerships in good time if they want to take advantage of the new regime.

THE "WHITE LIST" OF PERMITTED ACTIVITIES

A key principle of limited partnership law is that limited partners will lose their limited liability status if they take part in the management of the partnership business. However, there is little case law and no legislative guidance on what constitutes management, leading to uncertainty in practice. This is often problematic for limited partners and their advisers, who want to make sure their status is preserved and for lawyers advising managers where they are required to give legal opinions on limited liability. As such, one of the most useful proposals in the consultation is the introduction of a white list of permitted activities that, if done by a limited partner, would not of themselves cause that limited partner to be regarded as taking part in the management of the partnership business.

The draft list contains various rights that are commonly included in existing partnership agreements, such as limited partners enforcing rights under the partnership agreement, or taking part in a decision about varying the partnership agreement. Also included on the list is the confirmation that a limited partner acting as shareholder or director of the general partner does not constitute the limited partner taking part in the management of the partnership in its capacity as limited partner. This is the existing practice for many joint ventures that are conducted through limited partnerships and for "skin in the game" investments by private fund managers. For all these sorts of situations, the white list will give a more robust legal basis to carry on as normal.

However, the white list would benefit from further review. The draft includes "*consulting or advising a general partner...about the affairs of the partnership, [or] its business*". The concept of limited partners advising the general partner about any of a partnership's affairs could be construed as a modification of the existing general principle rather than as providing guidance as to the boundaries of that principle. This concept would allow for significant expansion of the role of limited partner advisory committees as well as giving limited partners the legal (if not commercial) basis to ask for increasing consent rights.

The draft should also make clear that it is a non-exhaustive list to allow for other investor requirements or features that may arise over time. A "black list" of activities that would constitute management of the partnership business could also be a useful counterpart and provide further clarification.

MODERNISING ADMINISTRATION

Many of the proposed changes reduce the amount of detail required by Companies House, including by removing the requirements for limited partners to make capital contributions and for any capital contributions that are made to be disclosed. While disclosure of capital contributions is theoretically important in ensuring the extent of capital available to creditors is known, in practice, given that fund investors' capital contributions are very small compared to their larger, undisclosed loan commitments, the need to provide this information and keep it updated is a disproportionate administrative burden. Removing the disclosure requirement would also protect investor confidentiality, since even where capital contributions represent a small fraction of total commitments it is still possible to use them to accurately speculate as to the respective economic interests.

The proposals would also correct the anomalous inability of Companies House to remove dissolved limited partnerships from the register, saving third parties from having to order and download the filings to see if a partnership still exists. Removing the need for a Gazette notice on a transfer of a partner interest will also be useful in practice, since the legal transfer is not currently complete until the notice is published, which can take two or three days.

CONCLUSION

Overall, the proposals are a welcome update to current limited partnership law and will make the establishment and administration of limited partnerships in the UK simpler in several key respects. Industry engagement on the proposals will be important, especially on the scope of the white list and the definition of private fund limited partnership. Comments are due by 5 October 2015.

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This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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