

# REGULATORY COMPETITION IN PARTNERSHIP LAW

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**Abstract** Regulatory competition in company law has been extensively debated in the last few decades, but it has rarely been discussed whether there could also be regulatory competition in partnership law. This article fills this gap. It addresses the partnership law of the US, the UK, Germany, and France, and presents empirical data on the different types of partnerships and companies established in these jurisdictions. The main focus is on the use of a limited liability partnership (LLP) outside its country of origin. It is also considered whether some regulatory competition can take place in the law of limited partnerships.

## I. INTRODUCTION

Regulatory competition in company law has been extensively debated in the last few decades. It started in the US, where Delaware has managed to attract almost half of the companies listed at the NYSE. In particular, American academics have discussed whether the appeal of Delaware's corporate law presents a 'race to the bottom' or a 'race to the top'.<sup>1</sup> In the EU the 1998 decision of the European Court of Justice in *Centros* opened the door to 'forum shopping' in company law.<sup>2</sup> Since this decision private companies from continental Europe increasingly incorporate in the UK<sup>3</sup> and the academic literature has analysed the reasons and consequences of this development in some detail.<sup>4</sup>

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<sup>1</sup> See, eg L A Bebchuk, A Cohen and A Ferrell, 'Does the Evidence Favor State Competition in Corporate Law?' (2002) 90 *California Law Review* 1775; R Romano, *The Genius of American Corporate Law* (AEI Press, Washington, 1993); see also III C 3 below.

<sup>2</sup> For the case law of the ECJ see III C 1 a below.

<sup>3</sup> See M Becht, C Mayer and H F Wagner, 'Where Do Firms Incorporate?, Deregulation and the Cost of Entry' (2008) 14 *Journal of Corporate Finance* 241.

<sup>4</sup> See eg J Armour, 'Who Should Make Corporate Law? EC Legislation versus Regulatory Competition' (2005) 58 *CLP* 369; M Gelter, 'The Structure of Regulatory Competition in European Corporate Law' (2005) 5 *Journal of Corporate Law Studies* 247; M Siems, 'Convergence, Competition, Centros and Conflicts of Law: European Company Law in the 21st Century' (2002) 27 *European Law Review* 47.

In contrast to this, the question whether there could also be regulatory competition in partnership law in the EU has received little attention.<sup>5</sup> This article fills this gap. Since the discussion about regulatory competition in company law started in the United States Part II analyses whether there is also regulatory competition in US partnership law. Part III turns to the situation in the European Union, and Part IV concludes. Both for the US and EU, the main forms of partnership and the actual use of these forms are presented. That forms of company may function as alternatives ('vertical competition') is also addressed. Subsequently, both parts analyse whether partnerships can choose the legal form of another (US/Member) State and how law-makers react (or may react) to this development ('horizontal competition').

The main focus of this article is on the use of the limited liability partnership (LLP) outside its country of origin. This situation is particularly interesting because partnership law has usually been distinguished from company law by the personal liability of the participants. To a lesser extent, whether regulatory competition takes place in the law of limited partnerships will also be discussed. There is some evidence that publicly held private partnerships and private equity funds prefer certain jurisdictions. However, this is often not a result of differences in partnership law but is driven by other legal and non-legal factors.<sup>6</sup>

## II. THE SITUATION IN THE US

In the US there are general partnerships, limited partnerships, limited liability partnerships (LLPs) and, in some states, limited liability limited partnerships (LLLPs). Furthermore, types of companies may be used instead of an LLP or LLLP. In reality, some competition in partnership law can be observed, although the development is less pronounced than in US corporate law.

### *A. Types of Partnerships*

US partnership law is state law. However, most US states follow the two model acts drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL), namely the Revised Uniform Partnership Act of 1994 (RUPA) (as amended)<sup>7</sup> and the (Revised) Uniform Limited Partnership Act of 1916 (ULPA) (as amended).<sup>8</sup>

<sup>5</sup> There is some literature dealing with the specific question of whether the British LLP may be used by German law firms; see eg M Siems, 'Tschüss Deutschland nun auch im Personengesellschaftsrecht?—Deutsche und französische Rechtsanwaltskanzleien als LLPs' (2008) *Zeitschrift für Vergleichende Rechtswissenschaft* 107 60–78; H Schnittker, *Gesellschafts- und steuerrechtliche Behandlung einer englischen Limited Liability Partnership mit Verwaltungssitz in Deutschland* (Schmidt, Köln, 2006).

<sup>6</sup> See II C 3, III B 1 below.

<sup>7</sup> List of state laws at [http://www.nccusl.org/Update/uniformact\\_factsheets/uniformacts-fs-upa9497.asp](http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upa9497.asp) and <http://www.law.cornell.edu/uniform/vol7.html#partn>.

<sup>8</sup> List of state laws at [http://www.nccusl.org/Update/uniformact\\_factsheets/uniformacts-fs-ulpa.asp](http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ulpa.asp).

At common law, partnerships were just considered aggregates of the individual partners.<sup>9</sup> According to RUPA, however, entities distinct from their partners; therefore they may conduct business, acquire, hold, and dispose of property, and sue and be sued in their own name.<sup>10</sup> In this respect partnerships are similar to companies, but their taxation is different. Whereas companies are taxed at corporate and at shareholder level ('double taxation'), a partnership is a 'flow-through' entity, which means that there is a single level of taxation at the level of the partners.<sup>11</sup>

The relationship among partners is primarily governed by the partnership agreement, whereas the applicable partnership act only provides default rules. The main distinctions between the different types of partnerships concern the liability of the partners. The general partnership can be created without formalities for any purpose. However, partners are vicariously liable for the debts and obligations of the partnership, although the creditor first has to exhaust the partnerships assets.<sup>12</sup>

A limited partnership requires the filing of a certificate with the competent state authority.<sup>13</sup> It must have at least one general and one limited partner. The general partners are fully liable for all obligations of the partnership, whereas the limited partners are usually shielded from liability. Traditionally, the law on limited partnerships required that the limited partners did not take any part in the active management of the partnership. Gradually, however, the scope of the activities that limited partners can undertake has been extended.<sup>14</sup> In particular this is the case in Delaware, where limited partners can be allowed to vote on matters such as dissolutions, sales of assets, mergers, and admission or removal of a general partner; furthermore they can consult with and advise the general partner, and be a control person of the general partner.<sup>15</sup>

Limited liability partnerships (LLPs) go further. They were first introduced in Texas in 1991 because a number of business scandals made lawyers worry about personal liability and lobby for more protection than under general partnership law.<sup>16</sup> In 1996 the RUPA was amended to include provisions on the LLP, and by 2001 all fifty states adopted some form of LLP.<sup>17</sup> The establishment of an LLP requires state filing.<sup>18</sup> Moreover, LLPs have to file an annual report and pay annual fees.<sup>19</sup>

<sup>9</sup> See J William Callison, 'Federalism, Regulatory Competition, and the Limited Liability Movement: The Coyote Howled and the Herd Stampeded' (2001) 26 *Journal of Corporation Law* 951, 974.

<sup>10</sup> RUPA s 201(a).

<sup>11</sup> But see Internal Revenue Code § 7704 (exception for publicly traded limited partnerships).

<sup>12</sup> RUPA ss 306, 307.

<sup>13</sup> ULP s 201.

<sup>14</sup> LE Ribstein, 'The Evolving Partnership' (2001) 26 *Journal of Corporation Law* 819, 843.

<sup>15</sup> Delaware Revised Uniform Partnership Act § 17–303.

<sup>16</sup> On the history see eg R W Hamilton 'Professional Partnerships in the United States' (2001) 26 *Journal of Corporation Law* 1045, 1056–1058.

<sup>17</sup> See eg C G Bishop, 'The Limited Liability Partnership Amendments to the Uniform Partnership Act (1994)' (1997) 53 *Business Lawyer* 101.

<sup>18</sup> RUPA s 201(b).

<sup>19</sup> RUPA s 1003(c).

The law on LLPs varies in a number of instances between states. In some states only professionals who are required to have licenses to do business are allowed to form an LLP.<sup>20</sup> Filing fees are flat fees in some states and in others they depend on the number of partners.<sup>21</sup> In some states there are additional safeguards for the protection of creditors. For instance, there may be an obligation to provide a personal guarantee, to establish an escrow account or to contract a special insurance for the LLP.<sup>22</sup> Most importantly, there are differences in the scope of liability protection. In one third of US states partners are only protected for claims arising from torts committed by other partners (eg claims arising in malpractice, malfeasance or other professional negligence). The remaining states have extended the scope of a partner's liability shield to other claims.<sup>23</sup> This is also the approach of the amended version of RUPA, which states that:

(a)n obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner (...).<sup>24</sup>

However, even in these states the protection against liability is not unlimited. Partners remain personally liable for their own negligent or wrongful acts and that of persons under their direct supervision and control.<sup>25</sup> There are also further distinctions between states and between professions. In some states partners are liable for tax and wage liabilities.<sup>26</sup> And in some states certain professions (such as lawyers) have to comply with additional conditions to enjoy limited liability.<sup>27</sup>

Fifteen US states have also provided the possibility of transforming a limited partnership into a limited liability limited partnership (LLLP).<sup>28</sup> The ULPA is indifferent about the availability of this new form of partnership. However, for the states which provide the LLLP it is recommended that the

<sup>20</sup> TE Rutledge, 'To Boldly Go Where You Have Not Been Told You May Go: LLCs, LLPs, and LLLPs in Interstate Transactions' (2006) 58 *Baylor Law Review* 205, 227 (New York, California, Nevada and Oregon).

<sup>21</sup> See C R Goforth, 'An Overview of Organizational and Ownership Options Available to Agricultural Enterprises, Part I', (National AgLaw Center Publications, 2002), available at [http://www.nationalaglawcenter.org/assets/articles/goforth\\_ownership1.pdf](http://www.nationalaglawcenter.org/assets/articles/goforth_ownership1.pdf) at 38.

<sup>22</sup> Goforth *ibid*; M Hallweger, 'Limited Liability Partnership—Eine Gesellschaftsform für USAmerikanische Anwaltszusammenschlüsse und ihre Haftungsfragen Protection' [1998] *Neue Zeitschrift für Gesellschaftsrecht (NZG)* 531, 534.

<sup>23</sup> See eg Ribstein (n 14) 838; T E Rutledge, 'Limited Liability (or Not): Reflections on the Holy Grail' (2006) 51 *South Dakota Law Review* 417, 423–424.

<sup>24</sup> RUPA 1996 s 306(c).

<sup>25</sup> See eg Rutledge (n 23) 435–436, 447; Hallweger (n 22) 536.

<sup>26</sup> See Rutledge (n 23) 443–444.

<sup>27</sup> See R R Keatinge, 'Are Professional Partnerships Really Partnerships? LLPs, LLCs and PCs—Vicarious Liability Protections and Limitations' 60 *Consumer Finance Law Quarterly Report* 518; Rutledge (n 23) 447.

<sup>28</sup> See Callison (n 9) 953.

general partner's liability shall be limited, similar to the liability of the partner of an LLP.<sup>29</sup> Thus, the LLLP keeps the distinction between general and limited partners, although, in general, neither of them will be liable for the obligations of the partnership.

### *B. Vertical Competition: Alternative Forms of Doing Business*

In two important aspects S-Corporations, LLCs and PLLCs are similar to LLPs. On the one hand, the shareholders/partners are usually not personally liable. On the other hand, LLPs and these companies are not taxed at the entity level, thus avoiding the double taxation of corporate tax law.

The S-Corporation was introduced in 1958. Its name derives from the fact that it is taxed as a partnership according to Subchapter S of the Internal Revenue Code. *Inter alia*, this requires that the company must not have more than 100 shareholders and more than one class of stock.<sup>30</sup> Moreover, general state corporate law is applicable. This is different for the limited liability company (LLC). In the mid 1970s the oil and gas company Hamilton Brothers lobbied for a new and flexible form of company, which can be managed either by managers or the members themselves. It first succeeded in Wyoming in 1977.<sup>31</sup> By 1996 LLC statutes had been enacted in all US states, and in the same year the NCCUSL also drafted a Uniform Limited Liability Company Act (ULLCA).<sup>32</sup> Moreover, in 1988 the Internal Revenue Service decided that the LLC may be classified as a partnership for tax purposes.<sup>33</sup> Usually, this will be the case unless the LLC elects to be taxed as a corporation.

In general, the members of an LLC enjoy limited liability. Similar to the provision in RUPA,<sup>34</sup> the UCCLA states that:

[t]he debts, obligations, or other liabilities of a limited liability company, whether arising in contract, tort, or otherwise: (1) are solely the debts, obligations, or other liabilities of the company; and (2) do not become the debts, obligations, or other liabilities of a member or manager solely by reason of the member acting as a member or manager acting as a manager.<sup>35</sup>

Here too, however, this does not mean that the members of an LLC will escape liability in all cases. In particular, they may remain liable for their own misconduct.<sup>36</sup> The official comments to the ULLCA mention the examples of a personal guarantee, unauthorized agency and defamation.<sup>37</sup>

<sup>29</sup> ULPA s 404(c).

<sup>30</sup> For details see Internal Revenue Code s 1361.

<sup>31</sup> On the history of the LLC see eg Hamilton (n 16) 1058–1060.

<sup>32</sup> See also [http://www.nccusl.org/update/uniformact\\_why/uniformacts\\_why-ullca.asp](http://www.nccusl.org/update/uniformact_why/uniformacts_why-ullca.asp) for the 2006 reform of the ULLCA.

<sup>33</sup> Rev Proc 88-44, 1988-2 CB 634; Rev Rul 88-76, 1988-2 CB 360.

<sup>34</sup> See II B above.

<sup>35</sup> ULLCA s 304(a).

<sup>36</sup> See eg S Saab Fortney, 'Seeking Shelter in the Minefield of Unintended Consequences—The Traps of Limited Liability Law Firms' (1997) 54 Washington and Lee Law Review 717, 728.

<sup>37</sup> See UCCLA s 304 (Comment).

Professions such as lawyers, auditors, physicians, dentists and psychologists had often not been allowed to establish a business corporation or a (simple) LLC because corporations had not been regarded as being able to fulfil the professional's license requirements. To some extent, this was—and in some states still is—addressed by the possibility of establishing a professional association.<sup>38</sup> Moreover, since the late 1960s more and more states have allowed professionals to set up a professional corporation (PC). These PCs are usually treated as ordinary companies. In some states some professions (such as lawyers) remain, however, personally liable within defined limits.<sup>39</sup> More recently, many US states have also provided the form of a professional limited liability company (PLLC). The main difference is that a PC is usually a separate taxable entity, whereas the PLLC is taxed as a partnership.<sup>40</sup>

By and large, businesses and professionals can choose between general partnerships, limited partnerships, LLPs, (P)LLCs, and (professional) corporations. Exceptions are that in New York, California, Nevada and Oregon only professionals have the right to establish an LLP and that in California legal or accounting LLCs are inadmissible.<sup>41</sup> Apart from these special cases, it is fair to assume that some 'vertical competition'<sup>42</sup> between these different types of partnership and company takes place. Table 1 presents data on the

Table 1. *Types of entities formed in 2006*<sup>43</sup>

State	Business and Professional Corporations	Limited Liability Companies (LLCs)	Limited Partnerships	Limited Liability Partnerships (LLPs)	Limited Liability Limited Partnerships (LLLPs)
California	96,278	61,911	4,033	419	data n.a.
Delaware	33,449	97,508	9,901	114	139
Florida	157,310	123,055	1,543	492	Included in LP
Illinois	42,315	23,804	603	188	Included in LLP
New York	76,474	48,451	560	319	n.a.
Texas	36,473	58,288	16,355	5,310	n.a.

<sup>38</sup> See Hamilton (n 16) 1048–1049.

<sup>39</sup> See R W Hillman, 'Organizational Choices of Professional Service Firms: An Empirical Study' (2003) 58 *Business Lawyer* 1387, 1392–1393.

<sup>40</sup> See Rutledge (n 20) 217; Hamilton (n 16) 1051–52.

<sup>41</sup> See Rutledge (n 20) 227.

<sup>42</sup> For the distinction between vertical and horizontal competition see L E Ribstein, 'The Evolving Partnership' (2001) 26 *Journal of Corporation Law* 819.

<sup>43</sup> Source: International Association of Commercial Administrators (IACA), Annual Report of the Jurisdictions, available at [http://www.iaca.org/downloads/AnnualReports/2007\\_IACA\\_AR.pdf](http://www.iaca.org/downloads/AnnualReports/2007_IACA_AR.pdf). See also JC Dammann and M Schündeln, 'Where are Limited Liability Companies Formed? An Empirical Analysis', University of Texas Law, Law and Economics Research Paper No 126 (2008), available at <http://ssrn.com/abstract=1126257>. Note that in New York and Texas the legal form of the LLP is not available.

five most populated US states (California, Texas, New York, Florida, Illinois) plus Delaware, which deserves special attention.

First, one can observe that in four out of six states the number of new business and professional corporations is higher than the number of new LLCs. Unfortunately, it is not disclosed how many corporations are S-Corporations because only these corporations enjoy a comparable tax treatment to LLCs. Secondly, it can be noted that there are considerably more new companies than partnerships. In particular, there are between 11 (Texas) and 250 (Florida) more new LLCs than LLPs. Thirdly, the limited partnership is more popular than the LLP and LLLP in all states, although the latter types of partnership provide a more extensive liability shield.

Focussing on law firms the picture changes. Hillman collected data on all 65,000 US law firms in 2002: 48 per cent of them are professional corporations or associations, 26 per cent are general partnerships, 10 per cent sole proprietorships, 9 per cent LLPs and 7 per cent LLCs. The preference for LLPs strengthens as firms grow in size.<sup>44</sup> Similarly, Romley and Talley found that larger firms are more likely to be transformed into LLPs or LLCs. This was based on longitudinal data from 1993 to 1999, following the introduction of the LLP and the extension of LLC laws to professional firms in many states.<sup>45</sup>

There is also some general data available on how the different types of companies and partnerships developed over time. Ribstein and Keatinge report the development between 1996 and 2004: The number of LLCs increased from 221,000 to 1,270,000 and the number of S-Corporations increased from 2,290,900 to 3,523,900 while the number of other corporations declined from 2,240,800 to 2,066,806.<sup>46</sup> Hamilton provides information on the change of newly established entities from 1999 to 2000 in Texas: the number of new LLCs increased by 34 per cent and the number of new LLPs by 15 per cent, whereas the number of new professional corporations decreased by 3 per cent.<sup>47</sup>

A number of reasons can be brought forward as to why a particular type of company or partnership is chosen. LLPs and LLCs are similar in many respects. For existing general or limited partnerships it may, however, be easier to switch to an LLP than to an LLC. This concerns the initial choice as well as the ongoing operations because the LLP allows 'access [to] the existing network of general partnership case law and forms while opting into limited liability'.<sup>48</sup> Furthermore, the LLP may be more suitable for smaller, less

<sup>44</sup> Hillman (n 39) 1399.

<sup>45</sup> J Romley and E L Talley 'Uncorporated Professionals' USC Law and Economics Research Paper No 04-22 (2004), available at <http://ssrn.com/abstract=587982>.

<sup>46</sup> L E Ribstein and R R Keatinge, *Ribstein and Keatinge on Limited Liability Companies* (2nd edn, Thomson/West, St Paul, 2005) §2: 1.

<sup>47</sup> Hamilton (n 16) 1053–1054.

<sup>48</sup> Ribstein (n 42) 833.

formal firms because the partnership-style default rules of LLP laws may be more appropriate than the corporate-style default rules applicable to LLCs.<sup>49</sup>

Conversely, depending on the applicable state law, the LLC may have the advantage that the extent of liability protection may go further than with the LLP.<sup>50</sup> Entities which operate in several states may also prefer the LLC because LLCs are now accepted in all US states. Therefore the members of an LLC can be sure that they enjoy protection against liability, whereas this is a matter of debate for LLPs which operate in a state that does not offer full protection.<sup>51</sup>

Finally, businesses and professionals need to examine the specific fee and tax structure of the state in question. Hamilton nicely illustrates the complexity of these rules in Texas. Having presented the data on newly established entities, he explains that:

The figures set forth above are skewed by local rules applicable only in Texas. For example, corporations and LLCs in Texas are subject to an annual state franchise tax that is equal to 0.25 per cent of net taxable capital plus 4.5 per cent of 'net taxable earned surplus.' While Texas has no formal personal income tax at the state level, the second portion of the franchise tax is certainly a form of income tax in disguise. However, the franchise tax is applicable only to corporations and limited liability companies but not to professional corporations, professional associations, or limited liability partnerships. LLPs nevertheless, are subject to a different tax that itself may be relatively onerous: An annual fee of \$200 per year for each partner that is protected by the liability shield. Professional corporations and professional associations, while providing similar shields against liability, are subject to neither the franchise tax nor the LLP annual membership fee. These arbitrary tax rules have a direct impact on basic decisions. For a law firm with one hundred partners in Texas, for example, a professional corporation or professional association entails a significant tax saving as contrasted with either an LLP or LLC.(. . .).<sup>52</sup>

### *C. Horizontal Competition: Choice Between US States*

Horizontal regulatory competition occurs when someone establishes a company or partnership in a particular legal system only because that country's law is positive for him, thus influencing legal developments. Three requirements are necessary to make this competition work:<sup>53</sup> First, according to the rules of private international law, it must, in principle be possible for companies or partnerships to be able to freely choose a particular legal system

<sup>49</sup> A R Bromberg and L E Ribstein, *Limited Liability Partnership, The Revised Uniform Partnership Act and the Uniform Limited Partnership Act (2001)* (Apen, Austin, 2008) § 1.04(c),(d).

<sup>50</sup> See II A and B above.

<sup>52</sup> Hamilton (n 16) 1054.

<sup>53</sup> For these requirements see M Siems, *Convergence in Shareholder Law* (CUP, Cambridge, 2008) 297–335.

<sup>51</sup> See II C I below.



(‘supply’). Secondly, companies or partnerships must let themselves be ‘attracted’ by a legal system, given free choice (‘demand’). Thirdly, it has to be clarified whether and how legislators react to these conditions of competition.

### 1. Supply

In the US companies can freely choose their place of incorporation. In practice this has mainly led to a market for reincorporations. A mere change in corporate domicile is not possible in the US. However, the merger of an existing company with a newly-founded shell company in the target state does not pose significant problems and does not lead to taxation of hidden reserves. According to the internal affairs doctrine the applicable law is usually that of the place of incorporation, although in states such as California and New York there are special rules for pseudo-foreign companies.<sup>54</sup>

Partnership law is more complex. There are only a few differences among US states in general partnership law. Conversely, with respect to limited partnerships, LLPs and LLLPs, a number of variations exist, for instance, regarding the permitted activities of the limited partner and the scope of liability protection.<sup>55</sup> Thus, regulatory competition is conceivable.

Like companies, partnerships can freely choose the place of registration and thus the applicable law regarding their internal affairs.<sup>56</sup> ULPA and RUPA explicitly state that the law under which a foreign limited (liability) partnership is formed governs the relations among the partners, between the partners and the partnership, and the liability of partners for an obligation of the partnership.<sup>57</sup> However, there is an exception if the foreign state does not permit the business in question to be conducted by a limited (liability) partnership.<sup>58</sup> This is relevant in states such as New York and California wherein only professionals (and not ordinary business) can establish an LLP.<sup>59</sup>

A limited partnership has to apply for a certificate of authority to conduct business in a foreign state.<sup>60</sup> For LLPs the procedure is slightly easier because only a statement of foreign qualification has to be filed.<sup>61</sup> Neither the certificate of authority nor the statement of qualification can simply be denied because of a difference between foreign law and the law under which the partnership was formed.<sup>62</sup> Moreover, the effect of the failure to have a

<sup>54</sup> See generally Siems (n 53) 299; L E Ribstein and E A O’Hara, ‘Corporations and the Market for Law’ [2008] *University of Illinois Law Review* 661, 716–721 (for the constitutional protection of the internal affairs doctrine).

<sup>55</sup> See II A above.

<sup>56</sup> See Ribstein and O’Hara (n 54) 664 and 702; Rutledge (n 20) 221.

<sup>57</sup> ULPA s 901(a); RUPA s 1101(a).

<sup>58</sup> ULPA s 901(c); RUPA s 1101(c).

<sup>59</sup> See II A above.

<sup>61</sup> RUPA s 1102. For differences between states see Hallweger (n 22) 535.

<sup>62</sup> ULPA s 901(b); RUPA s 1101(b).

<sup>60</sup> ULPA s 902

certificate or to qualify does not impair the validity of contracts of the partnership or waive the limitations of liability.<sup>63</sup>

A partnership may also decide to change its place of registration from one state to another. Details depend on the specific state laws. In Delaware the procedure is quite straightforward. A partnership which plans a conversion from a non-Delaware LLP to a Delaware LLP has to file three simple documents—a certificate of conversion, a statement of partnership existence and a statement of qualification—to the Delaware Division of Corporations. The total costs are US \$400.<sup>64</sup>

Despite all, the role of the local rules should not be underestimated. Regardless of the place of registration, a professional partnership has to comply with the ethical rules in each state in which it operates.<sup>65</sup> In some cases this may lead to vicarious liability for the firm's debt.<sup>66</sup> Moreover, it is possible that differences between the extent of liability protection lower the level of protection. According to Rutledge, a full shield LLP in a partial shield jurisdiction will likely afford its partners only partial liability. And an LLLP in a non-LLLP jurisdiction will likely not afford its general partners limited liability.<sup>67</sup>

Overall, there is therefore a mixture between 'type A' and 'type B' regulatory competition.<sup>68</sup> 'Type A' regulatory competition means that persons can only choose a particular legal system if they also establish residence there. Thus, there is a 'bundling effect' because the residence decision has to balance all relevant legal and non-legal factors. Conversely, 'type B' regulatory competition is stronger because persons can engage in 'cherry picking' by taking residence in one state and choosing the law of another one. In partnership law there is some 'type B' regulatory competition because, as a starting point, other US states have to accept the place of registration and thus the applicable law. However, so far as local rules play a role, there is only 'type A' regulatory competition.

## 2. Demand

For public corporations it is well established that companies feel 'attracted' to a particular legal system, because 40 per cent of all firms listed on the NYSE are incorporated in Delaware.<sup>69</sup> There is also some discussion evolving for

<sup>63</sup> ULP s 907(c),(d); RUPA s 1103(b),(c).

<sup>64</sup> See [http://corp.delaware.gov/Non-DE %20LLP%20to% 20DE%20LLP.pdf](http://corp.delaware.gov/Non-DE%20LLP%20to%20DE%20LLP.pdf). For the conversion from a Delaware LLP to a non-Delaware entity see <http://corp.delaware.gov/DE%20LLP%20to%20Non-DE %20Entity.pdf>.

<sup>65</sup> See Ribstein (n 42) 834.

<sup>66</sup> See Ribstein and O'Hara (n 54) 695; Bromberg and Ribstein (n 49) § 7.04(b).

<sup>67</sup> Rutledge, (n 20) (2006).

<sup>68</sup> See K Heine and W Kerber, 'European Corporate Laws, Regulatory Competition and Path Dependence' (2002) 13 *European Journal of Law and Economics* 47, 51; Siems (n 53) 303.

<sup>69</sup> See L A Bebchuk and A Cohen, 'Firms' Decisions Where to Incorporate' (2003) 46 *Journal of Law and Economics* 383, 391.

LLCs. This is of particular interest here because LLCs and LLPs may often be functional equivalents.

According to Ribstein and O'Hara, 'Florida has emerged the clear leader, with Delaware far behind, and several states bunched not far behind Delaware'.<sup>70</sup> In all states but Delaware and Florida LLC formations roughly reflect business activity in the state. Ribstein and O'Hara assume that this preference for the home state is the result of a simple cost-benefit analysis. For public corporations the costs of forum shopping are only marginal whereas for smaller companies the costs are likely to be high compared to the value of the firm. In public corporations the benefits of choosing a particular law are also higher because they are more likely to be subject to shareholder suits and because using the same standards as other companies facilitates trading of their shares.<sup>71</sup> With respect to Florida's attractiveness for LLCs, Ribstein and O'Hara indicate that the 'Florida bar has used the LLC form to exploit these advantages in a number of ways, including by making it tax friendly, reducing fees, and crafting the statute to fit estate planning and asset protection needs'. Moreover, they emphasize Florida's general strength in attracting investment, which, for instance, is the result of 'a thriving small service business in the real estate, tourist, and retirement industries'.<sup>72</sup>

These results are contested by Dammann and Schündeln. Although, in general, they too find that most LLCs incorporate locally, they ascertain that 46.4 per cent of all LLCs with more than 1000 employees and 26.6 per cent of all LLCs with 500 and 999 employees are established elsewhere. Moreover, Dammann and Schündeln identify Delaware as the preferred jurisdiction because 42 per cent of all LLCs that are formed outside their principal place of business (PPB) are incorporated in Delaware. As the main reason for this preference they find 'statistically significant evidence that firms are less likely to be formed in their PPB state if the latter offers relatively lenient rules on managerial liability or if it allows companies to be dissolved via a less than unanimous resolution of the members'.<sup>73</sup>

In contrast to public corporations and LLCs it has hardly been discussed whether partnerships choose a particular legal system. Table 2 presents data on the number of limited partnerships, LLPs and LLLPs in the five most populated US states plus Delaware.

Apart from the absolute figures, this table also reports the number of partnerships per 100,000 inhabitants. These figures provide some indication of whether a state attracts partnerships whose main business is elsewhere. To be sure, the number of partnerships per capita is not a perfect proxy for pseudo-foreign partnerships because it can also reflect the general business climate of a particular state. However, at least to some extent, the figures for Delaware are likely to be driven by Delaware's law. Delaware dominates the market for

<sup>70</sup> Ribstein and O'Hara (n 54) 703.

<sup>72</sup> *ibid* 704.

<sup>71</sup> *ibid*.

<sup>73</sup> Dammann and Schündeln (n 43).

Table 2. Partnerships formed in 2006<sup>74</sup>

	LPs	LLPs	LLLPs	Population	LPs per 100,000	LLPs per 100,000	LLLPs per 100,000
California	4,033	419	n.a.	33,871,648	11.91	1.24	n.a.
Delaware	9,901	114	139	783,600	1263.53	14.55	17.74
Florida	1,543	492	Incl. in LP	15,982,378	9.65	3.08	n.a.
Illinois	603	188	Incl. in LLP	12,419,293	4.86	1.51	n.a.
New York	560	319	n.a.	18,976,457	2.95	1.68	n.a.
Texas	16,355	5,310	n.a.	20,851,820	78.43	25.47	n.a.

publicly held or ‘master’ limited partnerships. In particular, every ‘master’ limited partnership traded on the NYSE, AMEX or NASDAQ is a Delaware limited partnership.<sup>75</sup> On the one hand, this can be a result of Delaware’s partnership law. The Delaware Revised Uniform Limited Partnership Act emphasizes that maximum effect shall be given to the principle of freedom of contract,<sup>76</sup> and it allows limited partners to be granted some powers to supervise their investment.<sup>77</sup> On the other hand, it is likely that the general virtues of Delaware also play role. In particular, there are presumably some network effects at work because the specialized and qualified bar, bench and legislation of Delaware can guarantee practice-oriented application of the law.<sup>78</sup>

With respect to the other states one can speculate about some specific points. In New York and California only professionals can form an LLP,<sup>79</sup> which may have contributed to its relatively low use. The higher figure for Florida is presumably not specifically related to its LLP law but, rather, acts mainly as a reflection of the good general business climate, because the LLC is more popular than the LLP by a greater margin in Florida than elsewhere.<sup>80</sup> The popularity of the LLP in Texas may result from the fact that there the LLP has a longer tradition than in other states.<sup>81</sup> Illinois was the last of the six states of this table to provide a full shield against liability for partners of an LLP,<sup>82</sup> thus possibly explaining the relative low number of LLPs.

It is also interesting to examine whether partnerships from states which still provide only partial liability shields ‘emigrate’ to full shield states. The final column of Table 3 shows that in states with a full shield liability three times

<sup>74</sup> Sources: IACA (n 43) (for the number of partnerships); <http://www.census.gov/> (for the population data) Note that the legal form of the LLLP is not available in California, Florida, Illinois, New York, and Texas.

<sup>75</sup> See Ribstein and O’Hara (n 54) 705; J Goodgame, ‘Master Limited Partnership Governance’ (2005) 60 *Business Lawyer* 471, 485–486.

<sup>76</sup> DRULPA, § 17-1101(c).

<sup>77</sup> For corporate law see Romano (n 1); Siems (n 53) 319.

<sup>79</sup> See II.A above.

<sup>80</sup> See II.B above.

<sup>81</sup> See II.A above.

<sup>82</sup> See Illinois Partnership Act 205/15(b) (as amended in 2002).

<sup>77</sup> See II.A above.

<sup>80</sup> See II.B above.

Table 3. *Partial and full shield LLPs formed in 2006*<sup>83</sup>

	Number of LLPs	Population	LLPs per 100,000
Partial shield states (data for 10 states available)	1,204	61,138,415	2.373
Full shield states (data for 31 states available)	11,511	192,771,064	7.312
Full shield states without Texas (30 states)	6,201	171,919,244	6.726

more LLPs are established than in partial shield states. The difference between these two groups is, however, not statistically significant at the 5 per cent level.<sup>84</sup> Moreover, it is beyond the scope of this article to examine empirically where the ‘missing LLPs’ of the partial shield states may be found. Although it is possible that at least some of them have established an LLP in another state, it is also likely that many of them keep the faith to their home state but incorporate as an S-Corporation or an LLC.

### 3. *Reaction of law-makers*

The reactions of law-makers in the market for publicly held corporations are well discussed. Delaware’s legislature depends on the firms that have only their registered seat there. It receives from them a one-off incorporation fee and a periodic franchise tax. Since this financial advantage has—by contrast with bigger states—a significant effect on the state budget, there is a credible commitment that the law will remain business-friendly. Other smaller states may have a similar incentive. However, it is sometimes stated that today Delaware’s position is now so dominant that other states do not really compete with it.<sup>85</sup>

For LLCs it is assumed that legislators would not be competing for franchise fees.<sup>86</sup> However, there is some evidence that lawyers have successfully influenced law-makers, thus leading to some regulatory competition.<sup>87</sup> The outcome of this development is, on the one hand, that the state LLC statutes

<sup>83</sup> Sources: IACA (n 43) (for the data on partnerships); <http://www.census.gov/> (for the population data); Sandra K Miller and James J Tucker III, *Limit Practice Liability*, September, 2005, available at <https://www.aicpa.org/PUBS/jofa/sep2005/miller.doc> (for the information about partial and full shield states).

<sup>84</sup> The results of Student’s t-test are t: 1.341; p: 0.187 (with Texas); t: 1.213; p: 0.232 (without Texas). This means that there is a probability of 18.7 per cent (with Texas) and 23.2 per cent.

<sup>85</sup> L A Bebchuk and A Hamdani, ‘Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters’ (2002) 112 *Yale Law Journal* 553.

<sup>86</sup> Ribstein (n 42) 833.

<sup>87</sup> See C R Goforth, ‘The Rise of the Limited Liability Company: Evidence of a Race Between the States, But Heading Where?’ (1995) 45 *Syracuse Law Review* 1193; Ribstein (n 42) 833.

have evolved towards some uniformity.<sup>88</sup> On the other hand, the 1999 and 2002 revisions of the Florida LLC Act indicate that the law is becoming more flexible and business friendly by reducing the protection of creditors.<sup>89</sup>

The reactions of law-makers in partnership law show some similarity to these developments. Delaware dominates the market for limited partnerships, likewise the market for public corporations. The flexible structure of the law is presumably a key factor in Delaware's success. The state LLP laws also drive towards some uniformity, similar to the law applicable to the LLC. For instance, this can be seen in the trend towards full shield liability, which has the advantage that the partners can reduce their monitoring costs,<sup>90</sup> whereas creditors lose protection.

The fees that all but general partnerships have to pay may be some incentive to attract foreign partnerships. However, the major difference with public corporations is that most partnerships (with the exception of master limited partnerships) are considerably smaller than public corporations. It is therefore unlikely that partnership fees do (or will) play a major role for the budget of any state. Rather the main driving forces are presumably the entities themselves<sup>91</sup> and the networks (such as lawyers)<sup>92</sup> that may benefit from an attractive partnership law.

#### *D. Conclusion*

US partnership law—and the law on related forms of company—has seen a dynamic development in the last few decades. At least to some extent, this has led to both vertical and horizontal competition. In most states businesses and professions can freely choose between a number of entity forms, such as LLPs, LLCs and different types of corporations. Moreover, states themselves care about the attractiveness of their partnership law. This is most noticeable for the law on limited partnerships in Delaware and one can also identify some regulatory competition for the 'best' LLP law.

Can a similar development be expected in Europe? An analogy may be tempting because in Europe too there are general, limited and (occasionally) limited liability partnerships as well as limited liability companies as potential substitutes. However, the differences between the US and the EU also need to be analysed. For instance, on the one hand, the trend towards limited liability

<sup>88</sup> See B H Kobayashi and L E Ribstein, 'Evolution and Spontaneous Uniformity: Evidence from the Evolution of the Limited Liability Company' (1996) 34 *Economic Inquiry* 464.

<sup>89</sup> See Ribstein and Ohara (n 54) 704.

<sup>90</sup> For this rationale see L E Ribstein, 'Limited Liability and Theories of the Corporation' (1991) 50 *Modern Law Review* 80, 101. For further references see J A McCahery 'Introduction' in J A McCahery, T Raaijmakers, and E P M Vermeulen, *The Governance of Close Corporations and Partnerships—US and European Perspectives* (OUP, Oxford, 2004) 4–5.

<sup>91</sup> For the LLP in Texas see II A above.

<sup>92</sup> See D J Weidner, 'Pitfalls in Partnership Law Reform: Some US Experience' in McCahery et al (n 89) 359.

in the US is partly driven by the excessive tort risk after the ‘tort revolution’ in US law, which does not have a European counterpart.<sup>93</sup> On the other hand, one needs to consider for the EU whether the freedom of establishment of the Treaty may foster, and differences in legal traditions and culture may impede, regulatory competition in partnership law.

### III. THE SITUATION IN THE EU

The structure of this section will follow the framework used for the US. The main focus will be on UK, German and French law. First, the different types of partnerships will be outlined. This is slightly more complex than in the US because in the EU there are more significant differences between states. Secondly, here too, it must be considered which types of companies may be used instead of partnerships (‘vertical competition’). Thirdly, whether ‘horizontal competition’ in partnership law can be expected in the EU is examined.

#### A. Types of Partnerships

##### 1. General and limited partnerships

In all European countries there are general and limited partnerships. The law of the UK is in many respects more or less identical to that of the US states.<sup>94</sup> Like in the US, general partnerships are highly informal and unregistered. Limited partnerships need to be registered at Company House in Cardiff (for England and Wales), Edinburgh (for Scotland) or Belfast (for Northern Ireland).<sup>95</sup> Liability is usually unlimited for all partners, except with regard to limited partners in limited partnerships who do not take part in management and so are not liable for the acts of the firm.<sup>96</sup> Like in the US, in Scotland limited partnerships have legal personality, but this is not the case in England.<sup>97</sup> While English law permits partnerships to sue or to be sued in the firm’s name, this does not change the substantive law.<sup>98</sup>

There were 568,000 partnerships in the UK in 2002, out of which 10,369 were limited partnerships.<sup>99</sup> British limited partnerships are particularly popular in the investment industry, being used by private equity, venture

<sup>93</sup> Ribstein (n 42) 836, 853. See also P W Huber, *Liability: The Legal Revolution and Its Consequences* (Basic Books, New York, 1988).

<sup>94</sup> D A DeMott, ‘Transatlantic Perspectives on Partnership Law: Risk and Instability’ (2001) 26 *Journal of Corporation Law* 879 (however, differences in the default rules on dissolution of a partnership).

<sup>95</sup> Limited Partnerships Act 1907 art 8. See also <http://www.companieshouse.gov.uk/index.shtml>.

<sup>97</sup> Partnership Act 1890 s 4(2).

<sup>98</sup> M Blackett-Ord, *Partnership Law* (Tottel 1997) 404.

<sup>99</sup> DTI, *Reform of Partnership Law: The Economic Impact—A Consultation Document*, April 2004, paras 4.2 and 4.3.

capital and property investment funds.<sup>100</sup> However, the Channel Islands of Jersey and Guernsey are strong competitors. These two jurisdictions can boast that their laws on limited partnerships have a number of advantages compared with English law. In Jersey and Guernsey limited partners can participate in the management of the partnership to a larger extent than under English law without losing liability protection. The names of the limited partners do not have to be disclosed in a public register. In Guernsey limited partnerships can choose to have a separate legal personality. Moreover, a favourable tax treatment and liberal investment and accounting laws contribute to the attractiveness of Jersey's and Guernsey's law.<sup>101</sup>

The next years may see a modernization of the law on limited partnerships in the UK. In 2003 a joined report of the (English and Welsh) Law Commission and the Scottish Law Commission set out extensive proposals to reform partnership law.<sup>102</sup> In 2006 the government decided to focus on the reform of limited partnership law.<sup>103</sup> Based on the report of the law commissions this reform may, for example, provide that limited partnerships are able to opt for an entity status, and clarify and extend whether and how limited partners can be involved in the business of the partnership.<sup>104</sup>

For German and French law one must distinguish between partnerships under civil law and partnerships under commercial law. All partners of a partnership under civil law ('BGB-Gesellschaft'; 'société civile') are personally liable.<sup>105</sup> In France, but not in Germany, creditors can sue a partner only after firstly suing in vain the partnership itself.<sup>106</sup> Another difference is that only in France is the civil partnership regarded as a legal person ('entité juridique' or 'personne morale').<sup>107</sup> However, in Germany, the Federal Supreme Court decided in 2001 that the civil partnership has 'legal capacity' ('Rechtsfähigkeit'), thus it can enter into contracts, own property, sue and be sued in its own name.<sup>108</sup> Typical examples of partnerships under civil law are

<sup>100</sup> DTI (n 98) paras 4.3 and 4.4; JA McCahery and EPM Vermeulen, 'Limited Partnership Reform in the United Kingdom: A Competitive, Venture Capital Oriented Business Form' (2004) 5 *European Business Organization Law Review* 61.

<sup>101</sup> See eg <http://www.altassets.net/casefor/countries/2003/nz4014.php>; <http://www.louvregrroup.com/pdfs/partnerships.pdf>; <http://www.thelawyer.com/cgi-bin/item.cgi?id=117415&d=122&h=24&f=46>.

<sup>102</sup> The Law Commission and The Scottish Law Commission, *Partnership Law, Reports Law Com No 283 and Scot Law Com No 192, 2003* (515 pages), available at <http://www.lawcom.gov.uk/docs/lc283-2.pdf>. See also G Morse, 'Partnerships for the 21st Century?—Limited Liability Partnerships and Partnership Law Reform in the United Kingdom' [2002] *Singapore Journal of Legal Studies* 455.

<sup>103</sup> See <http://www.berr.gov.uk/bbf/partnership/page25911.html>.

<sup>104</sup> DTI *Summary of Responses to the Consultation on Reform of Partnership Law: The Economic Impact*, July 2006, para 2.13; McCahery and Vermeulen (n 99) 79.

<sup>105</sup> French Code Civil art 1857; German Civil Code (BGB) § 714.

<sup>106</sup> French Code Civil art 1858.

<sup>107</sup> French Code Civil art 1842.

<sup>108</sup> BGHZ 146, 34. For a comment see O Maaß and M Siems, 'Die Rechtsfähigkeit der Gesellschaft bürgerlichen Rechts in Deutschland—Ein Vorbild für Österreich?' [2002] *Wirtschaftsrechtliche Blätter (wbl)* 2002, 149 (also dealing with Austrian law).



law firms. In France these partnerships must also comply with the law on the ‘société civile professionnelle’ (SCP),<sup>109</sup> which, for instance, provides default rules on the representation and decision making of partnerships established by professionals.<sup>110</sup>

German and French commercial partnerships must observe more formalities than partnerships under civil law, such as registration and accounting requirements. Like in the US and the UK, there is a distinction between general and limited partnerships. The former is called ‘*Offene Handelsgesellschaft*’ (OHG) in Germany and ‘*société en nom collectif*’ (SNC) in France. Here all partners are personally liable, although the creditor must first exhaust the partnerships assets.<sup>111</sup> In a limited partnership—called ‘*Kommanditgesellschaft*’ (KG) in Germany and ‘*société en commandite simple*’ (SCS) in France—the limited partners are not personally liable for the debts of the partnership except for the amount of their contribution.<sup>112</sup> Like the partnership under civil law, French commercial partnerships are legal persons whereas German commercial partnerships only have ‘legal capacity’.<sup>113</sup>

From a comparative perspective it is interesting that in many respects the German and French laws on limited partnerships already conform to the changes which are suggested for the UK. The limited partnership is a legal person in France. The German and French laws are also more liberal than UK law as it can be agreed that the limited partners take part in the internal administration of the partnership. In contrast to English law (and the former US law) this does not have the effect that they are treated like general partners.<sup>114</sup>

This raises the question why in the investment industry the limited partnership of UK law is more popular than its French and German counterparts. The main reasons are presumably to be found outside the codified partnership law. It is possible that the substantial body of case law and the highly respected judiciary of the UK play a role.<sup>115</sup> Since partnership law contains mainly default rules and since investment contracts often require legal agreements different from normal partnerships,<sup>116</sup> it is also likely that the major London law firms and business advisors as well as the English language contribute to the use of UK partnership law. Lastly, the popularity of UK limited partnerships for investment activities is presumably influenced by

<sup>109</sup> Loi no 66-879 du 29 novembre 1966 relative aux sociétés civiles professionnelles.

<sup>110</sup> Loi no 66-879 arts 11, 13, 14.

<sup>111</sup> French Code de Commerce art L 221-1(2); German Commercial Code (HGB) §§ 124, 128.

<sup>112</sup> French Code de Commerce art L. 222-2); German Commercial Code (HGB) §§ 161(1), 171.

<sup>113</sup> French Code de Commerce art L 210-6; German Commercial Code (HGB) §§ 124, 161(2).

<sup>114</sup> Generally see J Heenen, ‘Partnerships and Other Personal Associations for Profit, in *International Encyclopedia of Comparative Law* (Mohr, Tübingen, 1975) paras 1–167 (but also para 1–172: no authority to represent partnership); For Germany see also German Commercial Code (HGB) § 163. For the UK see Limited Partnerships Act 1908 art 5.

<sup>115</sup> McCahery and Vermeulen (n 99) 76.

<sup>116</sup> McCahery and Vermeulen (n 99) 71–72.

other areas of law (such as tax law or financial law)<sup>117</sup> and the general standing of London as the main financial centre of Europe.

## 2. Partnerships without personal liability

In 2000 the UK followed the lead of the US states and Jersey<sup>118</sup> in allowing limited liability partnerships (LLPs).<sup>119</sup> The UK LLP is a mixture between a partnership and a company and it has even been said that it is closer to the LLC than to the LLP of the US states.<sup>120</sup> With regard to terminology, it is interesting that the UK law uses the term ‘members’ of the LLP, thus avoiding both the terms ‘partners’ and ‘shareholders’.

In substance, the LLP shows a number of similarities to companies. First, the LLP has to be registered at the relevant Company House.<sup>121</sup> The applicants have to pay a registration fee and the LLP comes into existence upon incorporation. Secondly, the LLP has separate legal personality, distinct from its members.<sup>122</sup> Therefore it can own property, sue and be sued in its own name, and its existence is independent of changes in membership. Thirdly, the members of the LLP do not usually incur personal liability. However, there can be liability based on the tort of negligence. Whether such an action is successful depends on whether personal responsibility has been assumed for the advice, which has then been relied upon.<sup>123</sup> This is potentially wide because the courts may apply an assumption of personal responsibility.<sup>124</sup> Therefore, the members of an LLP may be advised to avoid becoming personally identified with a specific act or mission, for instance by carefully written letters of engagement.<sup>125</sup> Fourthly, in many respects, the running of the LLP is similar to the running of a company. In particular, LLPs have to draw up accounts and file them with Company House.<sup>126</sup> These requirements are the same as those for limited companies. In general, the accounts have to be audited, except in LLPs with turnover up to £1 million. Fifthly, the LLP can use a floating charge.

<sup>117</sup> See J Armour ‘Law, Innovation and Finance: A Review’ in J A McCahery and L Renneeboog (eds), *Venture Capital Contracting and the Valuation of Hi-Tech Firms* (OUP, Oxford, 2003) 133–161, who also refers to the role of insolvency and labour law for venture capital investment.

<sup>118</sup> On the US see III A above, on Jersey see III C 3 below.

<sup>119</sup> Introduced by Limited Liability Partnerships Act 2002.

<sup>120</sup> J Whittaker and J Machell, *The Law of Limited Liability Partnerships* (Jordans, Bristol, 2004) para 17.9.

<sup>121</sup> Limited Liability Partnerships Act 2000 s 2, 3.

<sup>122</sup> Limited Liability Partnerships Act 2000 s 1.

<sup>123</sup> *Cabvision Ltd v Feetum & Marsden (Feetum v Levy)* [2005] 1 WLR 2576, [2005] EWCA Civ 1601; *Tower Taxi Technology LLP v Marsden & ors* [2005] EWHC 1084, [2005] EWCA Civ 1503.

<sup>124</sup> See eg Whittaker and Machell (n 119) paras 15.5–15.14.

<sup>125</sup> See S Young, *Limited Liability Partnerships Handbook* (Tottel, Edinburgh, 2007) para 20.5.

<sup>126</sup> Limited Liability Partnerships Regulation 2001 s 3; Limited Liability Partnerships (Amendments) Regulations 2005.

Since this security over a group of changing assets must be entered in the companies register, it can be used by the LLP but not by other partnerships.<sup>127</sup>

In other respects, the LLP continues to display features of a partnership. Concerning the internal affairs of the partnership, the members of the LLP enjoy organisational flexibility. For instance, the LLP agreement may state who represents the partnership, how profits are distributed and how decisions between the members are taken. The default rules are that all members take part in the management of the LLP and that all of them have equal rights and duties.<sup>128</sup> Furthermore, the LLP is classified as a partnership for tax purposes.<sup>129</sup> Thus only the members, not the LLP itself, are subject to taxation. This is particularly relevant for large firms with highly paid individuals as corporation tax provides relief for smaller firms, and an exemption from national insurance contributions may encourage the incorporation of a limited company.<sup>130</sup>

Critics submitted that the LLP was unlikely to be accepted by practice.<sup>131</sup> For instance, they criticised the reference to company law and argued the lack of a standard form constitution would lead to great complexity. Moreover, the running of an LLP was feared to be too complex and expensive, because the accounting, auditing, filing and disclosure requirements of company law were too burdensome for partnerships. Empirical data show however that an increasing number of LLPs have been set up, and that the number of newly established LLPs has also been growing (Table 4). In particular, the LLP is a popular legal form for law and audit firms.<sup>132</sup>

Table 4. *LLPs in the UK since 2003*<sup>133</sup>

Time	Total number	Increase in last 12 months
31 March 2003	4,442	n.a.
31 March 2004	7,396	2,954
31 March 2005	11,924	4,528
31 March 2006	17,499	5,575
31 March 2007	24,555	7,056
24 February 2008	31,070	7,272 <sup>134</sup>
29 June 2008	33,903	8,142 <sup>135</sup>

<sup>127</sup> See Freedman, 'Limited Liability Partnerships in the United Kingdom—Do They Have a Role for Small Firms?' (2001) 26 *Journal of Corporation Law* 897, 912.

<sup>128</sup> Limited Liability Partnerships Act 2000 ss 5, 6; Limited Liability Partnerships Regulation 2001 s 7.

<sup>129</sup> Limited Liability Partnerships Act 2000 s 7; Finance Act 2001.

<sup>130</sup> See Freedman (n 126) 914. See also III B 1 below.

<sup>131</sup> See Freedman (n 126) 902–903.

<sup>132</sup> For instance, the 'Big Four': PwC LLP, KPMG LLP, Deloitte & Touche LLP, Ernst & Young LLP.

<sup>133</sup> Source: <http://www.companieshouse.gov.uk/about/businessRegisterStat.shtml>.

<sup>134</sup> Estimation based on shorter period. <sup>135</sup> *ibid.*

In Germany the legal entity most similar to the UK LLP is the 'Partnerschaftsgesellschaft' (PartG).<sup>136</sup> It was specifically introduced for professions such as lawyers or auditors. In many respects the PartG is similar to the general commercial partnership (OHG).<sup>137</sup> There is, however, some protection against liability: '[I]f only some of the partners were involved in the operation of a particular contract, only they are personally responsible (besides the partnership itself), unless their involvement is regarded as subordinate'.<sup>138</sup> In other words, the partners who were not involved in a particular operation are protected from incurring liability.

Other business enterprises also have the possibility of choosing a partnership without personal liability. They can form a limited partnership (KG), whose only general partner is a German limited liability company (GmbH). This 'GmbH & Co KG' is highly popular: 145,000 out of the 175,000 KGs are GmbH & Co KGs.<sup>139</sup> The drawback of a GmbH & Co KG is that one must also incorporate a GmbH. This requires €25,000 minimum capital and compliance with the rules on capital maintenance. Still, the main entity is the partnership (the KG); therefore, a GmbH & Co KG has the advantage of a more flexible governance and finance than a pure GmbH.

A one-sided method of liability protection is the 'silent partnership' ('stille Gesellschaft').<sup>140</sup> The person who runs the business deals with third parties in his or her own name and therefore incurs personal liability, whereas the silent partner's participation in the business is purely financial. The silent partnership is not registered, it does not have 'legal capacity' and it does not do any own business. Therefore, the risk of the silent partner is limited to his or her own investment.

In France there is no entity like the LLP or the PartG. However, it is possible that a company is the only general partner of a limited partnership.<sup>141</sup> French law also provides for a 'silent partnership', which is called 'société en participation' (SEP).<sup>142</sup> Like in Germany, the SEP is an unregistered and undisclosed partnership, which does not do business with third parties. It is also the only partnership under French law which does not have separate legal personality.

It can be concluded that the UK LLP does not have a direct equivalent in German and French law. The German PartG is most similar to it. However, in contrast to the LLP, it is only available to certain professions, and provides only partial protection against liability. The option of using a limited

<sup>136</sup> Gesetz of 25 July 1994, BGBl I 1994, 1744 (PartGG).

<sup>137</sup> In PartGG §§ 4(1)(s1), 6(3)(s.2), 7(2)-(4), 8(2)(s2), 9(1), 10(2) there are even explicit references to the OHG law.

<sup>138</sup> § 8(2) PartGG as modified by Gesetz of 22 July 1998, BGBl I 1878 (author's translation).

<sup>139</sup> Business Guide Niedersachsen, 2007, available at [http://www.invest-in-germany.com/uploads/media/BusinessGuide\\_Niedersachsen.pdf](http://www.invest-in-germany.com/uploads/media/BusinessGuide_Niedersachsen.pdf).

<sup>140</sup> German Commercial Code (HGB) §§ 230–236.

<sup>141</sup> See C J Mesnooh, *Law and Business in France* (Nijhoff, Boston, 1994) 77.

<sup>142</sup> French Code Civil art 1871. See also Heenen (n 113) para 1-1 (participation association has no equivalent in England).

Table 5. *Number of partnerships and companies*<sup>143</sup>

	Limited partnerships (KGs in Germany; SCs in France)	LLPs (PartGs in Germany)	Limited liability companies (GmbHs in Germany; SARLs in France)	Public companies (AGs in Germany; SAs and SASs in France)
United Kingdom	10,369	33,903	2,118,700	11,500
Germany	175,000 <sup>144</sup>	5,237	995,940	15,033
France	data n.a.	n.a.	1,123,194	71,173

partnership with a company as general partner is also not as convenient as an LLP, because it requires two entities (a company and a partnership). Finally, the ‘silent partnership’ (or SEP) only protects the ‘silent partner’, not the person who is actually dealing with third parties. Overall, it could therefore be plausible to suggest that German and French businesses try to use the LLP instead of their domestic forms of partnership—unless forms of company provide a sufficient alternative.

### B. Vertical competition: Alternative Forms of Doing Business

#### 1. Companies and partnerships in general

The most likely competitor to the LLP is the limited company. Here too there is usually liability protection for all members/shareholders (in contrast to the limited partnership). Both legal forms are also typically used in a way where there is no separation between ownership and control as the members/shareholders are themselves involved in the running of the business (in contrast to public companies). Thus, one may wonder whether the lack of an LLP law has resulted in more limited companies in Germany and France. Table 5, however, shows a quite different result because there are considerably more limited companies in the UK than in Germany and France.

For Germany this may be partly due to the fact that the German GmbH law is less business friendly than UK law, in particular due to its high minimum capital of € 25,000.<sup>145</sup> However, differences in the laws on limited companies

<sup>143</sup> For the UK data on limited partnerships and LLPs see n 98 and 132; the UK data on limited and public companies are based on Commission Staff Working Document, Impact assessment on the Directive on the cross-border transfer of registered office, SEC(2007) 1707, Annex I Table A 2. For the German data on KGs, GmbHs, and AGs see n 138; the German data on PartGs are based on T Lenz in W Meilicke (ed), *Partnerschaftsgesellschaftsgesetz* (2nd edn, Beck, Munich, 2006), § 1 para 13; The French data are based on [http://www.insee.fr/fr/themes/tableau.asp?ref\\_id=NATnon09222&reg\\_id=0](http://www.insee.fr/fr/themes/tableau.asp?ref_id=NATnon09222&reg_id=0).

<sup>144</sup> 145,000 of these are GmbH & Co KG, see III A 2, above.

<sup>145</sup> GmbHG §5(1). However, the Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 23 October 2008, BGBI. I 2008, 2026, has

cannot explain the French data because in 2003 the French SARL law was modernized with, for example, the minimum capital reduced to €1.<sup>146</sup> The high number of French public companies (SAs and SASs)<sup>147</sup> is also only a partial substitute for the relative low number of French limited companies. If one adds all forms of limited liability entities (ie the final three columns), it can be seen that in total there are about twice as many of these entities in the UK than in Germany or France.<sup>148</sup> Thus, the high number of UK limited companies is presumably not only a result of a favourable company law but driven by general socio-legal factors which foster entrepreneurship.

Focussing on the data for the UK one can note that there are 62.5 times more limited companies than LLPs. This is somehow similar to the situation in the US where in the states examined in the previous part there are between 11 (Texas) and 250 (Florida) more new LLCs than LLPs.<sup>149</sup> A difference between the US and the UK is, however, that the US LLC is taxed as a partnership whereas the British limited company is taxed as a company. There are also further differences between UK and US tax law. Freedman explains this in more detail:

(W)hile it is clear in the United States that the LLP and LLC have major tax advantages for small firms over incorporation, the U.K. tax position is quite different. The double taxation of corporate profits experienced under the pure classification system of corporate tax in the United States means that tax transparent business forms bring serious tax savings. In the United Kingdom, corporate distributions are not subject to such extensive double taxation as in the United States, due to the availability of tax credits for shareholders on dividends in many cases. It follows that the tax pressures to move away from incorporation are not so great for United Kingdom as for United States small businesses. Indeed, due to the introduction of small corporation tax reliefs, such as a ten percent corporation tax starting rate if relevant profits do not exceed £10,000, incorporation may be a beneficial way for small businesses to shelter profits in some circumstances.<sup>150</sup>

Therefore a better explanation is that the US-/UK LLP differs from the LLC/limited company in not being a legal form aimed at all types of business. Rather the LLP has a special purpose because it responds to the needs of particular professions such as lawyers and auditors. Thus, the following section will examine the special case of law firms, in particular, whether in France and Germany forms of company are available to law firms which may make it unnecessary to use the LLP.

introduced a new type of limited company ('Unternehmensgesellschaft'), which can be started with a minimal capital of € 1 but which has to allocate one quarter of its annual profits to its capital reserve until the €25,000 level is achieved.

<sup>146</sup> Loi no 2003-721 du 1er août 2003 pour l'initiative économique.

<sup>147</sup> The SAS is a simplified form of SA (eg regarding its corporate governance and restrictions on the transfer of shares), aimed at smaller companies.

<sup>148</sup> Precisely, it is 1.8 times more than France and 2.1 times more than Germany.

<sup>149</sup> See II B above. <sup>150</sup> Freedman (n 126) 903-904 (footnotes omitted).

## 2. Law firms in France and Germany

Since 1990 French law firms can incorporate as a company.<sup>151</sup> For these ‘sociétés d’exercice libéral’ (SELs) it is, for instance, a requirement that the lawyers hold more than half of the shares<sup>152</sup> and there are further restrictions on who can participate in the company.<sup>153</sup> There is also a special provision on personal liability. Despite the fact that shareholders of a company are usually not personally liable, there is an exception for SELs: ‘each lawyer is responsible for his or her own conduct and can therefore become personally liable in addition to the SEL’.<sup>154</sup>

In detail, there are five different types of SEL, depending on the form of company that is chosen: the SELARL is a limited liability SEL, the SELAFA is a public SEL, the SELAS is a simplified public SEL, the SECA is an association limited by shares SEL, and the EURL is a one-person SEL.<sup>155</sup> The most popular form is the SELARL (Table 6), because it is most flexible and does not require minimum capital.<sup>156</sup>

Table 6. *Law firms in France*<sup>157</sup>

	1997	2000	2003	2004	Change 2004/1997	Proportion 1997	Proportion 2004
SELARL	418	721	989	1148	174.6%	12.8%	25.9%
SELAFA	132	246	221	188	42.4%	4.0%	4.2%
SELAS	–	–	34	59	n.a.	0.0%	1.3%
SELCA	–	–	5	8	n.a.	0.0%	0.2%
EURL	14	18	18	27	0.5%	0.4%	0.6%
SCP	1997	2138	2262	2267	13.5%	61.1%	51.2%
SEP	32	26	24	31	–3.1%	1.0%	0.7%
Association <sup>158</sup>	628	647	645	663	5.6%	19.2%	15.0%
Others	47	44	41	39	–16.9%	1.4%	0.9%

<sup>151</sup> Loi no 90-1258 du 31 décembre 1990 relative à l’exercice sous forme de sociétés des professions libérales soumises à un statut législatif ou réglementaire ou dont le titre est protégé et aux sociétés de participations financières de professions libérales. All legal forms which law firms are allowed to use can be found in Loi no 71-1130 du 31 décembre 1971 portant réforme de certaines professions judiciaires et juridiques, art 7 (as amended).

<sup>152</sup> Loi no 90-1258 art 5(1).

<sup>153</sup> Loi no 90-1258 art 5(2).

<sup>154</sup> Loi no 90-1258 art 16 (author’s translation).

<sup>155</sup> Loi no 90-1258 art 2.

<sup>156</sup> Code de Commerce Art L 223-2 in contrast to Art L 224-2 (€37,000 minimum capital for French joint-stock companies).

<sup>157</sup> Source: Observatoire du Conseil National des Barreaux (Janvier 2005) 13.

<sup>158</sup> The ‘association’ is just a loose form of collaboration (cf Loi du 1er juillet 1901 relative au contrat d’association); lawyers contract with clients in their own name and remain personally liable.

Comparing companies and partnerships it can be seen that the use of partnerships (SCPs and SEPs) and associations has been more popular than the incorporation as an SEL. However, there is a trend towards incorporation. In 1997 there were 4.7 times more partnerships and associations than SELs, in 2004 this figure dropped to 2.5, and in 2007 there are just 1.3 times as many partnerships and associations than SELs.<sup>159</sup>

The development in Germany started a few years later. In 1995 the Supreme Court of Bavaria decided that law firms can incorporate as a limited liability company (GmbH).<sup>160</sup> Details were subsequently regulated in special rules on the 'Lawyer-GmbH' ('Rechtsanwaltsgesellschaft').<sup>161</sup> For instance, it is a requirement that only other legal advisors are shareholders of a Lawyer-GmbH, that lawyers have to hold the majority of the votes, that the establishment of a Lawyer-GmbH needs approval from the local bar association and that a special insurance is provided.<sup>162</sup> In 2005 the German Federal Supreme Court decided that lawyers can also incorporate as a public company (AG).<sup>163</sup> There is some legal uncertainty as to what is required for incorporating and running a Lawyer-AG but presumably the requirements are similar to those for the Lawyer-GmbH.<sup>164</sup>

Empirical data shows that in Germany all three legal forms which provide (some) liability protection are growing in importance (see Table 7). The PartG

Table 7. *Law firms in Germany*<sup>164</sup>

Year	Number of				PartGs per 100,000 lawyers	GmbHs per 100,000 lawyers	AGs per 100,000 lawyers
	lawyers	PartGs	GmbHs	AGs			
1997	85,105	78	11	0	91.65	12.93	0.00
2000	104,967	n.a.	42	0	n.a.	40.01	0.00
2001	110,367	n.a.	75	0	n.a.	67.96	0.00
2002	116,305	n.a.	122	0	n.a.	104.90	0.00
2003	121,420	n.a.	159	0	n.a.	130.95	0.00
2004	126,793	1,061	168	0	836.80	132.50	0.00
2005	132,569	1,286	179	0	970.06	135.02	0.00
2006	138,104	1,645	217	0	1,191.13	157.13	0.00
2007	142,830	1,725	260	5	1,207.73	182.03	3.50
2008	146,910	2,061	297	8	1,402.90	202.16	5.45

<sup>159</sup> Source: Observatoire du Conseil National des Barreaux (Octobre 2008) 53, available at [http://www.cnb.avocat.fr/OBSERVATOIRE-ACTUACITES\\_r18.html](http://www.cnb.avocat.fr/OBSERVATOIRE-ACTUACITES_r18.html).

<sup>160</sup> BayObLG, NJW 1995, 199.

<sup>161</sup> Gesetz of 31 August 1998, BGBl I, 2600 (enacting §§ 59 c ff. BRAO).

<sup>162</sup> BRAO, §§ 59 d, e, j.

<sup>163</sup> BGH, NJW 2005, 1568.

<sup>164</sup> However, according to OLG Hamm (decision of 26 June 2006 Az 15 W 213/05) no approval from the local bar association is necessary.

<sup>165</sup> Source: Bundesrechtsanwaltskammer, available at <http://www.brak.de>. It is not reported how many lawyers have established a partnership under civil law ('BGB Gesellschaft').



is, however, considerably more popular than Lawyer-GmbH and Lawyer-AG. Comparing the German data with the French, it can also be seen that there are less incorporated law firms in Germany than in France. A likely explanation for this is that in Germany there is less need for incorporation because the PartG already provides some protection against liability.<sup>166</sup>

This leads to the general question whether in France and Germany the possibility of using the corporate form makes it unnecessary to introduce a UK-style LLP. In a second step, the next part<sup>167</sup> will then examine whether French and German (law) firms can and would also choose the UK LLP itself, thus, leading to competition between Member States' partnership laws.

The establishment of a UK-style LLP is easier than the incorporation of a company. A partnership does not require minimum capital, in contrast to all German and most French forms of company. There are also fewer formalities. For instance, in order to establish a UK LLP one needs only file an application with Company House but there is no need for a notarial deed (unlike in most civil law countries).<sup>168</sup>

The liability protection of a UK LLP under partnership law is as good as the liability protection for companies. However, the tort of negligence can result in personal liability of the lawyer who represents the LLP in a particular case.<sup>169</sup> The extent of liability protection is therefore somewhat inferior to that of a lawyer who is a shareholder in a German Lawyer-GmbH because only in exceptional cases would German courts 'lift the veil' of the GmbH<sup>170</sup> or assume a separate quasi-contractual relationship between a lawyer of a Lawyer-GmbH and a client.<sup>171</sup> The situation is quite different in France. Here even the lawyer who is the shareholder of an SEL is always personally liable for his or her own conduct. Thus a UK-style LLP would offer better liability protection.

Several aspects have to be considered for the running of a law firm. In some regards one may falsely expect differences between companies and LLPs. Typically, it is easier for companies to attract external capital; however, they must fulfil stricter accounting and disclosure requirements. Yet, as previously mentioned, external investment in the equity of incorporated law firms is usually not allowed. Thus, in both types of legal entities, the same lawyers are usually the members/shareholder as well as the managers/directors.<sup>172</sup> The

<sup>166</sup> See III.A.2 above.

<sup>167</sup> See III.C below.

<sup>168</sup> See also J A McCahery, EPM Vermeulen, M Hisatake, and J Saito 'The New Company Law—What Matters in an Innovative Economy?' Working Paper 2006, available at <http://ssrn.com/abstract=942993> 33, 43.

<sup>169</sup> See III A 2 above.

<sup>170</sup> See eg W Zöllner in Baumbach and Hueck, *GmbHG* (18th edn, Beck, Munich, 2006), Anhang GmbH-Konzernrecht, para 114.

<sup>171</sup> See eg V Triebel and D Silny, 'Die persönliche Haftung der Gesellschafter einer in Deutschland tätigen englischen Rechtsanwalts-LLP' (2007) *Neue Juristische Wochenschrift* (NJW) 1034, 1036.

<sup>172</sup> However, in the UK the Legal Services Act 2007, ss 71-111 allows 'Alternative Business Structures' (ABS) with external ownership. Presumably it will take until 2011 until these new structures can be authorised (see <http://www.sra.org.uk/sra/legal-services-act.page>). For a comparative analysis of liberalisations of law firm structures see Commission Staff Working

accounting and disclosure requirement are also similar. In contrast to ordinary partnerships, the LLP has to comply with the same rules applicable to limited companies. Both for limited companies and LLPs there are some exceptions for small firms.

In other aspects the LLP is indeed more attractive than incorporated law firms. LLPs do not have to comply with the company law rules on capital maintenance.<sup>173</sup> This can also reduce personal liability because shareholders who deal with their own company often face the risk that their claims are subordinated in case of insolvency.<sup>174</sup> Furthermore, it can be an advantage that LLPs are taxed as partnerships. Although this is not always straightforward, pass-through taxation can be beneficial for firms with many highly paid individuals.<sup>175</sup>

Overall, the possibility of incorporating law firms only partially substitutes for the LLP. Since establishing and running an LLP is typically easier than establishing and running a company, German and French law firms (or other professions) would benefit if the LLP were also provided under their domestic law—unless they can already use the UK LLP itself. Following the structure of the first part,<sup>176</sup> the next section will therefore examine whether there is supply and demand for foreign partnership law in the EU and, if this is the case, how law-makers may react to these conditions of competition.

### *C. Horizontal Competition: Choice between EU Member States*

#### *1. Supply*

There are differences between the partnership laws of Member States.<sup>177</sup> Therefore, if firms can freely choose between these laws, there is a supply of partnership forms from different countries. In particular, it is worth considering whether firms from other Member States can choose the UK LLP. From a UK perspective this would not pose any problems because the LLP need not have any place of business in the UK (and, conversely, a foreign LLP would only be determined by reference to the law of the place where it was formed).<sup>178</sup> However, it could be the case that the other Member State opposes the evasion of its domestic law.<sup>179</sup> Thus, the first sub-section will analyse

Document, Progress by Member States in reviewing and eliminating restrictions to Competition in the area of Professional Services of 5 September 2005, SEC(2005) 1064, paras 58–64.

<sup>173</sup> This is based on the Second Company Law Directive 77/91/EEC of 13 December 1976 (as amended).<sup>174</sup> For instance in Germany according to BGHZ 90, 381.

<sup>175</sup> See III.A.2, B.1 above.

<sup>176</sup> See II.C above.

<sup>177</sup> See III.A above.

<sup>178</sup> See Whittaker and Machell (n 119) paras 17.1 and 17.12.

<sup>179</sup> As it may be the case in Germany; see I Saenger, 'Wegzug von Personengesellschaften' in Dieter Birk (ed), *Transaktionen, Vermögen, Pro Bono, Festschrift zum zehnjährigen Bestehen von P+P Pöllath + Partners* (Beck, Munich, 2008) 95, 300, 304 (real seat of a partnerships has to be Germany). Note that the Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations ('Rome I') excludes partnership law in art 1(2)(f).

whether, according to European law, firms have the right to choose the partnership law of another Member State. The second sub-section will then examine which law is applicable to these LLPs, whether only UK law, or also the law of the other Member State.

a) Freedom of establishment and partnerships

The case law of the European Court of Justice has led to a comprehensive set of criteria as to how the freedom of establishment (EC Treaty, articles. 43, 48) affects the treatment of foreign companies in the EU. According to the landmark decision in *Centros* a Member State has to recognize a company which is formed in accordance with the law of another Member State even if this company has its actual centre of administration ('real seat') in the former country. Although Member States can adopt appropriate measures for preventing or penalising fraud, it is not regarded as fraud that the company wants to evade the minimum capital requirements of its home country.<sup>180</sup> *Überseering* confirmed the relevance of the statutory seat instead of the real seat. It was held that where a company is formed in accordance with the law of a Member State in which it has its registered office but then moves its real seat to another Member State, the latter country must not deny the company's legal capacity.<sup>181</sup> *Inspire Art* addressed the limits of these principles. It was again emphasized that while Member States can prevent fraud, this did not justify a law on pseudo-foreign companies which imposed conditions relating to minimum capital and directors' liability on a company formed in accordance with the law of another Member State.<sup>182</sup> Finally, *Sevic* prohibits discrimination against cross-border mergers. If a Member State allows a domestic merger of companies without liquidation of one company and transfer of the whole of its assets to another company, it also has to be possible for a foreign company to take part in these types of mergers.<sup>183</sup>

In *Cartesio* the ECJ implicitly assumed that the freedom of establishment was also applicable to a Hungarian limited partnership.<sup>184</sup> However, it is not

<sup>180</sup> Case C-212/97 *Centros Lt. v Erhvervs-og Selskabsstyrelsen* ECR [1999] I-1459.

<sup>181</sup> Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH* ECR [2002] I-9919. However, the country in which the company was incorporated may impose restrictions; Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483 confirmed in Case C-210/06 *Cartesio Oktató és Szolgáltató bt*, judgment of 16 December 2008.

<sup>182</sup> Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.* ECR [2003] I-10155.

<sup>183</sup> Case C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

<sup>184</sup> Case C-210/06 *Cartesio Oktató és Szolgáltató bt*, judgment of 16 December 2008 (however, there was no violation of the Treaty since the case only concerned restrictions by the country in which the partnership was established; see n 180).

obvious that all partnerships enjoy the freedom of establishment. The decisive question is how to interpret article 48(2), which states:

companies or firms [to which the freedom of establishment applies] means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

The first problem of this paragraph is how it relates to the laws of the Member States. The reference to ‘civil or commercial law’ and ‘public or private law’ implies some dependence on the legal forms provided by the Member States. However, this does not mean that it would be entirely for the Member States to decide which entities are protected by the freedom of establishment, lest they could undermine the full effectiveness (‘*effet utile*’) of the freedom of establishment. Thus a European interpretation of article 48(2) is needed.

For this interpretation the words ‘companies or firms’ appear to indicate a very wide scope which would cover all partnerships. Similarly, the German and French terms (‘*Gesellschaften*’, ‘*sociétés*’) refer to both companies and partnerships. However, the words ‘other legal persons’ (as well as ‘*sonstigen juristischen Personen*’ and ‘*les autres personnes morales*’) are puzzling, because in most countries not all partnerships are legal persons. Uniquely in Scotland even ordinary partnerships are regarded as legal persons.<sup>185</sup> In France the same is the case for most partnerships except SEPs.<sup>186</sup> The reverse is true in England: in general, partnerships are not legal persons, however, there is an exception for LLPs.<sup>187</sup> Finally, the German situation is peculiar because partnerships are never legal persons, however, most partnerships—with the exception of ‘silent partnerships—have ‘legal capacity’.<sup>188</sup>

The easiest solution would be to understand the word ‘other’ as a mere reference to the fact that there can be legal persons which are not companies or partnerships, such as local public authorities.<sup>189</sup> This would, however, go too far. The purpose of article 48 is to extend article 43, which grants the freedom of establishment to natural persons. Thus, for European citizens which establish a partnership article 43 and not article 48 is relevant if the partnership itself cannot enter into contracts, own property, sue and be sued. Applying article 48 to these partnerships would have the effect that, for instance, non-EU citizens who establish a silent partnership under German or French law could use this strategy in order to be protected by the freedom of establishment of the Treaty. This is not the purpose of article 48. It is therefore necessary to exclude partnerships which cannot do business in their own

<sup>185</sup> Partnership Act 1890 s 4(2).

<sup>187</sup> Limited Liability Partnerships Act 2000 s 1.

<sup>188</sup> See III.A.1 above.

<sup>189</sup> See eg German Civil Code (BGB) § 89; Requirements of Writing (Scotland) Act 1996 ss 2, 3 (partnerships; companies) and ss 4, 5 (local authorities; other bodies corporate). Of course, these entities may often be ‘non-profit-making’ and therefore the freedom of establishment may not protect them.

<sup>186</sup> See III.A above.

name.<sup>190</sup> Article 48 requires an entity that can enter into contracts, own property, sue and be sued. As a result, the only partnerships from the three countries discussed here which are not covered by article 48 are the French SEPs and the German ‘silent partnerships’.

#### b) The applicable law

Since the UK LLP is protected by the freedom of establishment, it can be used by firms from other Member States.<sup>191</sup> Naturally, this will lead to the applicability of UK LLP law and not the partnership (or company) law of the other Member State. For instance, it would be a violation of the freedom of establishment if the other Member State imposed a minimum capital requirement on foreign LLPs. It is, however, permissible (and likely) that LLPs need to register foreign branches.<sup>192</sup>

A somewhat paradoxical result may occur for the relationship between the LLP law on the one hand and the applicable tort and insolvency law on the other. For LLPs who do business in the UK the limited liability under LLP law is counterbalanced by a creditor-friendly tort and insolvency law. When courts assume personal responsibility, this can lead to liability based on the tort of negligence;<sup>193</sup> and UK insolvency can lead to personal liability if there is wrongful trading.<sup>194</sup> However, according to private international law, an LLP which is only doing business in another Member State has to comply with the tort law of that Member State,<sup>195</sup> and this law may often be less demanding.<sup>196</sup> Similarly, at least according to some commentators, the applicable insolvency law depends on the place of business, so that these LLPs could evade the possibly stricter UK insolvency law.<sup>197</sup> As a result, the members of such an LLP are likely to enjoy an even greater protection against liability than a UK-based LLP.

<sup>190</sup> For a similar result see Al Randelzhofer and U Forsthoff in E Grabitz and M Hilf, *Kommentar zur Europäischen Union* (Beck, Munich, 2001) art 48 EG para 7.

<sup>191</sup> By analogy to the case law of the ECJ for companies; see (n 179–n 182).

<sup>192</sup> See M Henssler and H-P Mansel, ‘Die Limited Liability Partnership als Organisationsform anwaltlicher Berufsausübung’ (2007) *Neue Juristische Wochenschrift* (NJW) 1393, 1399.

<sup>193</sup> See III.A.2 above.

<sup>194</sup> Insolvency Act 1986 s 214 IA 1986. For applicability to the LLP see SR Cross, ‘Limited Liability Partnerships Act 2000: Problems Ahead’ (2003) *Journal of Business Law* 268, 273.

<sup>195</sup> See Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (‘Rome II’) art 4; Triebel and Silny (n 170). For a different view see Henssler and Mansel (n 191) 1395–1387 (UK tort law applicable via *dépaçage*).

<sup>196</sup> That is the case in Germany and (presumably) in other civilian legal systems whose tort law is based on the German Civil Code; for Germany see Siems (n 5) 73.

<sup>197</sup> For the similar problem concerning the UK limited company see eg C Kersting and C Philipp Schindler, ‘The ECJ’s Inspire Art Decision of 30 September 2003 and its Effects on Practice’ (2003) 4 *German Law Journal* 1277, 1290; T Koller, ‘The English Limited Company—Ready to Invade Germany’ (2004) 15 *International Company and Commercial Law Review* 334, 341 f.

If a foreign law firm uses the LLP, the local professional law remains applicable.<sup>198</sup> However, particular rules of professional law may also be categorized as belonging to partnership law. For instance, it would be a violation of the freedom of establishment if the Member State of the real seat tried to by-pass the liability protection of UK LLP law by imposing unlimited liability under professional law.<sup>199</sup> Similarly, it is not permissible to apply local professional rules which are specifically designed for incorporated law firms. In the German literature it has been suggested that the establishment of a German-based LLP law firm requires approval from the local bar association, by analogy with the rules on Lawyer-GmbHs.<sup>200</sup> This alignment to the corporate form would, however, undermine the nature of the LLP as a partnership. In *Überseering* the ECJ held that a lawfully established company from one Member State must also be regarded as a company—and not a partnership—in other Member States.<sup>201</sup> Likewise, the freedom of establishment requires other Member States to accept the UK LLP as a partnership. Therefore, professional rules which are specifically aimed at companies are not applicable.

The tax treatment of foreign LLPs can be complex, in particular if an LLP has branches in several Member States. The crucial starting point is whether the LLP is classified as a company or as a partnership under tax law. In contrast to the historical distinction used in commercial law, tax law typically relies upon a number of criteria in order to determine which legal rules are applicable. After some legal uncertainty the German tax authorities now take the view that the LLP is subject to partnership taxation.<sup>202</sup> If other Member States came to a different result, LLPs which operate across borders may have the problem that they are subject to different tax regimes in different countries.<sup>203</sup> Finally, tax treaties may be relevant in facilitating (or complicating) the taxation of LLPs whose main place of business is outside the UK.<sup>204</sup>

### c) Result

In the EU, firms from all Member States can already choose the legal form of the LLP. Freedom of establishment also guarantees that the members of such

<sup>198</sup> See eg B Grunewald and H Müller, 'Ausländische Rechtsberatungsgesellschaften in Deutschland' (2005) *Neue Juristische Wochenschrift* (NJW) 465, 466.

<sup>199</sup> This is discussed, but rejected, in Germany; see Siems (n 5) 73.

<sup>200</sup> M P Weller and F Kienle, 'Die Anwalts-LLP in Deutschland—Anerkennung—Postulationsfähigkeit—Haftung (Teil II)' [2005] *Deutsches Steuerrecht* (DStR) 1102, 1104.

<sup>201</sup> Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH* ECR [2002] I-9919.

<sup>202</sup> SenFin Berlin of 19 January 2007, *Internationales Steuerrecht* (IStR) 2007 447–448.

<sup>203</sup> See P Essers and Gerard TK Meussen, 'Taxation of Partnerships/Hybrid Entities' in McCahery et al (n 89) 415.

<sup>204</sup> For a list of double-taxation treaties between the UK and other countries see <http://www.icaew.com/index.cfm?route=154613>.

Table 8. Number of newly incorporated UK limited companies where the majority of directors reside in another country<sup>205</sup>

'Directors'										
Residence	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Denmark	133	135	178	163	299	1,131	1,484	239	288	280
France	1,112	1,396	1,491	1,408	1,214	1,298	1,411	1,477	1,759	1,670
Germany	600	633	776	807	717	1,164	2752	10,263	13,728	16,438
Italy	440	442	538	422	329	370	428	431	553	748
Netherl.	501	506	583	467	521	637	732	1,571	2,193	2,156
Poland	31	29	41	20	24	34	301	116	140	154

an LLP enjoy liability protection, which may even surpass the protection of members of UK-based LLPs. Some complications may arise due to the interplay between LLP law and professional law and domestic and foreign tax law. This legal uncertainty may be one reason why few firms from continental Europe have chosen to establish an LLP instead of a domestic legal entity. However, there may be other considerations which influence the demand for 'going foreign' in partnership law.

## 2. Demand

Private companies from continental Europe increasingly incorporate in the UK. Becht et al empirically examined this development. The Table 8 presents their data for selected Member States from different parts of Europe.

They show that since the 1999 decision of the ECJ in *Centros*<sup>206</sup> the average number of incorporations increased from 146 to 671 firms per year. They also provide evidence of what drives foreign incorporations: using differences-in-differences regressions they find that legal migration rates are explained by country-specific incorporation costs and minimum capital requirements.<sup>207</sup> This explains, for instance, why more German than French firms have incorporated limited companies in the UK.

There is no meaningful hard data available on how many LLPs operate in continental Europe. The German commercial register shows only three entries,<sup>208</sup> but it is likely that a number of LLPs do business Germany without having registered a branch. Generally, of course, one can assume that only few LLPs have been established in continental Europe. This leads to the question

<sup>205</sup> Source: Becht et al (n 3) 248.

<sup>206</sup> See III C 1 a above.

<sup>207</sup> Becht et al (n 3) 249. The differences-in-differences technique measures whether legal changes in one country (but not the other ones) have had an impact on corporation decisions.

<sup>208</sup> Search at [http://www.handelsregister.de/rp\\_web/search.do](http://www.handelsregister.de/rp_web/search.do).

whether development similar to that for limited companies can be expected in the future.

Becht et al have shown that the clarification of the law by the ECJ was of crucial importance for the use of the limited company. Therefore, one would expect that when (or if) the ECJ clarifies the law of foreign LLPs, this will also encourage their use. This may then have a self-enhancing effect because the more foreign LLPs are established, the more often courts will be forced to deal with them, which will then provide clarification of the law, in turn leading to more LLPs.

Similar to the situation for limited companies it is likely that differences between countries matter. On the one hand, the LLP may have different benefits for firms from different Member States. For instance, in Germany there is already the PartG, which provides a partnership with some limited liability for all partners.<sup>209</sup> Thus, for German firms the LLP would 'just' mean some 'upgrading' of the PartG form. Conversely, French law does not provide a general protection against liability for partnerships. However, French company law is more business friendly than German company law,<sup>210</sup> thus it is difficult to assess which legal system may drive more firms into the UK LLP. On the other hand, non-economic reasons may also play a role. Speculating, it could be the case that for cultural reasons German and Dutch firms are more willing to establish a UK company or partnership than their French, Italian and Polish counterparts.

The development of pseudo-foreign limited companies also shows the important role of registration agents and legal advisors. A number of websites offer cheap and quick registration of limited companies, in particular for firms from Germany, Austria and the Netherlands.<sup>211</sup> Some of these websites also offer the cheap and quick establishment of a UK LLP,<sup>212</sup> thus indicating that there appears to be at least some demand for the LLP. Furthermore, continental lawyers with expertise in UK law can reduce the costs of establishing and running a UK legal entity. There are already approximately 45 books on the UK limited company written by German lawyers.<sup>213</sup> In the last two years the first two books on the LLP were published in German<sup>214</sup> and there are also a number of articles on the LLP in German law journals.<sup>215</sup> Thus, at least in

<sup>209</sup> See III A 2 above.

<sup>210</sup> See III B 1 above.

<sup>211</sup> Becht et al (n 3) 242, 245, 255.

<sup>212</sup> For instance, <http://www.formationshouse.com>, <http://www.companyregistrations.co.uk> and <http://www.ukincorp.co.uk> offer their services in German, French and other European languages. Other websites who offer the establishment of an LLP appear mainly oriented towards the UK market; see <http://www.yorkplace.co.uk>; <http://www.sdgonline.com>; <http://www.start.biz>; <http://www.chalfen.com>.

<sup>213</sup> Search in <http://www.amazon.de> (Fachbücher).

<sup>214</sup> H Schnitker und S Bank, *Die LLP in der Praxis: Gesellschaftsrecht und Steuerrecht der Limited Liability Partnership* (Beck Munich 2007); Schnitker (n 5).

<sup>215</sup> References in Siems (n 5); Triebel and Silny (n 170).



Germany, there may be the potential that lawyers will also be intermediaries for the LLP.

In the UK the LLP is a very popular legal form for medium and large law firms. Thus, it may promote the use of the LLP elsewhere that the market for legal advice has changed considerably in the last few years.<sup>216</sup> Whereas previously small local law firms had dominated the market, an increase in competition and a number of mergers have led to a growing number of lawyers per firm. In these bigger law firms a partner can hardly observe how the other partners advise their clients. Thus, there is a growing need for liability protection by choosing an entity such as the LLP.

Overall there are therefore a number of reasons why it can be expected that firms from continental Europe will demand the UK LLP. This leads to the question how law-makers would react to this development, in particular whether they would start competing in partnership law.

### 3. Reaction of law-makers

Many Member States have modernized their law on limited liability companies in the last few years. In 2003 the reform of the French SARL reduced the minimum capital to €1<sup>217</sup> and in Spain a new flexible form of limited liability company ('Sociedad Limitada Nueva Empresa' or SLNE) was introduced.<sup>218</sup> The UK Companies Act 2006 led to a simplification of the law applicable to limited companies.<sup>219</sup> In 2007, Estonian company law was made more business friendly.<sup>220</sup> In 2008 the German law was reformed by introducing a new type of entity, which does not require minimum capital at the moment of incorporation.<sup>221</sup> There are also plans to modernize the law on limited liability companies in the Netherlands and in other countries.<sup>222</sup>

Can a similar dynamic be expected for LLP law? The history of the LLP indicates that lawmakers take the experiences of other jurisdictions into account and are keen on modernizing their law. The development in the US has already been mentioned.<sup>223</sup> In Europe, the LLP was first introduced in Jersey

<sup>216</sup> See eg B E Aronson, 'Elite Law Firm Mergers and Reputational Competition: Is Bigger Really Better?' (2007) 40 *Vanderbilt Journal of Transnational Law* 763.

<sup>217</sup> Loi no 2003-721 du 1er août 2003 pour l'initiative économique.

<sup>218</sup> Ley 7/2003, de 1 de abril, de la sociedad limitada Nueva Empresa.

<sup>219</sup> See the summary of key benefits at <http://www.berr.gov.uk/bbf/co-act-2006/Major%20Benefits%20to%20Business/page35194.html>.

<sup>220</sup> See JJA Burke, 'Corporate Governance in Estonia: Intact despite 2007 amendment to Commercial Code' *Baltic Rim Economies Review* 4/2007, Expert Article 129.

<sup>221</sup> Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG), as approved by the German parliament on 26 June 2008.

<sup>222</sup> BH and L Lennarts, 'The Reform of Dutch Private Company Law: New Rules for the Protection of Creditors' (2007) 8 *European Business Organization Law Review* 567; J A McCahery, E D G Kiersch and L Timmerman, *Private Company Law Reform: International & European Perspectives* (CUP, Cambridge, 2007).<sup>223</sup> See II.A above.

in 1997.<sup>224</sup> Then, the UK legislator feared that law and accounting firms would emigrate to Jersey and so it enacted the Limited Liability Partnership Act 2001.<sup>225</sup> Japan and Singapore introduced the legal form of the LLP in 2005 and 2006<sup>226</sup> and India followed suit in 2008.<sup>227</sup> Jersey modified its law in 2009 ‘in the light of international developments so as to ensure that Jersey has a competitive LLP offering’.<sup>228</sup>

There is cause to expect that in continental Europe law-makers may feel induced to follow the path of the UK. The alternative strategy—trying to stop domestic firms establishing a UK LLP—is hardly feasible due to freedom of establishment.<sup>229</sup> Germany has already introduced the PartG—an ‘LLP light’—in 1994 and strengthened the liability protection in 1998.<sup>230</sup> Moreover, the reforms of the law on the limited company in many Member States show that law-makers in other countries are also responding to business interests, even if this means reducing the (direct) protection of creditors.

The history of the current LLP laws also suggests that interested parties and networks are a main driving force behind these new laws. In the US, lawyers played a key role.<sup>231</sup> With respect to Jersey’s LLP law it is reported that in the mid 1990s two members of the big accounting firms approached the Jersey authorities with a proposal for an LLP and offered assistance with parliamentary drafting.<sup>232</sup> And for the UK it has been complained that the ‘LLP resulted entirely from political pressure from professional firms for limited liability in respect to their activities and from their unwillingness to incorporate’.<sup>233</sup> Still, there may also be opposing forces in other Member States. McCahery et al speculate that the civil law notaries would frustrate attempts to provide a UK-style LLP because the availability of limited liability without a notarial deed would lead to a drop in their revenues.<sup>234</sup> However, this is not really plausible because firms from all Member States can choose the UK LLP in any event. Moreover, lawyers and other professionals who may establish an LLP in the future are often partnerships under civil law<sup>235</sup>—and these partnerships also do not require a notarial deed.

A more substantive opposition may submit that the LLP is a product of a ‘race to the bottom’. In company law some believe that there can be a ‘race to the top’, because, as with other forms of competition, here too the market’s

<sup>224</sup> See P Morris and J Stevenson, ‘The Jersey Limited Liability Partnership: A New Legal Vehicle for Professional Practice’ (1997) 60 MLR 538; J Payne, ‘Limiting the Liability of Professional Partnerships: In Search of this Holy Grail’ (1997) 18 Company Lawyer 81, 85–87.

<sup>225</sup> See Cross (n 193) 270; McCahery et al (n 167) 35.

<sup>226</sup> See McCahery et al (n 167).

<sup>227</sup> RDER See [http://www.pib.nic.in/release/rel\\_print\\_page1.asp?relid=51749](http://www.pib.nic.in/release/rel_print_page1.asp?relid=51749).

<sup>228</sup> See Consultation paper, available at <http://www.gov.je/StatesGreff/MinisterialDecision/EconomicDevelopment/2008/mde20080050.htm>. This led to the Limited Partnerships (Amendment) (Jersey) Law 2009 L.6/2009.

<sup>229</sup> See III.C.1. a above.

<sup>231</sup> See II.A. C.3 above.

<sup>233</sup> Freedman (n 126) 898.

<sup>235</sup> See III.A.1 above.

<sup>230</sup> See III.A.1. above.

<sup>232</sup> Morris and Stevenson (n 222) 542.

<sup>234</sup> McCahery et al (n 167) 33.

invisible hand leads to an optimal pattern for corporate governance.<sup>236</sup> By contrast the counter-view stresses that there is a 'race of laxity'<sup>237</sup> or 'race to the bottom',<sup>238</sup> since the law is deregulated at the expense of other groups, such as the shareholders, creditors or employees. In the context of LLPs the interests of members and employees are unlikely to be affected. The principle-agent problem between directors and shareholders/members is specific for public companies because the owners do not manage the day to day business of the firm. Employee interests matter for companies if a jurisdiction provides employee co-determination or works councils. Again, this is not relevant for the LLP.

With respect to creditor interests one could argue that limited liability for partnerships means that creditors lose protection. However, it is unclear how creditors are best protected. Regarding the limited liability company, it is controversially discussed whether the minimum capital requirement is really useful.<sup>239</sup> As for partnerships one may question whether the personal liability of natural persons is really valuable if substantial damages have been caused. Moreover, the LLP provides more indirect creditor protection than ordinary partnerships due to stricter registration, accounting and disclosure requirements. As a result, it may even be the case that creditors would prefer it if medium-size partnerships become more professional by transforming into an LLP.

#### D. Conclusion

Regulatory competition in partnership law is likely to develop in Europe. The starting point for this development is the UK LLP, which—due to freedom of establishment—can also be used in other Member States. To be sure, other Member States also address the needs of firms to provide some protection against liability. For instance, in Germany and France there are special legal forms aimed at the protection of lawyers against malpractice of their partners. However, the LLP has a special appeal because it combines the flexibility and taxation of a partnership with full liability protection under partnership law.

Future research could examine comparative partnership law of European countries in more detail. It would be interesting to find out whether (as it was implicitly assumed in this article) UK, French and German law have been the main legislative models for other European countries. Moreover, there is a

<sup>236</sup> See in particular Romano (n 1) 14 f.

<sup>237</sup> Justice Brandeis in *Liggett v Lee*, 288 US 517, 559.

<sup>238</sup> W.L. Cary, 'Federalism and Corporate Law: Reflections upon Delaware' (1994) 83 *Yale Law Journal* 663. For further references see (n 1).

<sup>239</sup> See eg J Armour, 'Legal Capital: an Outdated Concept' (2006) 7 *European Business Organization Law Review* 5; E Ferran, 'The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union' [2006] *European Company and Financial Law Review* 178.

need for contextualized comparisons. This article has presented some empirical data. However, it has also become apparent that more comprehensive data on all Member States would be needed in order to conduct a full-fledged quantitative comparative analysis.

#### IV. SUMMARY

Regulatory competition in company law has been extensively debated in the last few decades, but it has rarely been discussed whether there could also be regulatory competition in partnership law. This article has filled this gap. It has addressed the partnership law of the US, the UK, Germany and France, and has presented empirical data on the different types of partnerships and companies established in these jurisdictions.

The first part found that in the US there is both vertical and horizontal competition in partnership law. In most states, businesses and professionals can freely choose between a number of entity forms, such as LLPs, LLCs and different types of corporations. Moreover, states themselves care about the attractiveness of their partnership law. This is most noticeable for Delaware's law on limited partnerships but one can also identify some regulatory competition for the 'best' LLP law.

The second main part has turned to the situation in the European Union. Here the legal landscape is more diverse because only UK law knows the LLP, whereas in Germany and France there are other forms of partnership and company law which, for instance, may be used by law firms (eg PartG, Anwalts-GmbH, SCP, SEP, SELARL). However, these legal forms can only provide a partial substitute for the UK LLP. Since the freedom of establishment of the EC Treaty allows continental firms to choose the UK LLP, it is therefore likely that regulatory competition will also develop in partnership law in the EU.