

**SCOPE AND RESTRICTION ON LIABILITY UNDER THE
LIMITED LIABILITY PARTNERSHIP ACT, 2008**

I. INTRODUCTION

Businesses operate mainly as companies, sole proprietorship and partnerships. To bridge in the gap created in service sector that related to the professionals, in the business structure, the Limited Liability Partnership Act, was enacted in 2008 (for short “LLP Act”) to strengthen new business environment.¹

According to Black’s Law Dictionary, a limited liability partnership (for short “LLP”) is “a partnership in which a partner is not liable for a negligent act committed by another partner or by an employee not under the partner’s supervision.” Thus, a LLP is a form of business organization in which the liability of the partners is limited to the extent of their interest in the partnership, owing to its company type separate legal personality and yet having organizational suppleness and tax treatment of a partnership.² While the LLP itself will be liable to the full extent of its assets, the liability of its members will be limited. Partners in an LLP will not be responsible for another partner’s debts, obligations, or liabilities resulting from negligence, malpractice or misconduct.

The objective of the LLP law is quite clear. It seeks to achieve the principal benefits of both partnership and company as forms of business organization. Primarily, it aims at freeing the mind of a professional from the fear that his personal assets may be attached for the negligent and other wrongful acts of his copartners, over which he has no control.³ This, the law does, by providing the shield of limited liability by way of a separate legal personality.⁴ In other words, it enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.⁵ The other objective is to allow to the LLP the same organization liveness and freedom from compliances as are available to a general partnership, thus calling for a new form of corporate governance.⁶ Additionally, an LLP is also conferred the same status as a general partnership for tax purposes, by following the - flow-through system, so that the tax incidence does not act as a disincentive against this form of organization, i.e. LLP is an alternative corporate business form that combines the advantages of the limited liability of a company and flexibility of a partnership into a single form of organization.⁷

II. WHAT ARE THE PROS AND CONS OF A PARTNER BEING AN AGENT?

A. Meaning of Agent

¹Article on ‘Limited Liability Partnership’ available at <http://www.legalserviceindia.com/article/1122-Limited-Liability-Partnership.html>

²FAQs by Ministry of Corporate Affairs available at http://www.mca.gov.in/LLP/nature_llp_faq.html

³Hamilton, –Registered Limited Liability Partnership: Present at the Birth (Nearly) 66 University of Colorado Law Review 1065, 1066.

⁴ Maurice, –A New Personal Limited Liability Shield for General Partners: But Not All Partners are Treated the Same! 43 Gonzaga Law Review 369.

⁵ The Latest Hybrid in India: Limited Liability Partnership! SOAS Centre for International Studies and Diplomacy Conference on 20-21 July 2007, available at <http://www.cisd.soas.ac.uk/Editor/assets/vikramadityasinghmalik.pdf>

⁶Limited Liability Partnership: An Insight available at [icai.org/resource file/9996417-421.pdf](http://icai.org/resource_file/9996417-421.pdf)

⁷FAQs by Ministry of Corporate Affairs available at http://www.mca.gov.in/LLP/nature_llp_faq.html

1. According to Black Law Dictionary:

“an agent is one who represents and acts for another under the contract or relation of agency”.

2. Section 26 of Limited Liability Partnership Act, 2008 -***Partner as agent***

“Every 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.”

3. Section 18 of Partnership Act, 1932 -***Partner to be agent of the firm***

“Subject to the provisions of this Act, a partner is the agent of the firm for the purpose of the business of the firm.”

4. Section 182 of Indian Contract Act, 1872-***"Agent" and "principal" defined or to represent another***

“An "agent" is a person employed to do any act for another, who is so in dealings with third persons. The person for whom such act is done, or represented, is called the "principal".”

An agent is a person who has the capacity to bind his principal by his acts done within the authority granted by the principal. In case an agent is beyond his authority and the third party dealing with the agents knows that the agent is acting beyond authority or his person to believe that he is acting so, and still deals with such agent, he cannot bind the principal for the acts of such agent. This is the broad principle of agency enunciated under the Indian Contract Act, 1872. Partners serve as general agents of the partnership. In the normal course of business, a partner has the capacity to represent partnership and undertake business transaction on its behalf. Accordingly, the partners may bind the partnership through their actions. However, the LLP Act categorically states that every partner is the agent of the LLP, but not of other partners and this agency is restricted for the purpose of business of LLP only. Hence, a partner is not liable for a negligent or wrongful acts committed by another partner or by an employee not under the partner's supervision. Unlike traditional partnership, a partner of LLP will not be regarded as an agent of other partners of LLP. In other words, if there is a wrong doing or gross negligence by any one of the partners, the liability of such acts shall not traverse to the other partners. Thus, this feature of LLP categorically provides that the partners do not have any mutual agency relationship inter-se in an LLP. Liability of partners shall be limited except in the case of unauthorized acts, fraud and negligence.⁸

The LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. In an LLP, all partners have a form of limited liability for each individual's protection within the partnership, similar to that of the shareholders of a corporation. However, unlike corporate shareholders, the partners have

⁸Article on 'Analysis of Limited Liability Partnership Act' available at <http://www.legalservicesindia.com/article/article/analysis-of-limited-liability-partnership-act-470-1.html>

the right to manage the business directly. In an LLP one partner is not responsible or liable for another partner's misconduct or negligence;⁹ this is an important difference from that of an unlimited partnership.

The LLP can continue its existence irrespective of changes in partners and is capable of entering into contracts and holding property in its own name.¹⁰

Mutual rights and duties of the partners are managed by an LLP agreement which is an agreement between partners or between partners and the LLP. However in the absence of such agreement the LLP would be governed by the framework provided in Schedule 1 of Limited Liability Partnership Act, 2008 which describes the matters relating to mutual rights and duties of partners of the LLP and of the LLP and its partners.¹¹

B. Pros:¹²

- Low cost of formation.
- Easy to establish.
- Easy to manage and run.
- Enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.
- LLP and its partners are distinct from each other. Partners aren't liable for acts of partners.¹³ In other words, LLP partners don't share fiduciary duties to each other but have fiduciary duties to the LLP as they act as agents of the LLP. In the case of an unlimited partnership, each individual partner is the agent not only of the partnership, but also directly of each and every other partner. This therefore creates what might be seen as a "web" of agency relations (and therefore fiduciary duties) between the partners and the partnership. In contrast, in the case of the LLP, the situation is more a "hub-and-spoke" arrangement, whereby each member is merely the agent of the corporate LLP.
- No partner is liable for the wrongful act or omission of any other partner of LLP, but the partner will be personally liable for his own wrongful act or omission.
- Though the LLP has a separate entity, the Partner who acts as an agent can represent and act on behalf of the LLP in the absence of co-partners.
- No exposure to personal assets of the partners except in case of fraud.¹⁴
- Professionals can form multi disciplinary professional LLP, which wasn't allowed earlier.

⁹Section 27 of Limited Liability Partnership Act, 2008

¹⁰FAQs of Ministry of Ministry of Corporate Affairs. Available at http://www.mca.gov.in/LLP/nature_llp_faq.html

¹¹ Limited Liability Partnership authored by Tax Guru. Available at <http://taxguru.in/corporate-law/limited-liability-partnershipllp2.html#sthash.XD2g908h.dpuf>

¹²FAQs of Ministry of Corporate Affairs available at http://www.mca.gov.in/LLP/nature_llp_faq.html

¹³Section 3 of Limited Liability Partnership Act, 2008

¹⁴Section 30 of Limited Liability Partnership Act, 2008

- Apart from that, the benefit accrued under the aspect of the partner in a limited liability who is fulfilling the role of an agent under the same, is that the ownership of different types of asset accumulated by the partner, while working under the firm as its agent, can be easily transferred to the firm since the procedure of transfer shall be limited by the scope provided under the LLP Agreement only. This renders the transferability of owner easy. This transfer may also arise when a partner resigns from his role under the LLP and his assets accumulated by the partner, while working under the firm as its agent, ought to be transferred to the firm or to the other partners or to any other real or artificial person as provided under the LLP Agreement and then too this transfer shall be in accordance with the procedure provided under the LLP Agreement only.

C. Cons:

- Any act of the partner without the other partner, may bind the LLP.
- Under some cases, liability may extend to personal assets of partners.
- The liability of the LLP and partners who are found to have acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

III. NATURE, EXTENT AND LIMITATION OF LIABILITIES UNDER THE LLP ACT

1. Section 26 - Partner as agent:

“Every 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.”

2. Section 27 - Extent of liability of limited liability partnership:

1. *“A limited liability partnership is not bound by anything done by a partner in dealing with a person if—*
 - a. *the partner in fact has no authority to act for the limited liability partnership in doing a particular act; and*
 - b. *the person knows that he has no authority or does not know or believe him to be a partner of the limited liability partnership.*
2. *The limited liability partnership is liable if a partner of a limited liability partnership is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the limited liability partnership or with its authority.*
3. *An obligation of the limited liability partnership whether arising in contract or otherwise, shall be solely the obligation of the limited liability partnership.*
4. *The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership.”*

3. Section 28 - Extent of liability of partner:

1. *“A partner is not personally liable, directly or indirectly for an obligation referred to in sub-section (3) of section 27 solely by reason of being a partner of the limited liability partnership.*
2. *The provisions of sub-section (3) of section 27 and sub-section (1) of this section shall not affect the personal liability of a partner for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the limited liability partnership.”*

A. Nature

- LLP is an alternative corporate business form that gives the benefit of limited liability of a company and the flexibility of a partnership.
- The LLP is a separate legal entity, is liable to the full extent of its assets but the liability of the partners is limited to their agreed contribution in the LLP. Under the LLP structure, liability of the partner is limited to his agreed contribution.¹⁵
- The internal governance structure of a company is regulated by a contractual agreement between the partners.¹⁶
- No partner is liable on account of the independent or unauthorized acts of other partners, thus allowing individual partners to be shielded from joint liability created by another partner’s wrongful acts or misconduct.¹⁷

B. Extent

- A partner is not personally liable to LLP solely by reason of being a partner of LLP. However there shall be personal liability arising for the wrongful acts or omission of a partner, but not for the wrongful acts or omissions of any other partner of LLP.
- LLP is not bound by anything done by a partner dealing with a person if:¹⁸
 - ✓ The partner in fact has no authority to act for the LLP in doing a particular act; and
 - ✓ The person knows that he has no authority or does not know or believe him to be a partner of a LLP.
- An LLP 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 LLP in doing a particular act and the person knows that he has no authority or does not know or believe him to be a partner of the LLP.¹⁹ In other words, the crux is that if the third party deals with a person knowing that such person does not have authority to the subject or that such person are not at all a partner of the LLP while he is representing so, then such person cannot make LLP liable for the deal. This is based on the principle of agency under the Indian Contract Act, 1872.

¹⁵Section 3 of Limited Liability Partnership Act, 2008

¹⁶Section 23 of Limited Liability Partnership Act, 2008

¹⁷Section 27 of Limited Liability Partnership Act, 2008

¹⁸Section 27 of Limited Liability Partnership Act, 2008

- ✓ When the third party deliberately deals with a partner without authority/ a person who is not a partner but is acting on behalf of LLP, and later on holds LLP liable for the deal then a LLP may not be held liable for the acts of the partner towards the third party.
 - ✓ When the third party does not know the position of the partner incapacitating him to make the deal but the party is presumed to know such a fact because of it being an open fact LLP being mentioned in the documents registered with the registrar which are accessible for public inspection – in this position an LLP may not be held liable.
 - ✓ When the third party doesn't know the position of the partner incapacitating him to make the deal and the party is not in a position to know such facts about LLP, then LLP may be held liable for the acts of such partner.
- An obligation of the LLP whether arising in contract or otherwise, is solely the obligation of LLP.²⁰The liabilities of the LLP shall be met out of the property of the LLP.²¹
 - The LLP Act provides for the minimum of two partners to carry on LLP.²² If at any time the number of partners of a LLP is reduced below two and the LLP carries on business for more than six (6) months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period.
 - The partnership firm would be liable to the full extent of its assets, while the partner would be liable only to the extent of their agreed contribution. But these protections do not affect the personal liability of a partner for his own wrongful act or omission.²³
 - Liability of partners shall be limited except in case of unauthorized acts, fraud and negligence.²⁴ But a partner shall not be personally liable for the wrongful acts or omission of any other partner.²⁵
 - It also seeks to provide that LLP shall not be liable for any wrongful act or omission by a partner in the course of the business of the LLP within his authority.

C. First Schedule of the LLP Act:

According to First Schedule, all the partners of an LLP are entitled to share equally in the capital, profits and losses of the LLP. This provision is similar to Section 13(b) of the Indian Partnership Act.

In ***M. Govinda & Co. v. Commissioner of I.T., Andhra Pradesh***,²⁶ the Hon'ble Supreme Court has held that where partners have agreed to share the profits in certain proportions, the presumption is that the losses are also to be shared in like proportions. Where in a partnership the profits are shared in a certain proportion, the fair inference is that losses are to be

²⁰Section 27(4) of Limited Liability Partnership Act, 2008

²¹Section 28(3) of Limited Liability Partnership Act, 2008

²²Section 11(1) of Limited Liability Partnership Act, 2008

²³ Section 28(2) of Limited Liability Partnership Act, 2008

²⁴Section 30 of Limited Liability Partnership Act, 2008

²⁵ Section 28(2) of Limited Liability Partnership Act, 2008

²⁶AIR 1975 SC 2284

shared in the same proportion in the absence of a contract to the contrary; the onus of proving that they are not liable for the loss lies on persons who so assert.²⁷

First Schedule also keeps an eye on unethical and anti-competitive conducts of partners. It mandates that each partner shall render true accounts and full information of all things affecting the LLP to any partner or his legal representatives. This provision intends that partners remain truthful and honest in their dealings. In *Corpus Juris Secundum*²⁸, the nature of obligations between partners is so described:

“Except to the extent that they are regulated by the express contract between them, the status, duties and obligations of partners as to each other are implied and enforced by the law. Generally speaking, the relationship of partnership is fiduciary in character, and imposes on the members of the firm the duty of dealing with one another in the utmost good faith and with respect to partnership affairs.”

D. Partner by Holding Out

The LLP Act also provides that any person (not being a partner in any LLP), who by words spoken or written or by conduct, represents himself, or knowingly permits himself to be represented to be a partner in a LLP (known as ‘partner by Holding out’) is liable to any person who has on the faith of any such representation given credit to the LLP, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.²⁹

It has further been provided that where any credit is received by the LLP as a result of such representation, the LLP shall, without prejudice to the liability of the person so representing himself or represented to be a partner, be liable to the extent of credit received by it or any financial benefit derived thereon.

The provisions have also been made in the Act to provide that where after a partner's death the business is continued in the same LLP name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.³⁰

E. Limitation

Limited liability means an obligation of the LLP whether arising in contract or otherwise, is solely the obligation of the LLP. The liabilities of the LLP shall be met out of the property of the LLP, thus the claim can be made against a LLP to the full extent of its assets.

- Partners will not be jointly and severally liable either in contract or in tort for the acts, omission of any other partner simply by the virtue of their partnership of LLP. This is because, every partner of LLP is its agent but partners are not agents for each other, and thus joint and several liabilities is avoided. However, in cases of fraud or gross negligence there is unlimited liability on the partner of a LLP to the extent of his personal assets and not of other partners.
- The liability of partners of a LLP, if it is wound up is limited.
- Liability of partners under LLP is restricted to the extent of the money contributed to the firm by such partners.

²⁷*K. PitchaiahChettiar v. G. SubramaniamChettiar*, AIR 1934 Mad 494

²⁸*Corpus Juris Secundum*, vol. 36, paragraph 76

²⁹Section 29 of Limited Liability Partnership Act, 2008

³⁰Section 29 (Proviso) of Limited Liability Partnership Act, 2008

- LLP provides each of its individual partner's protection against personal liability for certain partnership liability unlike partnership firm where they are personally liable for the obligations of the entire partnership.

IV. WHEN CAN A LIMITED LIABILITY BECOME UNLIMITED?

LLP, is a partnership where one partner is not liable for the negligent acts of another partner or an employee, who do not act under his supervision. However, it is pertinent to note that fraud is an exception to the limited liability rule.³¹

A. Section 30 of LLP Act: Unlimited liability in case of fraud

"In the event of an act carried out by a limited liability partnership, or any of its partners, with intent to defraud creditors of the limited liability partnership or any other person, or for any fraudulent purpose, the liability of the limited liability partnership and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the limited liability partnership:

Provided that in case any such act is carried out by a partner, the limited liability partnership is liable to the same extent as the partner unless it is established by the limited liability partnership that such act was without the knowledge or the authority of the limited liability partnership....

Thus, if LLP or any of its partners carry out an act, with intent to:

- ✓ defraud creditors of the LLP or any other person or
- ✓ for any fraudulent purpose,

The liability of the LLP and the partners who acted as such shall be unlimited for all or any of the debts or other liabilities of the LLP. So, in case of fraud the protective cap of limited liability becomes ineffective. In case of a fraud carried out by a partner, the LLP is also liable to the same extent as the partner. The only way for LLP to avoid its liability is to establish that LLP was not aware of the fraud carried out by the partner. So, the burden of proof to prove that the fraudulent act of partner was not within the knowledge of the LLP is on LLP.

B. Penalty

Section 30 - Unlimited liability in case of fraud

(2) Where any business is carried on with such intent or for such purpose as mentioned in sub-section (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

(3) Where a limited liability partnership or any partner or designated partner or employee of such limited liability partnership has conducted the affairs of the limited liability partnership in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the limited liability partnership and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct:

³¹ Section 30 of Limited Liability Partnership Act, 2008

Provided that such limited liability partnership shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the limited liability partnership.”

Thus, each person who was knowingly a party to the fraud business shall be punished

- with imprisonment for a term which may extend to two years and
- with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.³²

It is not enough that law forgives the wrong doer with criminal liability only. Where an LLP or any partner or designated partner or employee of such LLP has conducted the affairs of the LLP in a fraudulent manner, then without prejudice to the criminal liability which may arise under any law applicable at that time, the LLP and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.³³ Here also in order to avoid liability the LLP has to prove that fraudulent act of its partner, designated partner or employee was not within its knowledge.

It is not like that the guilty partner would make LLP liable and absolve himself for the loss caused to the LLP. Every partner shall indemnify the LLP for any loss caused to it by his fraud in the conduct of the business of the LLP.³⁴

Thus Section 30 of LLP seeks to provide for unlimited liability of the LLP and its partners in case LLP or any of its partners carry out an act with intent to defraud creditors of the LLP or any other person or if they carry out an act for any fraudulent purposes. LLP is liable to the same extent as the partners unless it is established by the LLP that such an act was without the knowledge or the authority of the LLP. Further, such LLP or the partner shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.

V. CONCLUSION

With the liberalization and globalization of Indian economy, the LLP, as an alternate mode of carrying business, will encourage joint ventures and would make Indian service sectors globally competitive. The onset of concept of LLP is an apt step in commercial sector of India. LLP structure has enabled small and medium professional enterprises (such as accounting and law firms) and family partnerships to expand as they have been able to admit outsiders with capital or skill as partners. The hybrid structure of LLP will facilitate entrepreneurs, service providers and professionals to organize and operate in an innovative and efficient manner for effectively competing in the global market.³⁵

An LLP is preferred because it is specifically-designed to limit malpractice claims against uninvolved partners. Each partner is liable only for debts and obligations created as a result of his or her own negligence, malpractice or misconduct, or negligence, malpractice or misconduct by any person under that partner’s direct supervision.

It is an alternative corporate business vehicle that gives the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a traditional partnership. Partners are exempted from liability only if they are innocent not when they are intentionally indulging in wrong acts. In cases of fraud the wrong doer partner as well as the LLP is unlimitedly liable, if the partner’s act was within the knowledge of LLP.

³² Ibid

³³ Section 30 (3) of Limited Liability Partnership Act, 2008

³⁴Section 30 of Limited Liability Partnership Act, 2008; First Schedule of Limited Liability Partnership Act, 2008

³⁵FAQs on LLP in Ministry of Corporate Affairs, available at http://www.mca.gov.in/LLP/nature_llp_faq.html

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The LLP acts as an engine of growth for economic development of the country and would lead to the growth of professional services in the country.³⁶

³⁶Analysis on Limited Liability Partnership Act available at <http://www.legalservicesindia.com/article/article/analysis-of-limited-liability-partnership-act-470-1.html>