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Exploring the scope of liability shield in a limited liability partnership

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Abstract

The biggest benefit of forming a Limited Liability Partnership is the limited legal liability which allows partners to limit their liability while organizing themselves internally as a partnership. Unlike limited partnership or general partnership, a Limited Liability Partnership does not expose its partners to unlimited legal liability. The liability of the Limited Liability Partnership is limited to the amount that the partners contributed to the limited liability partnership for its formation. Using a doctrinal research methodology, this paper analyzed the scope of liability shield in a Limited Liability Partnership. The writers found out that although, Companies and Allied Matters Act, 2020 provided for limited liability of partners in Limited Liability Partnership, its applicability to debts owed to individual partners remains a problem. As such, the writers therefore recommended that there should be a provision in CAMA clearly extending the application of shield of liability to debts owed to individual partners by the Limited Liability Partnership on the ground that the exclusion of such debts from the coverage of limited liability will contravene the legislative intent on the provision of Limited Liability Partnership.

Keywords: Explore, scope, partners, liability shield, limited liability partnership

1. Introduction

Generally, a partnership has no independent corporate legal existence distinct from that of its partners. Partnership law is based on the law of agency with each partner becoming an agent of the others. As such, a partnership could not benefit from the protection of limited liability. As stated by the Court in the case of *Cox v Hickman*,^[1] the liability of one partner for the acts of his co-partners is in truth the liability of a principal for the acts of his agent. Thus, in Nigeria, prior to Companies and Allied Matters Act, 2020^[2], the repealed CAMA 1990 only had provisions for general partnership. That is, it permitted individuals to enter into partnership for business wherein the business entity is not separate from the partners. The implication of this is that partners' assets are unprotected from litigation and all partners share liability for the wrongs committed by one of them. In addition, partnerships are dissolved upon the death or withdrawal of one of the partners, thereby endangering the business. Nevertheless, many have used this business vehicle to float their businesses due to ease of formation, tax reduction and organizational flexibility. Despite these benefits, it remains an area of concern that business entities are not separate from the partners since every partner in a firm is liable jointly with the other partners for all the debts and obligations of the firm incurred while he is a partner and after his death, his estate is also severally liable in a due course of administration for such debts and obligations so far as they remain unsatisfied, subject to the prior payment of his separate debts^[3].

Thus, the continued need for a new legal entity that will have the organizational flexibility and tax status of a partnership with limited liability for its members. Consequently, in 2009, the Lagos State government created the Lagos State Partnership Law allowing for the establishment of Limited Liability Partnership. Although, the Limited Liability Partnership was introduced in Lagos^[4], its application is restricted to the shores of Lagos being a product of state law. As such, key national legislation governing investments did not recognize Limited Liability Partnership^[5] indeed, these ultimately led to the introduction of Limited Liability Partnership in CAMA 2020^[6] which allows partners to limit their liability while organizing themselves internally as a partnership. The provision therefore grant the partners of the Limited Liability Partnership, the flexibility of organizing their internal managerial structure as a partnership based on mutual agreement, while limiting the liability of the partners to the extent of their interests in the partnership, which is akin to the spate legal personality of a company.

2. The Nature of Limited Liability Partnership

The Limited Liability Partnership is an alternative corporate business vehicle that provides the benefits of limited liability but allows the partners, the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement^[7]. Limited Liability Partnership is therefore a body corporate which has legal personality separate from its partners and it combines features of both companies and partnerships. Morse, described Limited Liability Partnership as being essentially a company externally but one which may run with minimal formal legal requirements since there is no formal requirement for a written agreement regulating the partners, perhaps other than a few default rules^[8]. Limited Liability Partnership therefore combines the benefits of a corporate structure such as limited liability companies with those of a partnership structure and may best be described as a hybrid of the general partnership and the registered company. In its capacity as a corporate entity, the Limited Liability Partnership is conferred with a separate legal personality from its partners^[9]. It has perpetual succession and a common seal and can sue and be sued, in its own name, it can continue in existence irrespective of the changes in the constitution of partners and it is capable of entering into contracts and holding property in its own name, organized and operates on the bases of an agreement^[10], without imposing detailed legal and procedural requirement of a joint stock company.

Moreover, as a partnership, all its partners may be involved in management, may share equally in the capital, profits and losses of the firm and may be indemnified for payments made or personal liability borne in the ordinary and proper conduct of the business or for anything necessarily done for the preservation of the firm or its property^[11]. Indeed, the most crucial feature of the limited liability partnership is that it clothes the partners with liability protection, irrespective of their involvement or non-involvement in management.

3. Distinguishing Limited Liability Partnership from other Business Forms

In order to understand the concept of Limited Liability Partnership, it is important to distinguish the concept from other forms of business organizations like company, limited partnership and general partnership.

Limited Liability Partnership unlike a general or limited partnership, has a separate legal personality and thus have perpetual succession^[12]. Another effect of the separate legal personality is that any change in the partners of a Limited Liability Partnership does not affect the existence, rights or liabilities of the Limited Liability Partnership^[13]. The Limited Liability Partnership is also not subjected to rigorous procedural requirements like company^[14]. Limited Liability Partnership is different also from a limited partnership in that unlike the former, at least one of the partners of the latter is a general partner^[15], who is in the ordinary control of day to day business of the firm and has unlimited personal liability besides the general partner, there is also at least one partner who has limited liability for debts and claims arising out of business decisions and activities^[16]. Thus, Limited Liability Partnership combines multiple features of a company with a partnership and enables partners who are actively involved in the business of their partnership to limit their liability for the partnerships debts

and obligations. CAMA also limits the number of partners in a limited partnership to twenty^[17] while a Limited Liability Partnership does not have a maximum.

Furthermore, Limited Liability Partnership is different from a general partnership in the sense that in general partnership, all partners are personally liable for all business debts to the extent they exceed the assets of the partnership vis-a-vis a third party, the liability is joint and several^[18]. The basis for this sort of liability is perhaps the entitlement of each partner to represent as an agent, supervise as a principal and take decisions for the partnership business as well as other partners. In a Limited Liability Partnership, on the other hand, no partner is liable for the actions of any other partner beyond the extent of his share in the Limited Liability Partnership. Under Limited Liability Partnership, the partner enjoys limited liability status, and at the same time, the partners are free to arrange the internal structure of their business flexible, based on a concluded agreement between them^[19]. As such, liability protection is extended to all partners in Limited Liability Partnership while limited partners are stipulated in limited partnership provided they have not been involved in the management of the firm. The concept of not being personally liable therefore protects the innocent partners from liability that arise due to errors, omissions, negligence, incompetence, or malpractice conducted by other partners or by employees who are under the supervision of that other partners^[20]. Thus, this protection given by this Limited Liability Partnership is often depicted as offering 'piece of mind' assurance to innocent partners because this protection is created to avoid a partner's concern that his wealth will diminish due to the negligence or malpractice conducted by a partner not under his/her control or supervision or even by someone that he/she may not even know^[21].

Limited Liability Partnership also like Company has a separate legal personality, while the limited partnership and general partnership do not have separate personality^[22]. The implication of separate personality is that the assets of Limited Liability Partnerships are squarely its own and are shielded from the personal creditors of the partners^[23]. Additionally, partners in the Limited Liability Partnership may trade with it and retain the same rights and obligations against it as any non-partner^[24]. Perhaps, unlike Limited Liability Partnership and Company, limited partnership and general partnership do not have perpetual succession which may hinder them from continuing beyond the life of the general partners^[25]. Indeed, there can be a single member Limited Liability Company^[26], however, in cases of Limited Liability Partnership, there has to be at least two partners in the firm^[27]. And similar to the Company, the assets of the Limited Liability Partnership are shielded from those of the partners. This implies that creditors of individual partners would not be allowed to proceed against the assets of the firm in order to satisfy debts owed by such partner^[28]. Again, Limited Liability Partnership like Company has to maintain such books of account as provided in section 772 of CAMA. The writers are of the opinion that the need for financial declaration is non-discriminatory for the limited liability defence provided by the Limited Liability Partnership. However, such accounting records of a company shall at all times be open to inspection by the officers of the Company^[29]. Moreover, the accounting records of the public company are required to be displayed on its website^[30]. This implies that the financial

whereabouts or information of a public Company unlike a Limited Liability Partnership is open to public dissection. Perhaps, in *Re Magi Capital Partners LLP* ^[31], the Court held that in matters of dissolution, that a Limited Liability Partnership is more akin to a company than a partnership since this involves the winding up of a separate legal entity incorporated under a statute. Again, one can convert from Private Limited Company into Public Limited Company but in the other case, CAMA does not permit the conversion of Limited Liability Partnership into Private Limited Liability Company or Public Limited Liability Company. The writers are therefore of the opinion that this discourages the startups to opt for the option of Limited Liability Partnership on the touchstone that it hinders their interests in the long run.

4. Limited Liability Partnership under CAMA 2020

CAMA introduces the concept of Limited Liability Partnership in section 746 as a body corporate with a legal entity separate from the partners having perpetual succession and whose change in the partners of Limited Liability Partnership does not affect the existence, rights or liabilities of the Limited Liability Partnership. This is aimed at improving the ease of doing business in Nigeria by ensuring that entrepreneurs are able to form partnership and also enjoy reduced personal liability. Thus, by the provision of section 746 CAMA, two or more persons desirous of carrying on a lawful business with a view to profit may form or incorporate a Limited Liability Partnership under the Act as a legal entity separate from that of its partners having perpetual succession. A Limited Liability Partnership is therefore a body corporate formed and incorporated under the CAMA 2020 with separate legal personality from its partners and with perpetual succession. It can sue in its name and can acquire, own, hold and develop or dispose of property whether moveable or immovable, tangible or intangible.

The major purport of having a Limited Liability Partnership is to reduce personal liability on the partners and this is achieved through the recognition of the Limited liability Partnership as a legal personality. At least two partners are required to join in the incorporation of a Limited Liability Partnership ^[32]. There is no maximum, the partners may either be an individual or a body corporate ^[33] Limited Liability Partnership is required to be registered with the Corporate Affairs Commission in the manner prescribed under the CAMA ^[34] with at least two designated partners ^[35], one of whom must be resident in Nigeria. The designated partner will be responsible for fulfilling the compliance obligation under the Act and will be liable to all penalties imposed on the Limited Liability Partnership for any contravention of those provisions ^[36]. By virtue of the provision of section 754(1) CAMA, the mere affixation of Limited Liability Partnership may not be conclusive proof of the status of a Limited Liability Partnership. It is only the production of a certificate of registration that will be conclusive evidence of registration of a Limited Liability Partnership ^[37]. CAMA also provides that foreign limited liability partnerships who wish to carry on business in Nigeria need to be registered under CAMA 2020 before commencing business ^[38]. The Minister by regulation has the power to exempt foreign Limited Liability Partnership from the requirement of incorporation ^[39].

5. Limited Liability of Partners

Limited Liability Partnership provides each of its individual partner protection against personal liability unlike general

partnership firm where they are personally liable for the obligation of the entire partnership. Section 765 CAMA therefore provides that a partner of a Limited Liability Partnership is, for the purpose of the business of the Limited Liability Partnership, the agent of the Limited Liability Partnership but not of other partners. This provision is perhaps the most striking feature of the Nigerian law on Limited Liability Partnership, distinguishing it from a general partnership, wherein a partner is an agent of the firm and also other partners for the purpose of the business of the firm. In a Limited Liability Partnership, the partners have limited personal liabilities ^[40]. Consequently, the liability of a partner will be met out of the assets of the Limited Liability Partnership. Innocent partners of a Limited Liability Partnership are not subject to personal vicarious liability of the Limited Liability Partnership merely because they are its partners. Thus, in the case of *Megadyne Information System v Rosner, Owens & Nunziato* ^[41], the California Court of Appeal stated thus:

While partners are agent of the Limited Liability Partnership, they are not agents of one another and the legislation does not regulate the relationship between the partners. The reason for the omission was the potential conflict between the duty, which the partner owe to the Limited Liability Partnership (as agents) and any duty, which they owe one another. The solution adopted was to impose the former duty as a matter of statutory obligations and to leave it to the partners to address their internal relationship in a separate Limited Liability Partnership agreement.

However, according to CAMA, in instances where the Limited Liability Partnership or any of its partners act with the intent to defraud creditors of the Limited Liability Partnership or any other person, the liability of the Limited Liability Partnership and partners who acted in that manner shall be unlimited for all or any of debts or other liabilities of the Limited Liability Partnership ^[42].

6. Scope of Liability Shield in a Limited Liability Partnership

The fundamental attribute of Limited Liability Partnership is the limited liability that shields the personal assets of the partners from the reach of the creditors of the business entities. When the Limited Liability Partnership is formally registered, the partners of the Limited Liability Partnership are not accountable or personally liable, either directly or indirectly for any liability imposed on the Limited Liability Partnership, just simply because they are the partners. Such liabilities of the Limited Liability Partnership may rise from obligations of the Limited Liability Partnership by way of indemnification, assessment, contribution or otherwise in contract or otherwise ^[43]. In a Limited Liability Partnership, a partner is not personally liable, directly or indirectly for any obligation arising in contract or otherwise, solely by reason of being a partner of the Limited Liability Partnership ^[44].

Notwithstanding the foregoing, the personal liability of a partner for his own wrongful act or omission is not affected and a partner shall not be personally liable for the wrongful act or omission of any other partner of the limited liability partnership ^[45]. The writers are of the view that the above provision of CAMA therefore ensures that the personal assets of a partner would not be attached to the negligent or wrongful act of his co-partners and thus widens the horizon

for the people interested in startups and free them from this fear as opposed to general partnership where partners could be at risk in the event of failure of the business. However, in *Hosking v Marathon Asset Management Limited Liability Partnership* ^[46], it was held that the profit share of a partner can potentially be subject to forfeiture where the partner has breached his fiduciary duties to the partnership. Moreover, section 766 (1) CAMA provides that a Limited Liability Partnership is not bound by anything done by a partner in dealing with a person if the partner in fact has no authority to act for the Limited Liability Partnership in doing a particular thing and that person knows that the partner has no authority, does not know or believe him to be a partner of the limited liability partnership. Indeed, the pertinent question arising from the provision of limited liability is whether limited vicarious liability apply to partners in Limited Liability Partnership when the obligation arising in contract or otherwise are owed to a fellow partner? CAMA is silent on this issue. However, New York Court of Appeal denied the applicability by holding that limited liability did not apply to debts owed to a partner of the firm ^[47]. Conversely, California Court of Appeal held that limited liability barred a claim by one partner against other partners for debts owed by the partnership ^[48]. Thus, whether or not debts owed to partners are protected by limited liability is critically important. Section 767 CAMA provides to the effect that a partner is not personally liable, directly or indirectly for any obligation arising in contract or otherwise, solely by reason of being a partner of the Limited Liability Partnership. Although, the language of this provision does not explicitly deal with debts owed to co- partners, the writer is therefore of the view that the intent is to provide a corporate Limited Liability Company-like liability shield for partners, protecting them from and only from debts, obligations and liabilities of the partnership ^[49]. Thus, liability of partners in Limited Liability Partnership is limited regardless of the status of the creditors. Indeed, one big advantage of a Limited Liability Partnership is that partners are not personally liable and cannot be forced to pay a business debt or liability with personal property or assets. As such, *Ederer v Gusky* ^[50], if widely followed, would defeat the intention of the legislature in providing for Limited Liability Partnership. The law therefore is not intended to preclude personal liability for debts owed to fellow partners. In addition, CAMA explicitly carves out an exception to limited liability by holding partners personally liable for his own wrongful act or omission ^[51]. This suggests that if the legislature intended to preclude debts owed to partners from the coverage of limited liability, it likely would have explicitly stated so in the statute as one of the exception. Perhaps, given the legislative intent to equalize Partners in Limited Liability Partnership with Limited Liability Company members, in terms of liability protection, the writers are therefore of the opinion that an interpretation of the provision of CAMA on limited Liability Partnership to exclude debts owed to Partners by the partnership in a Limited Liability partnership from the coverage of limited liability will contravene the legislative intent.

7. Conclusion and Recommendations

The introduction of Limited Liability Partnership in CAMA, 2020 is quite commendable, it is expected that this new provision will provide coverage to a lot of small and large

enterprises, provide the benefits of a company as well as traditional partnership firms and incite the growth of more partnership groups who intend to place a restriction on the liability to be incurred by the partners. The Limited Liability Partnership provision has also created a leeway for more individuals and professional groups to aggregate their resources and at the same time limiting their liability in furtherance of the business objectives. Although, CAMA provided for limited liability of partners in Limited Liability Partnership, its applicability to debts owed to individual partner's remains a problem. As such, the writers therefore recommend that CAMA should provide for a clearly laid out provision extending the shield of liability to such debts. Again, CAMA provides that shield of liability should not be available to a partner for his own wrongful act or omission ^[52]. The pertinent question is whether such shield of liability will be available to partners who are themselves negligent. The writers are of the opinion that it is assumed that shield of liability will not be available to such partner. Notwithstanding the assumption, the writer recommends that there should be a provision in CAMA clearly excluding the application of liability shield to negligent partners.

8. References

1. 8 HL Cas, 1860, 268.
2. Hereinafter referred to as 'CAMA'
3. *Northampton Regional Livestock Centre Company Ltd v Cowling EWCA Civ*, 2015, 651.
4. Partnership (Amendment) Law of Lagos. 2009.
5. Example CAMA, ISA & Regulations.
6. CAMA, s746.
7. Sachdeva A M & Sachdeva S, 'The Indian LLP Law: Some Concerns for Lawyers and Chartered Accountants', SEBI & Corporate Law, 3. Jaya Sharma C S, 'Nuts & Bolts of the LLP Amendment Bill, 2009, 9(6). 2021' <<https://www.taxguru.in/Company-law/nuts-bolts-llp-amendment-bill-2021.html>> accessed 13 November 2021.
8. Morse G, 'Partnership for the 21st Century-Limited Liability Partnerships and Partnership Law Reform in the United Kingdom', (2002) 2002 Sing J Legal Stud, 465.
9. Ss 746, 756; *Salomon v Salomon AC* 22; *Union Bank of Nigeria PLC v F E Orharhuge*,(2000) 2 NWLR (Pt 1897, 645-495.
10. The mutual rights and duties of the partners within a limited liability partnership are governed by this agreement; CAMA, s767 (1), 769.
11. CAMA, s 763 (5); paragraphs 2.3 and 5 of the Fifteenth Schedule to CAMA 2020.
12. *Ibid*, s 746.
13. *Ibid*.
14. For example it is not required to hold a statutory meetings; CAMA, s 235; a Public Company is required under s 375(6) CAMA to display its accounting record on its website.
15. Richmond D R, 'Law Firm Partners as their Brothers' Keepers', *Kentucky Law Journal*. 2007;96(2):2231-263
16. CAMA, s 795 (3).
17. *Ibid*, s 795 (2).
18. ie each partner may be sued for the full amount of any claim.
19. CAMA, s 762.

20. Dewi Y K, 'Adopting a Limited Liability Partnership for the Legal Profession in the Partnership Law: A Critical Review from Indonesia's Perspective', (2021) 24 (2) Journal of Legal, Ethical and Regulatory Issues, 5.
21. Dewi, art cit, p 5.
22. CAMA, s 746 (1).
23. In a two partner limited liability partnership eg partner A would not have to be overly concerned with the fortunes or misfortunes of partner B. This is in contrast to limited partnerships, which do not have separate personality and are thus exposed to the personal creditors of each of the partners whose creditors may easily attach the assets of the firm. And not being a separate person, the limited partnership cannot own property, transact or sue in its name.
24. CAMA, s 792.
25. Ibid, s 805(2) and 808 and ss 32, 33 and 37 of PA 1890.
26. Ibid, s 18 (2).
27. Ibid, s 748 (1).
28. Ibid, s 746.
29. Ibid, s 375(1).
30. Ibid, s 374.
31. (2003) EWHC 2790.
32. CAMA, s 748.
33. By virtue of section 747 of CAMA, an individual shall be disqualified from joining in the formation of a Limited Liability Partnership if he is of unsound mind and has been so found by a court in Nigeria or elsewhere or an undischarged bankrupt. This means that for an individual to qualify as a partner in a limited liability partnership, he must be of sound mind and have the financial capacity.
34. CAMA, s 753.
35. Ibid, s 749.
36. CAMA, s 750.
37. Ibid, s 754; NNPC v Lutin Investment Ltd & Anor (2006) LPELR 2024 (SC).
38. Ibid, s 788 (1).
39. Ibid, s 788 (2).
40. ie their personal assets cannot be utilized or legally sequestrated in settlement of business debts and liabilities.
41. (2002) WL 31112563.
42. CAMA, s 769(1).
43. Ibid, s 766 (3).
44. Ibid, s 767 (1).
45. Ibid, s 767 (2); In Edlinger v United States (2010) WL 1485951, the liability of a partner to the extent of his interest in the partnership or act or omission was upheld.
46. (2016) EWHC 2418.
47. Ederer V Gursky (2007) 881 NE2d 204.
48. Rappaport v Gelfand (2011) 197 Cal. APP 4th Supp 1213.
49. ie against a partner's alleged vicarious liability for the obligations of the entity.
50. Supra.
51. CAMA, s 767 (2).
52. Ibid, s 767.