

OWNERSHIP STRUCTURES

Partnerships and Limited Liability Companies

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Reviewing project documentation recently for a group of architects I was disappointed, but not surprised, to find two things:

- (1) The documents made no reference to copyright, and
- (2) There were express provisions for novation and termination at will.

The project was undoubtedly attractive, but there was a sharp intake of breath when I pointed out that the net effect of the draft documents was that, while they would carry out the outline conceptual designs, the developer had the option to complete the detailed designs (including any costing improvements) inhouse or using another, perhaps cheaper firm. At best, they would be novated to the builders, and at worst, their designs would be used by some one else.

Looking at the more fundamental issue of the identity of the contracting party, for sound legal reasons (if not entirely scrupulous ones), the development rights and the contracting party for the appointment were through a shelf company with an initial capital of \$100. My clients were interested when I pointed out that they could expect that company to be wound up once the development had been successfully sold on.

This raised a further question on how this talented, but disparate group and their support teams might work together.

The simplest approach was for them to become associated for the project, without any legal formality. Thoughts of administrative convenience, with single invoicing under a very groovy letterhead, were clearly going through their minds; and why not? Many architectural practices have developed in this way over the years.

There are consequences for this approach however. To the extent that this group could be said to be *carrying on a business in common with a view to profit*, then they have formed a partnership. This is not, of course, the end of the world, but it does mean that any partner can commit the credit and incur liability on behalf of the partnership as a whole. That liability is shared jointly and severally, and is unlimited. Reading through the jargon, one partner could make a mistake, and all the others, or the one perceived to be richest, would be liable for the entire loss, without the benefit of any limitation of liability.

There was an interesting complication for these guys, as they intended to undertake this project using the cache associated with their own names, their unlimited liability was personal, without the protection of the company structures and family trusts they'd become accustomed to. On reflection, they sensibly decided that a stand alone, project specific company might suit their needs better. They also recognised that it might provide

additional protection against some of the more unappealing aspects of the project documentation.

A limited liability company, formed for the project, allowed the parties to set the levels of shareholding, and corresponding return, to reflect the value and extent of their respective involvements. It also provided an opportunity reward individual designers and project managers within their organisations with an equity stake in the project, not that any of them did, as I recall.

Directorships were held by the more administratively minded of the lead designers, and all seemed happy.

I did need to run through a number of critical items, some of which were unexpected.

While limited liability companies do provide just that; limited liability, that limitation can be pierced more readily than might be apparent. The risk is, perhaps, greatest and most obvious where the directors allow the company to trade while it is insolvent, or where they undertake certain activities like making distributions to shareholders without undertaking a solvency test, or allowing the company to be wound up without considering the interests of creditors. Most of these are fairly obvious, and would fall under the heading of reckless trading, and they provide a good incentive for most sensible people to avoid being company directors.

The risks are not, however, confined to directors. It may surprise some, and it certainly did have this effect on one or two of my clients, that the responsibilities and liabilities of directors under the Companies Act 1993 will also apply to those who avoid being directors, but who still direct or exercise control over the directors they appoint.

All is not doom and gloom, however. Provided directors and owners do not act recklessly, or use their companies to behave in a way which is not in the best interests of the company, its creditors or shareholders, the limitation of liability and other protections companies provide will be effective.

For employees offered an equity stake, either in the firms they work for or for project specific entities, the risks and rewards need to be carefully balanced. There is undoubtedly kudos associated with the recognition of being a shareholder. That recognition is frequently, but not always, accompanied by better quality of work and remuneration. Shareholders are also provided with (some of) the details of the inner workings of their companies, and usually expect to be involved in decisions which are important to the company.

For many, though, the major decisions still seem to be made before the shareholders meet, or resolutions are asked for. Much of this can have the flavour of the whiskey bottle decisions made by “key partners” of old. The perception remains that the real power lies with certain directors; but with more responsibility resting with the shareholders. The extent to which this uncharitable view prevails will depend on how and why the shares are allocated, and the rights which go with them. That is detail which goes beyond the limits of this article.

My clients seemed happy with the proposal, and went off to get independent advice; particularly on tax issues.