

House of Commons
Regulatory Reform Committee

**PROPOSAL FOR THE
REGULATORY REFORM
(REMOVAL OF THE 20
MEMBER LIMIT) ORDER
2002**

Twelfth Report of Session 2001–02

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*Report, together with
Proceedings of the Committee*

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REGULATORY REFORM COMMITTEE

The Regulatory Reform Committee (previously the Deregulation and Regulatory Reform Committee) is appointed to consider and report to the House on proposals for regulatory reform orders under the Regulatory Reform Act 2001 and, subsequently, any ensuing draft regulatory reform order. It will also consider any “subordinate provisions order” made under the same Act.

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The full constitution and powers of the Committee are set out in House of Commons Standing Order No 141, available on the Internet via www.parliament.uk.

Publications

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TWELFTH REPORT

The Regulatory Reform Committee has agreed to the following report:

PROPOSAL FOR THE REGULATORY REFORM (REMOVAL OF THE 20 MEMBER LIMIT) ORDER 2002

Report under Standing Order 141

1. The Regulatory Reform Committee has examined the proposal for the Regulatory Reform (Removal of the 20 Member Limit) Order 2002 in accordance with Standing Order 141. We have concluded that a draft order in the same terms as the proposal should be laid before the House.

Introduction

2. On 7 May 2002 the Government laid before Parliament the proposal for the Regulatory Reform (Removal of the 20 Member Limit) Order 2002 in the form of a draft of the order and an explanatory memorandum from the Department of Trade and Industry (the Department).¹ The proposed regulatory reform order would amend the Companies Act 1985 and the Limited Partnerships Act 1907 to remove the prohibition on the formation of partnerships, limited partnerships, unregistered companies and associations with more than 20 members. This would effectively enable those bodies to have an unlimited number of members.

3. The House has instructed us to examine the proposal against the criteria specified in Standing Order 141(6) and then, in the light of that examination, to report whether the Government should proceed, whether amendments should be made, or whether the order should not be made.²

4. Our discussion of matters arising from our examination is set out below. Where a criterion specified in Standing Order 141(6) is not discussed in this report, this indicates that we have no concerns to raise about that criterion. In the course of our examination, we requested further information from the Department regarding the protection of partners or prospective partners from discrimination on the grounds of disability. The Department's response is discussed below.

Purpose of the proposal

5. The proposal would repeal sections 716 and 717 of the Companies Act 1985 and the reference to "twenty persons" in section 4(2) of the Limited Partnerships Act 1907. This would have the effect of removing the limit of 20 members for:

- any limited partnership, and
- any unregistered company, association or partnership that is formed for the purpose of carrying on any business that has for its object the acquisition of gain by the company, association or partnership.

¹ Copies of the proposal are available to Members of Parliament from the Vote Office and to members of the public from the Department. The proposal is also available on the Cabinet Office website <http://www.cabinet-office.gov.uk/regulation/act/proposals.htm>.

² Standing Order 141(2).

The proposal would also consequentially repeal section 127(3) of the Trade Union and Labour Relations (Consolidation) Act 1992, which provides that employers' associations are exempt from the 20 member limit set down by section 716 of the Companies Act 1985.

6. The 20 member limit is currently subject to a broad range of exemptions. These exemptions fall into two categories:

- exemptions specified in the Companies Act 1985: sections 716(2) and 717(1) provide that partnerships carrying on practice as solicitors, accountants or as members of a recognised stock exchange are exempt from the 20 member limit
- exemptions granted by regulations made at the discretion of the Secretary of State, in accordance with sections 716(2)(d) and 717(1)(d) of the Companies Act 1985.

Examples of professions exempted under this second category include actuaries, building designers, chartered engineers, general medical practitioners, surveyors, valuers and town planners; a complete list is set out at Annex D of the explanatory memorandum. The Department states that such exemptions are generally granted to professions that are subject to professional or statutory regulation that sets standards of conduct, sets sanctions for misconduct and imposes requirements for partners to hold personal qualifications (although many exemptions allow a proportion of partners to be non-professionals).³

Extent of the proposal's application

7. The proposal would extend only to Great Britain, despite the fact that the Limited Partnerships Act 1907 applies not only to Great Britain but also to Northern Ireland (whereas the Companies Act 1985 applies only to Great Britain).⁴ The law on partnerships has been devolved; it is therefore for the Northern Ireland Assembly to decide whether to make amendments equivalent to this proposal. The Assembly was consulted separately on the proposal.

Our assessment of the proposal against Standing Order 141(6) criteria

Removal or reduction of burdens

8. We consider that, by removing the 20 member limit, the proposal would remove a legal burden from members of partnerships and those contemplating entering into partnership arrangements. We are satisfied that the proposal would not create or impose any new burdens.

Necessary protection

9. In order to establish whether the abolition of the 20 member limit would remove any necessary protection, it is necessary to understand the historical rationale for the imposition of the limit. The limit was enacted in the mid-nineteenth century to prevent deed of settlement companies taking advantage of the common law requirement that, in order to sue such companies, all shareholders in the company had to be joined in the action.⁵ Interests in these companies were easily transferred, meaning that the body of members could fluctuate significantly. There was therefore an incentive to create a company with a large and fluctuating body of members, because such a company would be almost

³ Explanatory memorandum, para 12.

⁴ Although articles 665 and 666 of the Companies (Northern Ireland) Order 1986 (1986 NI 6), which apply only to Northern Ireland, are equivalent provisions to sections 716 and 717 of the Companies Act 1985.

⁵ A limit of 25 partners was first introduced in the Joint Stock Companies Act 1844; the Joint Stock Companies Act 1856 subsequently reduced this limit to 20 partners.

impossible to sue, meaning that members of such a company would effectively enjoy no liability, or only limited liability. By the end of the nineteenth century, however, potential plaintiffs were legally able to sue in the firm name, thus making the protection provided by the 20 member limit apparently redundant. As the Department itself points out, it is somewhat surprising that the limit has survived in the law so long.⁶

10. The reason advanced by the Department for the retention of the limit is that it may reflect:

... the view that partnerships, with the unlimited liability of partners, depend to a high degree on trust and confidence between partners. A limit of 20 partners reflects the accepted size below which partners could place their trust and confidence in their fellow partners. The larger the partnership, the less confidence and trust partners may place in other partners, whom they may never have met and may not know.⁷

The Department considers this justification is no longer sufficient reason to retain the limit, for the following reasons:

- there are a significant number of exemptions from the 20 member limit, and the number of exemptions is increasing
- many partnerships have been operating with hundreds of partners for many years
- in practice, there are already many *de facto* partnerships of more than 20 members in operation, because of the use of “parallel partnerships” – a group of partnerships, each consisting of no more than 20 members, operating in parallel with each other.

11. In addition to arguing that the 20 member limit has little practical effect, given that few partnerships are actually limited to 20 members, the Department puts forward three policy-based arguments as to why the protection provided by the 20 member limit is no longer appropriate:

- it should be for businesses themselves to decide on their nature and size, unless there are strong reasons to the contrary
- it is up to each individual to determine whether he or she wishes to join a partnership, or to allow others to join him or her in partnership; each individual will judge for him or herself whether the necessary trust and confidence is possible in the particular circumstances
- where it is considered that a particular business activity needs to be regulated, this is best achieved through specific legislative provisions.⁸

12. Having considered the arguments put forward by the Department, we agree with the Department’s statement that it is not necessary to retain the 20 member limit in order to continue any necessary protection. We do not consider that it is necessary to replace the limit with any other protections.

⁶ Explanatory memorandum, Annex C, para 3.

⁷ Explanatory memorandum, para 26.

⁸ The Department gives as an example the regulation (under the Financial Services and Markets Act 2000) of collective investment schemes. Such schemes are defined in section 235 of that Act as being “any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income”. The Department considers that those deed of settlement companies that perpetrated the frauds that led to the passing of the Joint Stock Companies Act 1844 would have fallen within this definition, as will limited partnerships formed as private equity funds.

Adequate consultation

13. **We consider that the proposal has been the subject of, and takes appropriate account of, adequate consultation.** We discuss an issue raised in the course of the consultation process in paragraph 18 below.

14. The Department issued a consultation paper on the proposal on 4 April 2001. The paper was circulated to approximately 1700 interested organisations and individuals, including the accounting profession, lawyers and judiciary, investment businesses and relevant professional and trade organisations, as well as government bodies and agencies, and academics. For a full list of those consulted, see Annex A of the explanatory memorandum.

15. We are satisfied that the paper was circulated to an appropriate group of consultees, as well as being made publicly available, and that the 12-week time frame for responses was adequate. We are also satisfied that the proposal demonstrates that the Department has given appropriate consideration to the points raised in response to the consultation paper.

16. Responses to the consultation paper were largely supportive of the proposal. Respondents raised three main issues with the Department:

- (a) Respondents expressed concern about the implications of the proposal for partners entering into large partnerships.
- (b) Respondents suggested that there should be some form of required registration of partnership details as a necessary protection in place of the 20 member limit.
- (c) Respondents raised the possibility that removal of the 20 member limit could result in interests in a firm being sold very widely to members of the public; these persons would then become directly liable for the firm's debts and obligations.

17. The Department's response to these issues is as follows:

- (a) The Department's response to this point has already been discussed, at paragraph 11 above.
- (b) The Department considers that it is not necessary to impose registration requirements additional to those already in existence. The issue will be given further consideration when the Law Commission and the Scottish Law Commission report on their current joint examination of partnership law, although the Department understands that the report will not recommend registration for general partnerships.⁹
- (c) The Department considers that adequate regulation of the marketing of interests in partnerships already exists. Both limited and unlimited partnerships are subject to the financial promotion rules set out in section 238 of the Financial Services and Markets Act 2000, meaning that interests can be sold only to sophisticated investors.¹⁰

⁹ The joint report of the Law Commission and the Scottish Law Commission is expected to be published in late 2002. See the explanatory memorandum, p B-12, response F6, for further details as to why the Department does not support additional registration requirements.

¹⁰ See the explanatory memorandum, pp B-4 to B-5, responses D3 and D4, for further details as to why the Department does not consider widespread selling of interests to members of the public to be a genuine risk.

We are satisfied with the Department's assessment of these issues.

18. We wish, however, to draw attention to one other response to the consultation paper. This response, from The Honourable Mr Justice Lindsay, President of the Employment Appeals Tribunal, raised concerns about the proposal in terms of its potential effect on the application of the Disability Discrimination Act 1995. The Act provides that it is unlawful for an employer to discriminate against a disabled person in certain employment situations. However, the Act does not apply to the position of partners in a firm;¹¹ nor does it apply to employers with fewer than 15 employees.¹² Mr Justice Lindsay raises the possibility that, if the 20 member limit is removed, an organisation may choose to designate some or all of its employees as "partners", so as to avoid the application of the Disability Discrimination Act 1995.

19. In its response to Mr Justice Lindsay's comments, the Department states that the Government:

... intends to bring partnerships into coverage when legislative time allows and [intends to ensure] that partners in partnerships of any size, as well as prospective partners are protected from disability discrimination.¹³

We asked the Department to expand on the phrase "when legislative time allows", by specifying when the Government intends to bring forward the relevant legislation. In response, the Department stated that, in October 2004, the Government intends to:

- end the current exemption from the Disability Discrimination Act 1995's employment provisions for employers with fewer than 15 employees
- make other changes to the Disability Discrimination Act 1995,¹⁴ including ending the occupational exemption or omission relating to partners in business partnerships.¹⁵

20. It is not, of course, within the scope of the present proposal to address issues of discrimination law. Nevertheless, we consider that, if the proposed regulatory reform order does pass into law, the Government should be aware of the possibility raised by Mr Justice Lindsay and should monitor the situation. It is possible that the removal of the 20 member limit would result in a more urgent need to introduce the changes to disability discrimination law to which the Government has already made a commitment. **We consider that the House should note the Government's commitment to introduce changes to disability discrimination law in October 2004.**

Preventing exercise of right or freedom

21. **We do not consider that the proposal would prevent any person from continuing to exercise any right or freedom that he or she might reasonably expect to continue to exercise.** We consider that the proposal is, in fact, likely to expand existing

¹¹ By contrast, section 11 of the Sex Discrimination Act 1975 and section 10 of the Race Relations Act 1976 expressly apply to a firm of partners, or to any persons proposing to form themselves into a firm of partners. It is unlawful for such a firm to discriminate against a person on the grounds of gender or race, respectively, in relation to a position as a partner in the firm. There is no equivalent provision in the Disability Discrimination Act 1995.

¹² See sections 4 and 7 of the Disability Discrimination Act 1995.

¹³ Explanatory memorandum, p B-11.

¹⁴ In accordance with the requirements of the European Community race and employment directives. For further information, see the Government's consultation document *Towards Equality and Diversity – Implementing the Employment and Race Directives* (URN 01/1466), published in December 2001 (available at <http://www.dti.gov.uk/er/equality/>).

¹⁵ Correspondence not printed.

freedoms, in that individuals will have an expanded ability to enter into business arrangements.

Costs and benefits

22. We have examined whether the Department has properly assessed the increases or reductions in costs or other benefits likely to result from the proposal's implementation. Clearly, the proposal's implementation would not result in any increased costs. On the contrary, the Department considers that implementation would result in significantly reduced costs to business. Savings are likely to arise from the removal of the need for partnerships to circumvent the 20 member limit, in particular through the setting up of parallel partnerships. However, the Department is unable to be specific about the total amounts of likely cost reductions, due to a lack of quantitative information on numbers of partnerships and parallel partnerships.¹⁶

23. We are satisfied that, in so far as possible, the proposal has been the subject of estimates of, and taken appropriate account of, increases or reductions in costs or other benefits that may result from its implementation.

Conclusion

24. We conclude that a draft order in the same terms as the proposal should be laid before the House. We consider that the House should note the Government's commitment to introduce changes to disability discrimination law in October 2004, set out at paragraph 19 above.

¹⁶ Although the Department's Regulatory Impact Assessment states that "in 2000 there were estimated to be 671,000 partnerships ... as of June 2001 there were 8,898 limited partnerships registered in England and Wales of which Companies House estimates approximately 3,000 to 4,000 are still functioning. Companies House for Scotland estimates that there are 3,555 limited partnerships in Scotland and that most of them are still functioning." See the explanatory memorandum, Annex C, paras 13 and 14.

PROCEEDINGS OF THE COMMITTEE RELATING TO THE REPORT

TUESDAY 16 JULY 2002

Mr Peter Pike, in the Chair

Mr Brian Cotter

Mr Dai Havard

Mr Mark Lazarowicz

Mr Chris Mole

Mr Denis Murphy

Dr Doug Naysmith

Mr Andrew Rosindell

Mr Brian White

The Committee deliberated.

Draft Report, proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph. – (*The Chairman.*)

Paragraphs 1 to 24 read and agreed to.

Resolved, That the Report be the Twelfth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

[Adjourned till Tuesday 23 July at half past Nine o'clock.]

**LIST OF COMMITTEE REPORTS PUBLISHED IN THE
CURRENT PARLIAMENT**

The following reports were published during this Parliament by the Regulatory Reform Committee under its previous name, the Deregulation and Regulatory Reform Committee. All reports are available from The Stationery Office.

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