APPENDIX C

[See page 46]

LIMITED LIABILITY PARTNERSHIP

Richard H. Bowes
Counsel
Alberta Law Reform Institute

Introduction

[1] At its meeting on in June 1999 the steering committee of the Uniform Law Conference of Canada decided to include the subject of limited liability partnership ("LLP") on the agenda of the 1999 conference. The Alberta Commissioners and Richard Bowes of the Alberta Law Reform Institute ("ALRI") were requested to prepare an issues paper with recommendations on LLPs.

[2] The LLP, which is not to be confused with the traditional limited partnership ("LP"), was invented in Texas in 1991. The LLP, as originally conceived in 1991, was essentially an ordinary partnership in which innocent partners were shielded from vicarious personal liability for "malpractice liabilities" of the firm. In other words, an individual partner of the LLP would not be liable for claims against the firm arising from negligence or other forms of malpractice unless the partner was personally involved in the negligence or malpractice. The LLP proved to be a very popular legislative innovation; by 1997 forty-eight states had enacted LLP legislation.[1]

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1 See ALRI at note 112.

[3] The impetus for LLP legislation in the United States was concern amongst professionals – particularly public accountants and lawyers – over what they regarded as excessive exposure to huge malpractice liability claims.[2] Canadian professionals have expressed similar concerns about liability, so it is not surprising that they would propose similar solutions. In Alberta the Institute of Chartered Accountants circulated a draft discussion paper advocating LLP legislation in late 1994. By 1995 the Law Society of Alberta had made similar written submissions to the Alberta government. We would be surprised if similar representations were not made at about the same time to governments across the country.

[4] The efforts of professional organizations to convince legislators to enact LLP legislation have not gone unrewarded. In 1998 Ontario amended its *Partnership Act*, as well as certain professional statutes, to provide for professional LLPs.[3] In May of this year Alberta enacted amendments to its *Partnership Act* and various professional statutes to provide for professional LLPs.[4] In both Ontario and Alberta, the LLP legislation was supported by Opposition parties as well as the Government party. We expect that LLP legislation is or soon will be on the legislative calendars in other provinces.

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2 There are, of course, alternative or additional explanations of why professionals might be facing huge liability claims. It is fair to say that public accountants have been the chief proponents of LLP legislation and other prophylactic measures against what they argue to be unfair professional liability exposure. Yet many knowledgeable observers, while not necessarily arguing against LLP legislation, have argued directly or indirectly that professionals are at least co-authors of their liability misfortune: see e.g. Susan Heinrich, "Clean Up Your Act, OSC Chief Warns Accountants" *National Post* (9 June 1999) C6.

3 *Partnership Act*, R.S.O. 1990 c. P.5, as am. by S.O. 1998, c. 2.

4 *Partnership Act*, R.S.A. 1980 c. P-2, as am. by Bill 34, 1999.

[5] When this paper discusses an issue in the design of LLP legislation, it briefly introduces the issue and, in some cases, indicates alternative approaches to dealing with the issue. Each alternative reflects an approach that has been adopted or proposed in one or more jurisdictions in Canada or abroad. The following abbreviated references are used to identify the source of alternative approaches to an issue:

Alberta, Colorado, Ontario (e.g.)	LLP legislation enacted by the named jurisdiction;
UPA 1996	Uniform Partnership Act (1996), as adopted by the National Conference of Commissioners on Uniform State Laws;
DTI	Draft LLP legislation circulated by UK Department of Trade and Industry: September 1998;
ALRI	Alberta Law Reform Institute Report on Limited Liability Partnerships: April 1999 (elaborating on recommendations made in Summary Report: December 1998). Copies of the Report will be available at the Conference

1. General Issues in Creating Uniform LLP Legislation

(a) Assumptions

[6] This section, which describes assumptions we have made in writing this paper, might have been titled, "Potential issues that are treated as non-issues for the purposes of this paper." These "non-issue issues" fall into two categories. The first category consists of issues that we assume will be dealt with in a particular way by the ULCC. These assumptions effectively turn such issues into non-issues for the purposes of this paper.

[7] The fundamental assumption in this first category is that the ULCC intends to adopt a uniform LLP act. It is also assumed that, at the very least, a uniform LLP act will allow certain professions to be carried on through LLPs that protect members of the firm from personal vicarious liability for malpractice claims against the firm. Thus, the issue whether professionals ought, as a matter of principle or policy, to be able to practise in such firms is not addressed in this paper.[5]

[8] The assumption that the ULCC intends to adopt a uniform LLP act turns another potential issue into a non-issue for the purposes of this paper. To conclude that professionals should be permitted to practise in firms that provide them with a shield against vicarious liability for malpractice claims does not lead inexorably to the conclusion that the firm in question should be an LLP. The corporation is an obvious alternative. Given the conclusion or assumption that professionals ought to be permitted to practise in limited liability firms, this conclusion could readily be implemented by allowing them to practise either in ordinary corporations or in "professional corporations" that are equipped with the appropriate liability shield. But given that the ULCC intends to adopt a uniform LLP act, the issue whether the LLP is the most appropriate vehicle for providing limited liability to professionals is not a live one in the context of this paper.

[9] The other category of potential issues that are not treated as live issues in this paper relates to details of LLP legislation upon which it does not seem necessary or realistic to seek uniformity at the present time. These details relate especially to (1) issues to which LLPs give rise but to which other business organizations also give rise, and (2) issues that are closely related to the regulation of specific professions or occupations. Such issues are general business-organization or professional- regulation issues rather than LLP-specific issues. Moreover, they are issues upon which different jurisdictions may currently take different approaches in their legislation relating to business organizations or professions.
[10] On such matters, it would be understandable if a jurisdiction attaches greater weight

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5 For a discussion of the issue, see ALRI at 54-102.

to making its LLP legislation consistent with its existing legislation relating to business organizations or professional regulation than to making its LLP legislation uniform with LLP legislation in other provinces. While uniform treatment of such business-organization or professional-regulationissues might be a worthwhile objective, it is not an objective that can conveniently be pursued within the context of the project on LLPs.

[11] The main group of issues that we have assumed that the uniform LLP act will not address in detail is registration requirements or, more generally, disclosure requirements. We assume that a partnership (or prospective partnership) must comply with some sort of registration requirement in order to acquire the status of, or at least to carry on business as, an LLP. However, the difficulty of setting out detailed registration requirements in a uniform Act can be illustrated by briefly considering the different contexts and challenges faced by the drafters of LLP legislation in Ontario and Alberta.

[12] One of the idiosyncrasies of Ontario's LLP legislation (as compared to US legislation) is that an LLP can be created simply by agreement of its partners; LLP status does not require registration.[6] Once formed, however, an Ontario LLP cannot carry on business unless it has registered its name under the *Business Names Act*.[7] The *Partnership Act* itself says nothing further about the information to be registered by LLPs because the *Business Names Act* is a comprehensive statute dealing with the registration of information about partnerships, sole proprietorships and corporations operating under assumed names.

[13] In contrast to the situation in Ontario, the drafters of Alberta's LLP legislation did not have the luxury of being able to deal with registration requirements for LLPs by adopting the requirements of existing Alberta business names legislation. The provisions of Alberta's *Partnership Act* that deal with the same general subject as Ontario's comprehensive *Business*

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6 *Partnership Act* (Ont.), s. 44.1.

7 *Ibid.*, s. 44.3(1).

Names Act (which was enacted in 1990) bear a closer resemblance to Ontario legislation enacted in 1869 and 1872 than to the 1990 legislation. In the absence of comprehensive, general-purpose business information legislation, drafters of Alberta's LLP legislation had no choice but to prescribe detailed LLP-specific registration requirements.

[14] Our point here is that the details of any jurisdiction's registration requirements for LLPs may well depend on whether it has comprehensive business name registration legislation and, if so, what that legislation requires for business organizations generally. Given the existing diversity in jurisdictions' approaches to business name registration requirements, we do not think it would be an exceptionally useful exercise for the uniform LLP act to deal in detail with such requirements.

[15] Business names legislation is concerned primarily with information about the person or persons using a particular name. LLPs might also be required to disclose certain financial information, such as audited or unaudited financial information. It could be argued that disclosure of information about a limited liability firm's financial affairs is reasonable consideration for the privilege of limited liability. The UK DTI would impose extensive financial disclosure requirements on LLPs. These requirements are similar to financial disclosure requirements to which UK companies are subject.

[16] In Canada, on the other hand, financial disclosure requirements tend to be regarded as an aspect of securities regulation rather than as an aspect of business-organizations law. In other words, they tend to be looked at as investor-protection requirements rather than creditor-protection requirements. If LLP legislation imposed financial disclosure requirements on LLPs *per se*, this would go beyond the sort of disclosure that is required by Canadian corporations statutes. Neither Ontario nor Alberta have imposed financial disclosure requirements on LLPs, and ALRI did not recommend such requirements. We do not think uniform legislation should require disclosure of financial information by LLPs.

(b) General Issues

[17] This section briefly describes the major issues or groups of issues that need to be addressed in the design of the uniform LLP act. The first group of issues concerns the nature and scope of the liability shield. The more general issue is whether the LLP should only provide a shield against personal vicarious liability for malpractice liabilities of the firm, or whether it should also provide limited liability for ordinary firm obligations, in the same manner as a corporation. A more specific issue focuses on the precise scope of the protection from vicarious liability for malpractice liability.

[18] The second major issue is whether LLPs should be available to any type of enterprise or whether they should be available only to certain types of enterprise, specifically, firms within certain self-governing professions. In this regard, Alberta and Ontario both take the restrictive approach, but in so doing part company with the great majority of US states.

[19] The third major group of issues relates to safeguards for persons who deal with LLPs. Here we touch upon the issue of minimum insurance requirements for professional LLPs. We do not deal with the issue in detail, however, because it is an issue that is closely related to issues of professional regulation upon which different jurisdictions may take different approaches. We deal in a little more detail with a safeguard that is traditionally associated with limited liability firms: restrictions on distributions of firm assets to the firm's members.

[20] The fourth major group of issues relates to the interface between LLP law and the general law of partnership. The general law of partnership is very similar from one common law province to the next, since the governing legislation in each province is based on and virtually unchanged from the *Partnership Act 1890* (UK). This means that the interface between LLP legislation and general partnership law should create virtually identical issues in each of the common law provinces.

[21] The final group of issues dealt with in this paper concerns "interjurisdictional" aspects of LLPs. It is concerned, in particular, with the law that should govern the liability of partners of an LLP that is formed in one jurisdiction but incurs liabilities in another. Should

the partners' individual liability be determined by the laws of the host jurisdiction or the home jurisdiction?

2. Nature of the Liability Shield

(a) Full Shield or Partial Shield

[22] The original Texas LLP statute (enacted in 1991) only protected its members from personal vicarious liability for liabilities of the firm arising from negligent or otherwise wrongful acts or omissions of other members or employees of the firm in the provision of professional services. All members of such "partial-shield" LLPs remained personally liable for the firm's ordinary contractual obligations. All states that enacted LLP legislation followed this partial-shield approach until 1995. In that year Minnesota enacted an LLP statute that gave members of LLPs essentially the same sort of limited liability as is enjoyed by shareholders of a corporation. Partners of a "full-shield" LLP are not liable, as such for any obligations of the LLP.

[23] UPA 1996 follows the full-shield approach, rather than the earlier partial shield approach. Many states that originally adopted the partial-shield approach have now adopted the full-shield approach. The partial-shield states may still outnumber the full-shield states, but the trend in the US is clearly towards the latter.[8] ALRI and the DTI have recommended the full-shield approach.[9] Both Ontario and Alberta, however, have adopted the partial-shield approach in their recent LLP legislation.

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[8] The ALRI report cites an article that indicates that by the end of 1997, about 20 states had moved to the full-shield approach. We expect that more have done so in the meantime.

[9] The ALRI approach would be subject to exceptions for certain "special" obligations for which directors of a corporation would be liable. This is discussed further below.

[24] The partial-shield approach can be supported on the basis that it fully responds to the particular concerns of the professions that have been pressing for LLP legislation. Those professions have expressed concern about excessive exposure to malpractice claims, not about excessive exposure to ordinary contractual obligations. Moreover, partial-shield LLP legislation would not have to address certain issues that need to be addressed by full-shield legislation, such as liability of firm members for wage claims.

[25] On the other hand, from a policy point of view, commentators on the general issue of limited liability have long considered that limited liability is more problematic in the context of "tort" (e.g. malpractice) liabilities than in the context of ordinary contractual liabilities. It has been suggested that the simplest and least confusing approach is to adopt the same "default" rule – limited liability or unlimited liability – for ordinary contractual obligations of a firm as is adopted for malpractice liabilities.

[26] It is hard to argue that there is a compelling policy reason for insisting that members of LLPs remain personally liable for ordinary contractual obligations when they can already avoid such liability through the expedient of forming management corporations.[10] All that the partial-shield approach would achieve is to require members of LLPs to incorporate a management corporation if they want to insulate themselves from ordinary contractual obligations of the firm.[11] Giving members of LLPs the same sort of liability shield as is enjoyed by shareholders of corporations has the advantage of eliminating pointless and potentially confusing variations between the rules applicable to different types of limited

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[10] Of course, management companies, like full-shield LLPs, would only shield members of a firm from obligations for which they have not expressly assumed personal liability by signing a personal guarantee or similar document.

[11] Of course, whether the liability shield is provided by a full-shield LLP or a management corporation, it will be of no assistance if the partners have undertaken personal liability for the firm's obligations by personal guarantee or other contractual means.

liability business organization.

[27] Recommendation 1

> **The uniform LLP act should adopt the full-shield approach, in which partners are not, as such, personally liable for any obligations of the firm, except in circumstances set out in following recommendations.**

[28] We note that although we have recommended the full-shield approach, most of the issues that are discussed below would arise, and would be dealt with in the same way, whether the uniform act took the full-shield or partial-shield approach. In the discussion that follows we note issues that only arise, or at least are more likely to arise, in the context of the full-shield approach.

[29] Literature discussing the alternative full-shield and partial-shield approaches sometime refers to the former as providing a corporate-style shield. That is, partners of a full-shield LLP get pretty much the same insulation from firm liabilities as do the shareholders of a corporation. In a corporation, while the shareholders may enjoy fairly complete insulation from corporate liabilities, various acts provide that directors and officers of a corporation are or may be personally liable for certain corporate obligations. Perhaps the best example of this is employee wage claims; directors (or directors and officers) are frequently made personally liable for six-months' unpaid wages. In Alberta, such liability may arise under either the *Business Corporations* Act or the *Employment Standards Code*.

[30] We believe that it will not be controversial that the policies that underlie provisions that impose liability on corporate directors for certain corporate obligations would also apply to full-shield LLPs. If LLPs had the same formal distinction between management and ownership that exists between directors and shareholders of a corporation, it would be a simple matter to impose liability for such obligations on the LLP equivalent of corporate directors. The problem is that in ordinary partnerships there is no formal distinction between management and ownership. The default rule of partnership law (which may be overridden

by agreement) is that all partners are entitled to participate in management of the partnership's affairs. Since LLPs are essentially ordinary partnerships with a liability shield, there is no formal statutory distinction between management and ownership. Therefore, there is no convenient way to impose liability for certain obligations on LLP managers, as opposed to LLP owners, as there is for corporations.

[31] Having proposed a full-shield LLP, ALRI further proposed that where the directors of an ordinary business corporation would be liable for certain obligations of a corporation, all partners in an LLP should be liable for that obligation. In essence, the ALRI proposal treats all partners as managers, which corresponds to partnership law's assimilation of ownership and management rights. In those provinces whose corporate legislation provides for unanimous shareholder agreements ("USA"), the liability position of LLP partners would be analogous to that of shareholders of a corporation who are parties to a USA that reserves to shareholders powers and duties that would normally be exercised by directors.

[32] Recommendation 2

> **Partners of a full-shield LLP should be liable for obligations of the LLP for which they would be liable if the LLP was a corporation and they were its directors.**

3. Scope of Personal Liability for Malpractice Claims

[33] The issues under this heading are concerned with the particular matter of liability for professional malpractice. As such, they would arise under either the full-shield or partial-shield approach.

[34] Although American partial-shield LLP legislation is narrow in the sense that it does not apply to ordinary contract obligations of the firm, it is broad in the sense that it applies to claims arising from virtually any sort of wrongful act or omission in the provision of

professional services. The following fragment, from Texas' original LLP statute, indicates the breadth of the shield in this respect:

> *A partner in a registered limited liability partnership is not individually liable for debts and obligations of the partnership arising from errors, omissions, negligence, incompetence or malfeasance committed in the course of the partnership business by another partner or a representative of the partnership. . .*[12]

Although the precise wording varies from state to state, the basic idea is the same; partners are not vicariously liable for malpractice claims against the firm arising from matters in which they had no direct involvement, regardless of the nature of the malpractice. This is also the approach taken by Alberta.[13]

[35] Ontario seems to be unique in providing a much narrower liability shield:

> *. . . a partner in a limited liability partnership is not liable . . . for debts, obligations and liabilities of the partnership or any partner arising from negligent acts or omissions that another partner or an employee, agent or representative of the partnership commits . . .*[14]

Since the shield applies only to obligations arising from negligent acts or omissions, there seems to be considerable scope for malpractice to which the shield would not apply.

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[12] Tex. Rev. Civ. Stat. Ann., art. 6132b-15 (West Supp. 1998). In addition to providing a shield against vicarious personal liability for professional malpractice, this wording would also seem to cover ordinary torts, such as where a partner in a law firm negligently runs over a pedestrian while driving their car on firm business.

[13] *Partnership Act* (Ab), s. 11.1.

[14] *Partnership Act* (Ont.), s. 10(2).

For example, if a partner of an Ontario LLP was implicated in *fraudulent*, as opposed to merely negligent, misrepresentation it seems doubtful that the other partners would avoid vicarious personal liability for the misrepresentation.

[36] Our view is that if innocent partners are to be protected from vicarious liability for malpractice liabilities at all, it is hard to justify a distinction between negligence and other forms of malpractice. If a partner's innocence is a good reason for shielding them from vicarious liability for the negligent acts of another partner or employee, it also seems like a good reason for shielding them from liability for wrongful acts that go beyond negligence. Therefore, we prefer the broader approach of US legislation and Alberta to Ontario's "negligence-only" approach.

[37] Recommendation 3

> **Innocent partners in an LLP should be protected from vicarious liability for all manner of wrongful acts or omissions in the provision of professional services, not just for negligent acts or omissions.**

[38] The liability shield provided by an LLP to its partners, like that provided by a corporation to its shareholders, only protects them from liability that would otherwise flow through the firm to the partners (or would flow through one partner or employee of the firm to all partners on principles of vicarious liability). The shield offers no protection from direct personal liability for breach of a duty that a partner personally owes either to a client of the firm or to a third person. This raises the issue of in what circumstances a partner of an LLP will be considered to owe, and to have breached, a duty to a client or third person who has a claim against the firm.

[39] It would be possible to leave it to judicially crafted "duty of care" principles to determine the circumstances in which a partner of a LLP will be held to owe a duty to clients of the firm or to third persons. Nevertheless, the common practice in LLP legislation is to

provide specifically that the liability shield does not apply to certain partners who were involved in the matter that created the liability. This restriction on who can shelter behind the liability shield typically applies to partners in the following categories:

(1) the partner whose wrongful acts or omissions are the cause of the liability;
(2) a partner who had knowledge of the wrongful act or omission in time to prevent the injury from occurring did not do anything about it;
(3) a partner who had supervisory responsibility over the person who actually committed the wrongful act or omission.

[40] Legislation implementing restrictions (1) and (2), above, would not be entirely unproblematic in terms of its practical application and interpretation. Nevertheless, as a matter of principle or policy, the first two restrictions seem unobjectionable. The first can be thought of as simply making it clear that a partner whose wrongful acts or omissions create a malpractice liability for the firm is considered to have owed and breached a personal duty to the person who suffered the injury. Similarly, the second restriction can be thought of as simply making it clear that a partner who acquires knowledge of wrongful acts or omissions by another partner or employee owes a duty to potential victims to take reasonable steps to prevent harm from materializing.

[41] Imposing liability on supervisors is more problematic from the perspective of principle and policy. In many American states, the provision regarding supervisor liability is framed in terms that clearly suggest that supervising partners are *vicariously* liable for wrongful acts or omissions of those they are supervising. Other states, however, make it clear that a supervising partner is only liable for failing to adequately supervise the person who actually commits the wrongful act or omission. In Canada, Ontario has followed the approach of those states that impose vicarious liability on supervising partners.[15] Alberta, following an

[15] *Partnership Act*, (Ont.), s. 10(3).

ALRI recommendation as well as the approach of some states, imposes liability on partners who are negligent in discharging supervisory responsibilities.[16]

[42] Why impose vicarious liability on supervising partners if it is considered to be unfair or unwise to impose vicarious liability on partners generally? One possible response is that the prospect of incurring vicarious liability for the actions of those being supervised may encourage supervising partners to exercise due diligence in discharging their supervisory responsibilities. On the other hand, it could be argued that a negligence standard of liability will provide supervisors with all the incentive they need to be diligent supervisors. Moreover, imposing vicarious liability on supervisors may provide a disincentive for partners, especially experienced senior partners, to assume supervisory roles.[17]

[43] Recommendation 4

The liability shield provided by an LLP should not protect a partner from personal liability for injury suffered by a person

(a) because of that partner's negligent or otherwise wrongful acts or omissions, including negligence in appointing, supervising or failing to supervise another member, employee or representative of the firm,

(b) because of the negligent or otherwise wrongful acts or omissions of another member, employee or representative of the firm, where the partner knew of the wrongful acts or omissions and failed to take reasonable steps to

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[16] *Partnership Act* (Ab.), s. 11.2(b).

[17] Why might experienced senior partners have a particular disincentive to assume supervisory roles if they are subject to vicarious personal liability? As compared to more junior partners, senior partners presumably will have more personal wealth to lose if they suffer a malpractice liability and they will have less working time left to recoup their loss.

prevent the acts, omissions or injury.[18]

4. What Sort of Enterprise May Use LLPs?

[44] Both Ontario and Alberta make LLPs available only to certain self-governing professions. This is also the approach taken in California[19] and proposed by the DTI. On the other hand, almost all states and UPA 1994 make LLPs available to any enterprise that might be carried on as an ordinary partnership. This latter is also the approach proposed by ALRI.

[45] We can think of no principled reason for restricting the use of LLPs to certain professions. If the LLP has certain advantages over the corporate form in some business contexts, it is difficult to see why those advantages should be available to members of certain professions but not to enterprises generally. From the perspective of outsiders, nothing about the LLP need make it any riskier to deal with than an ordinary, limited liability business corporation. It may be true that fewer non-professional enterprises than professional enterprises would choose the LLP form over the corporate form, if given the opportunity to do so. But that does not provide a cogent reason for denying non-professional enterprises that might wish to adopt the LLP form the opportunity to do so.

[46] Recommendation 5

Any enterprise that may be carried on through an ordinary partnership should be able to be carried on through an LLP.

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[18] The reference to preventing the injury from occurring assumes that a partner might not know of the wrongful act in time to prevent it, but may still have time to prevent a potential injury from materializing.

[19] In California, however, non-professional enterprises can use the limited liability company ("LLC"), which provides a partnership-like internal structure.

5. Safeguards for Persons Who Deal with LLPs

(a) Financial Responsibility (Insurance) Requirements

[47] Many US LLP statutes require professional LLPs to maintain a minimum level of professional liability insurance (or some equivalent such as a bond or letter of credit). Such a requirement is something of a novelty in the US, since professionals practising in unlimited liability firms are not generally required to maintain professional liability insurance. In Canada, of course, many professionals are required to carry specified levels of liability insurance even if they practise in unlimited liability firms. Therefore, imposing a requirement that professional LLPs maintain a specified level of liability insurance (or equivalent "financial responsibility" requirements) would probably not be particularly novel or controversial in the Canadian context. What might be more controversial is whether professional LLPs should be required to maintain *higher* levels of liability insurance than unlimited liability professional firms

[48] Both Ontario[20] and Alberta[21] provide that a professional firm may practise as an LLP only if it maintains a level of liability insurance specified by the relevant professional body. We do not think that uniform LLP legislation should go into any more detail than this, since mandatory professional insurance requirements are a matter of professional regulation that may be dealt with differently not only in one jurisdiction to the next, but also from one profession or occupation to the next within a jurisdiction.

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[20] *Partnership Act* (Ont) s. 44.2(b).

[21] In Alberta Bill 34 amends the relevant professional statutes to provide that the relevant governing body *shall* make regulations, rules or whatever specifying the amount of insurance that LLPs must have: see e.g. *Legal Profession Act*, s. 7.1, as am. by Bill 34. This section gives the Lieutenant Governor in Council ultimate authority over the amount of liability insurance to be provided by LLPs.

[49] **Recommendation 6**

Uniform LLP legislation should contain a *pro forma* requirement that professions or occupations to be determined by the jurisdiction should be subject to minimum insurance or similar financial responsibility requirements determined by the responsible body within the jurisdiction.

(b) Restrictions on Distributions to Partners

[50] While professional liability insurance requirements are more closely related to the regulation of professions than to "business organization" law, the matter of restrictions on distributions[22] of partnership property to the individual partners is well within the realm of business organizations law. Historically, whether in the context of business corporations or limited partnerships, part of the trade-off for limited liability has been restrictions on transfers of firm property to firm owners. The restrictions apply to payment of dividends, redemption of shares, reductions of capital and so on.

[51] The same rationale that underlies such restrictions in the case of corporations or limited partnerships would appear to support them for LLPs, as well. This is especially the case for full-shield LLPs, but restrictions on transfers could also serve a purpose in the context of partial-shield LLPs. For example, suppose that a partial-shield LLP faces a large professional malpractice claim (exceeding the amount of available liability insurance). Should the only restrictions on transfer of assets from the LLP to its members be those that arise under the general law of voidable transactions (e.g. fraudulent preferences and fraudulent conveyances), or should the LLP be subject to specific restrictions on transfers analogous to those that apply to corporations and limited partnerships?

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[22] By "distribution of partnership property," we mean any transfer of property from the partnership to its individual members, regardless of whether it occurs while the partnership is carrying on business or during its winding up.

[52] Most North American LLP legislation, including that of Ontario and Alberta, makes no overt attempt to restrict transfers of assets from an LLP to its members. This may reflect a conscious decision to rely on voidable transactions legislation, or it might reflect legislative inadvertence. The DTI and ALRI, on the other hand, both propose restrictions on transfers of assets from an LLP to its members where the transfer has an obvious potential to injure creditors. The ALRI proposal, which is based loosely on provisions in Colorado's LLP legislation, would restrict distributions to partners where the firm does not meat the dual "liquidity-solvency" test that is common in modern business corporation statutes.

[53] However, again following Colorado, ALRI would permit distributions to partners representing fair compensation for current services rendered to the partnership. The rationale for this exception is that, rather than depleting assets that would otherwise be available to meet claims, reasonable compensation for current services represents a fair exchange of value between the LLP and the partner providing the services. This would be analogous to the distinction between payment of a shareholder-employee'ssalary and a distribution to the shareholder-employee as a shareholder.

[54] **Recommendation 7**

Uniform LLP legislation should include restrictions on distributions of LLP assets to LLP members based on the same principles that underlie restrictions on transfers of corporate or limited partnership property to shareholders or limited partners.

[55] **Recommendation 8**

The restrictions on distributions should permit reasonable compensation for current services rendered to an LLP by a member of the firm.

[56] If a distribution occurs that is contrary to the proposed restriction, the obvious question is who is liable to restore the property (or its value) to the partnership (for the benefit of creditors of the partnership). ALRI proposed that the primary obligation to restore the property to the corporation should fall on the partners who receive the property. If there is still a shortfall, the partners who authorized the wrongful distribution should be jointly and severally liable for the shortfall. This is the approach that we recommend as well.

[57] **Recommendation 9**

> **Where there is a wrongful distribution of LLP property to a partner, the partner receiving the distribution should be liable to restore the property to the corporation, and partners who authorized the distribution should be jointly and severally liable for any shortfall in the amount recovered from the partner receiving the distribution.**

6. Interface with Ordinary Partnership Law

[58] Jurisdictions whose partnership law is based on English common law have traditionally viewed the partnership not as a separate legal entity, but as a relationship between the individual members of the partnership. This has certain implications in the context of LLPs that were not overtly addressed by either Ontario or Alberta.[23]

[59] We assume that it is uncontroversial that the limited liability that comes with LLPs will only protect a partner's non-partnership assets. The assets of "the partnership" will be liable for all claims against the partnership. The distinction between the assets of the firm and the assets of its owners is in theory (if not always in practice) easy to draw where corporations and their shareholders are concerned. The corporation is a legal entity that owns its own

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[23] Of course, one could replace the relationship theory of partnership with the entity theory, as the NCCUSL did in the Uniform Partnership Act, 1994. But such a fundamental change to partnership law is beyond the narrow scope of a project on LLPs.

property. The corporate liability shield only prevents liabilities from flowing through the corporation to its individual shareholders. The liability shield provides no protection for the corporation's own assets, which are always available to meet claims for which the corporation is legally liable.

[60] Since partnerships are not legal entities, partnership property is simply the co-owned property of the individual partners that is committed to the partnership business. Therefore, the principle that the assets of an LLP will be subject to all claims against the LLP entails that each partner is liable for the partnership's obligations at least to the extent of their interest in the partnership property. If a partner were subject to no liability whatsoever for a particular partnership obligation, it would seem to follow that their interest in partnership property would be immune to proceedings to enforce a claim against the partnership.

[61] The drafters of the Ontario and Alberta acts seem to have been content to leave it to implication that partners of an LLP would be liable for firm obligations to the extent of their interest in the partnership property. ALRI recommended that the statute should make it clear that all LLP partners are liable for firm obligations to the extent of their interest in the partnership property. We believe it would be prudent for the uniform LLP act to make it clear that a partner's interest in the partnership property of an LLP is subject to claims against the firm, even if the partner is not personally liable for the relevant claim.

[62] **Recommendation 10**

> **The uniform LLP legislation should make it clear that all partners of an LLP are liable for claims against the firm to the extent necessary to enforce the claims against the individual partners' interest in the partnership property.**

[63] A related issue arising out of the relationship theory of partnership concerns the effect of changes in the membership of a partnership between the date that a claim arises and the

date it is enforced. One implication of the relationship theory is that what would be viewed informally as a change in the membership of an ongoing partnership, whether through addition or subtraction of members, is technically a dissolution of one partnership and the formation of another. Obligations of the old partnership are *not* automatically obligations of the new partnership. Obligations of the old partnership will only become obligations of the new partnership if there is a novation. Since creditors of an LLP will normally only be able to look to the assets of "the firm," it seems worthwhile to make it clear that claims against what in a commercial sense is an ongoing LLP survive technical dissolutions and reformations of the partnership between the date the claim arises and the date it is enforced.[24]

[64] **Recommendation 11**

> **A claim against an ongoing LLP should be enforceable against partnership property of the ongoing firm, notwithstanding changes in membership of the partnership (constituting a technical dissolution and reformation) between the time the claim arose and the time it is enforced.**

7. Interjurisdictional Considerations

[65] It is presumed here that an LLP formed in one jurisdiction (the "home jurisdiction," perhaps a jurisdiction outside of Canada) will be able to register "extra-provincially" and carry on business in another jurisdiction (the "host jurisdiction") . The question arises whether the liability of partners for LLP obligations incurred in the host jurisdiction should be governed by the law of the host jurisdiction or the law of the home jurisdiction. More specifically, should uniform LLP legislation provide that extra-provincial LLPs that want to carry on business in the jurisdiction are subject to the provisions of the host jurisdiction's LLP legislation, or should it defer to the partner-liability provisions of the home

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[24] The matters considered in this section are considered in more detail at ALRI pp 120-130.

jurisdiction's LLP statute? This would be a purely academic point if one could safely assume that all jurisdictions will equip their LLPs with identical liability shields.

[66] So far as we are aware, US states are unanimous in deferring, as a general matter, to the LLP laws of the home jurisdiction for the purpose of determining the law that governs the liability of partners for LLP obligations. This is also the approach taken by Ontario[25] and Alberta[26] and is the approach we recommend, subject to the comments that follow.

[67] **Recommendation 12**

> **Where an LLP is formed under the laws of one jurisdiction (the "home jurisdiction") but carries on business in another jurisdiction (the "host jurisdiction"), the uniform LLP legislation (ie. host jurisdiction LLP legislation) should provide that, in general, the laws of the home jurisdiction govern the liability of individual partners of the LLP for LLP obligations incurred in the host jurisdiction.**

[68] We mentioned earlier that we did not think that uniform LLP legislation should go into the details of minimum insurance requirements for professional LLPs, because this is more a matter of professional regulation rather than business organization (LLP) law. We noted that different provinces could take different approaches to regulating professions, and these different approaches might show up in provisions relating to LLPs. For instance, different provinces might impose different minimum insurance requirements on professional firms generally, or professional LLPs in particular. The same sort of reasoning suggests that a jurisdiction should be able to regulate the conditions under which individuals may practise a profession within the jurisdiction, regardless of the nature of the firm in which they practice

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25 *Partnership Act* (Ont.), s. 44.4(4).

26 *Partnership Act* (Ab.), s. 79.996(1).

and regardless of where the firm is formed.[27]

[69] **Recommendation 13**

A jurisdiction's authority to regulate the practice of a profession within its territory should extend to establishing the conditions (such as minimum insurance requirements) under which LLPs formed outside the jurisdiction may practice the profession in the jurisdiction.

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[27] Section 79.996(2) of Alberta's *Partnership Act* provides as follows:

(2) Notwithstanding subsection (1), an Alberta partner of an extra-provincial LLP does not have any greater protection against individual liability in respect of his practice in Alberta than a partner in an Alberta LLP would have under this Part.

Since this provision refers to "his practice," it seems to be intended to refer to liabilities arising out of malpractice in which the particular partner is personally involved.