

Disputes between members of LLPs – power to expel?

The recent case of *Eaton v Caulfield* illustrates some of the risks created when members of an LLP do not expressly agree their mutual rights and obligations before disputes arise between them.

The Facts

Mr Caulfield, a solicitor, operated a legal recruitment consultancy through his company Caulfield Search Limited. Mr Eaton initially started working with Mr Caulfield on an ad hoc consultancy basis before incorporating his own limited service company, Eaton Search Limited. Mr Eaton then marketed his services as a partner with Mr Caulfield and a Mr Holloway, who also had his own service company.

Upon receiving tax advice from their respective accountants, Mr Caulfield, Mr Eaton and Mr Holloway agreed to incorporate an LLP. They were the designated members. The only terms agreed related to the sharing of the fees and costs of the LLP.

Even before the LLP was established, there were personal issues between Mr Eaton and Mr Caulfield. Mr Eaton felt as though fees were not split fairly. Mr Caulfield attached great importance to his “Caulfield Search brand”, which he believed had a distinct identity and carried substantial goodwill. Mr Caulfield found Mr Eaton’s behaviour irritating and unprofessional and felt as though he harmed the “Caulfield brand”.

The issues between Mr Eaton and Mr Caulfield came to a head following a presentation by Mr Eaton to a firm of solicitors. Mr Caulfield felt as though Mr Eaton had failed to prepare or perform adequately. Mr Eaton then stayed away from the office on what Mr Caulfield believed was the pretext of illness. Upon Mr Eaton’s return to the office he was dismissed by Mr Caulfield and expelled from the LLP.

Over the following days, Mr Eaton returned to the office but was unable to access his email account, which had an auto-reply saying that he had left the LLP. Mr Eaton’s profile was removed from the website, his swipe card was deactivated and he was in effect barred from the office. Mr Eaton brought a claim against Mr Caulfield, Mr Holloway and the LLP alleging that he had been unlawfully expelled and had suffered unfair prejudice.

The Consequences

Mr Caulfield believed that he was entitled to expel Mr Eaton and that he had done so validly and in the best interests of the LLP. Mr Caulfield believed that the “Caulfield brand” was his alone, that he was the sole “equity partner” of the LLP and was responsible for management decisions and that Mr Eaton and Mr Holloway understood and accepted this.

The Court disagreed and found that Mr Eaton had been unlawfully expelled from the LLP. Mr Caulfield, Mr Eaton and Mr Holloway had only discussed the terms of the LLP at a general level. Although Mr Caulfield regarded himself as the boss, and was regarded by Mr Eaton and Mr Holloway as being the more senior member, there was no agreement that he was the sole owner of the LLP or that he could expel Mr Eaton. A carefully drafted LLP agreement would have been required for Mr Caulfield to have the level of control he thought that he had.

Mr Eaton was therefore successful in his claim for unfair prejudice. As there was no express agreement over the ownership of the LLP, he was entitled to one third of the capital surplus of the LLP and to have the LLP wound up.

The Lesson

This case provides a clear reminder of the danger of becoming a member of an LLP without a clear written agreement being in place dealing with the respective rights and obligations of the members. In practice many LLPs will operate on the basis of an understanding about certain matters such as levels of profit shares, but there will be no specific agreement on other crucial matters such as exit. To the extent they are not disapplied by specific agreement of the members, the default provisions in LLP legislation will apply to regulate the situation and this may lead to an outcome which is wholly different from what the parties intended.

Furthermore, different levels of profit share do not automatically translate into different levels of ownership or control. Once a dispute between the members of an LLP arises, any member(s) purporting to exercise a power over any other member(s) must have a clear and legally sustainable basis for asserting that they have that power. Simply assuming that they do can have significant financial and legal consequences for members, even where they believe they are acting in the best interests of the LLP.

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