APPENDIX B

[see page 65]

MODEL LIMITED LIABILITY PARTNERSHIP ACT

(intended for inclusion in the Partnership Act)

General Comments

[1] It is assumed that the Model Act would be included as a separate Part of the enacting jurisdiction's Partnership Act.

[2] The Model Act deals only with the substantive law that would govern a limited liability partnership ("LLP"), once it has acquired that status. It does not deal with the conditions or formalities of becoming an LLP or the registration or reporting requirements for LLPs. It is assumed that an enacting jurisdiction will wish to tailor such requirements to fit with related provisions in its business corporations or business names legislation.

[3] The Model Act is neutral as to the type of enterprise that could be carried on as an LLP. The ULCC can see no cogent reason for limiting the availability of LLPs to certain types of enterprise. It is recognized, however, that a jurisdiction might decide to limit the availability of LLPs to certain types of enterprise.

[4] The Model Act does not contain any profession-specific provisions. It is assumed that provisions regulating the practice of a particular profession in an LLP would be included in the relevant professional statute.

PART I
LIMITED LIABILITY PARTNERSHIPS

Definitions

1 In this Part:

"[enacting jurisdiction] LLP" means a partnership registered under section # *[appropriate section of Partnership Act]* as an [enacting jurisdiction] limited liability partnership;

Comment: This definition assumes that the provisions dealing with registration of LLPs in an enacting jurisdiction will allow a partnership that does not currently have LLP status in any other jurisdiction to acquire that status under the laws of the enacting jurisdiction. Having done so, it is an enacting jurisdiction LLP. On the other hand, if a partnership that has already acquired LLP status under the laws of some other jurisdiction (Canadian or foreign) wishes to carry on business in the enacting jurisdiction, it may be required to register as an extra-provincial LLP.

"distribution" means, in relation to partnership property, a transfer of money or other partnership property by a partnership to a partner or an assignee of a partner's share in the partnership, whether as a share of profits, return of contributions to capital, repayment of advances or otherwise;

Comment: The starting point for this definition is the definition of "distribution" in section 101 (3) of the Uniform Partnership Act 1996 ("UPA 1996") proposed by the National Conference of Commissioners on Uniform State Laws. The Model Act's definition, however, is somewhat broader than the definition in UPA 1996. The latter refers to a transfer of money or property "to a partner in the partner's capacity as a partner," while this definition applies to any transfer of partnership property to a partner, regardless of the purpose of the transfer.

"extra-provincial LLP" means a partnership registered under section # ***[appropriate section of Partnership Act]*** **as an extra-provincial limited liability partnership;**

Comment: This definition assumes that the registration provisions of the Partnership Act relating to LLPs will allow partnerships that have acquired LLP status under the laws of some other jurisdiction to bring that status with them for the purpose of carrying on business in an enacting jurisdiction. To do so, they will register as an extra-provincial LLP.

"partnership obligation" means any debt, obligation or liability of a partnership, other than debts, obligations or liabilities of partners as between themselves or as between themselves and the partnership.

Comment: This definition would include, for example, a liability of a partnership arising in tort, as well as ordinary debts or liabilities arising under a contract. The provisions dealing with partnership obligations are not intended to deal with debts or liabilities of the partners as between themselves: hence, the exclusion of such liabilities at the end of the definition.

Application of Part

2 In the case of an [enacting jurisdiction] LLP or an extra-Provincial LLP, the other provisions of this Act are to be read subject to this Part.

Comment: As noted in the General Comments, it is assumed that the Model Act would be enacted as a separate Part (or other division) of a jurisdiction's Partnership Act. The most important examples of provisions that would be subordinated to this Part are those that impose joint (or joint and several) liability on the members of a firm for the firm's liabilities, or which impose indemnity or contribution obligations on individual partners.

Limited liability for partners of LLP

3(1) Except as expressly provided in this Part, in another Act or in an agreement, a partner in an [enacting jurisdiction] LLP

(a) is not personally liable for a partnership obligation solely by reason of being a partner,

(b) is not personally liable for an obligation under an agreement between the partnership and another person, and

(c) is not personally liable to the partnership or another partner by way of contribution, indemnity or otherwise, in respect of an obligation to which paragraph (a) or (b) applies.

Comment: This subsection follows UPA 1996 in creating a "full-shield" LLP, as opposed to the original "partial-shield" LLP. When Texas created the first LLP in 1995, partners were shielded only from vicarious liability for negligent or otherwise wrongful acts or omissions for which the partnership was liable. The liability shield did not affect the ordinary rule of partnership law that all partners are personally (jointly) responsible for performance of the partnership's ordinary contractual obligations. This rule is a reflection of the traditional view that when a partnership enters into a contract, each partner is a separate party to the contract, although the partners' obligation is joint.

Until 1995 all U.S. states that enacted LLP legislation followed the original partial shield model. In that year, however, two states enacted LLP statutes that provided, in effect, that partners, as such, were not personally liable for any partnership obligations. As of 1999, approximately half of the states have moved to the full-shield approach. The full-shield approach is closely analogous to the type of liability limitation that has long been provided to shareholders of limited liability business corporations.

It will be noted that the introductory words of subsection (1) are "Except as expressly provided in this Part, another Act . . ." It does not say, "except as expressly provided in this Act." Thus, provisions in other Parts of the Partnership Act that expressly impose personal liability on partners do not override the liability protections provided in subsection (1). The reference to "another Act" contemplates that a professional statute, for example, might narrow the protection that would otherwise be provided by the liability shield. The introductory words also contemplate that an agreement between the partnership and another party might expressly provide that some or all of the partners will be personally liable for the obligations arising under the contract. Alternatively, the partnership agreement itself might expressly cut back the protection that would otherwise be provided to individual partners by the statutory liability shield.

At first glance, it might appear that clause (b) is redundant to clause (a), because an obligation arising under a contract between the partnership and another person would necessarily be a partnership obligation to which clause (a) applies. However, as noted earlier, when "a partnership" enters into a contract, each member of the partnership is considered to be a party to the contract and responsible for its performance. In the absence of clause (b), it might be argued that clause (a) does not operate to shield a partner from liability as a party to the contract, as opposed to shielding them from liability as a partner for the partnership obligation. Admittedly, this argument would depend on a very restrictive reading of clause (a), but it was considered prudent to foreclose the argument by including clause (b).

Clause (c) deals with what is sometimes referred to as "indirect liability." The Partnership Act contains a provision to the effect that, subject to an agreement, the firm shall indemnify a partner for payments made or liabilities incurred in the ordinary and proper conduct of the business of the firm. It also provides that partners are bound to contribute equally towards the losses of the firm. Clause (c) has no effect on the obligation of the firm to indemnify individual partners. It affects the individual liability of partners to contribute when the firm has insufficient assets to discharge its liabilities, including a liability to indemnify one or more partners.

(2) Subsection (1) does not relieve a person who is a partner in an [enacting jurisdiction] LLP from personal liability for a negligent or otherwise wrongful act or omission of the person for which that person would be personally liable if the person were not a member in a partnership.

Comment: Subsection (2) merely confirms a result that would flow from a natural reading of subsection (1), which only purports to relieve partners from liability that they would incur solely by reason of being a partner. Direct personal liability for one's own negligent or otherwise wrongful acts or omissions is not liability incurred solely by reason of being a partner. Nevertheless, subsection (2) is included in the Model Act because it seems useful to emphasize that subsection (1) does not shield a partner from the ordinary legal consequences of their own negligent or otherwise wrongful acts or omissions.

This subsection does not define the circumstances in which a partner might incur personal liability because of their own wrongful acts or omissions. The circumstances in which a partner might incur such liability are determined by the general law.

(3) Subsection (1) does not protect a partner's interest in the partnership property from claims against the partnership in respect of a partnership obligation.

Comment: Under traditional common law principles of partnership law, as codified in the Partnership Act, a partnership is not a legal entity. It is a relationship that has certain legal consequences. One implication of this "relationship" or "aggregate" theory of partnership is that the term "partnership property" is simply a shorthand way of referring to property of which the partners, as such, are co-owners. Given this conception of partnership, it might be argued that if a statute says that a partner is not personally liable for a partnership obligation, then that partner's interest in the partnership property is not subject to proceedings to enforce the partnership obligation. With these technicalities of traditional partnership law in mind, subsection (3) is intended to make it clear that the liability shield provided by subsection (1) does not protect a partner's interest in the partnership property.

Partners subject to same liabilities as corporate directors

4(1) Partners in an [enacting jurisdiction] LLP are personally liable for any partnership obligation for which they would be liable if the partnership were a corporation of which they were the directors.

Comment: The general rule of corporations law is that neither shareholders nor directors of a corporation, as such, are personally liable for the corporation's liabilities. However, statutes sometimes impose liability on directors for certain obligations of a corporation. For example, in many jurisdictions directors of a corporation are made liable for a portion of unpaid wages. The rationale for such provisions seems to be that individuals who have the power and duty to manage the affairs of a corporation should be given robust incentives to ensure that the corporation acts in a socially desirable manner in certain contexts. This rationale would seem to apply with equal force to a limited liability partnership.

In an LLP, however, there is not the same formal separation of management (directors) and ownership (shareholders) that there is in a corporation. Thus, subsection (1) imposes the liabilities that would fall on a corporation's directors on all partners of an LLP.

(2) Where a corporation is a partner in an [enacting jurisdiction] LLP, the directors of the corporation are jointly and severally liable for any liability incurred by the corporation under subsection (1).

Comment: The comment on subsection (1) observed that the apparent rationale for provisions that make directors of a corporation liable for certain obligations of the corporation is to make the individuals who have the legal authority and duty to make certain decisions answerable for the consequences of those decisions. Subsection (1) applies this rationale by analogy to the partners of an LLP. But unlike the directors of a corporation, the partners of an LLP are not necessarily individuals. Some or all of the partners of an LLP could be corporations. To achieve the objective of making certain individuals personally responsible for certain LLP actions, this subsection extends the liability of a corporate partner of an LLP arising under subsection (1) to the directors of that corporation.

For example, suppose that an LLP has two partners, A (an individual) and B Ltd. C is the sole shareholder and director of B Ltd. The LLP goes bankrupt, leaving employees with unpaid wage claims. Under the laws of the relevant jurisdiction, if the LLP was a corporation, its directors would be liable for all or some portion of the unpaid wages. In these circumstances, the effect of subsection (1) is to impose liability for the unpaid wages on the two partners: A and B Ltd. The effect of subsection (2), in turn, is to make C liable for the wage claims along with B Ltd.

Obligations arising before partnership becomes LLP

5 Nothing in this Part limits the liability of partners in an [enacting jurisdiction] LLP for any partnership obligation that

(a) arose before the partnership became an [enacting jurisdiction] LLP, or

(b) arises out of a contract entered into before the partnership became an [enacting jurisdiction] LLP.

Comment: It will be noted that clause (b) covers an obligation that arises after the partnership became an LLP, if it arises out of a contract entered into before that time.

Restrictions on distribution of partnership property

6(1) An [enacting jurisdiction] LLP shall not make a distribution of partnership property in connection with the winding up of its affairs unless all partnership obligations have been paid or satisfactory provision for their payment has been made.

Comment: A traditional quid pro quo for the privilege of limited liability for the owners of an enterprise is that the owners' claims to the assets of the enterprise are subordinated to the claims of non-owner creditors of the enterprise. The term "distribution" is defined in section 1 to include any transfer of partnership property to a partner or an assignee of a partners' share in the partnership. This subsection deals with distributions in the course of the winding up of a partnership's affairs. The test here is somewhat more stringent than the test in subsection (2), which deals with distributions by an LLP that is not being wound up. Rather than applying a liquidity or solvency test, this subsection requires that third party claims actually have been paid or that satisfactory provision for payment of such claims (e.g. by the setting aside of funds) have been made.

(2) In circumstances other than in connection with the winding up of its affairs, an [enacting jurisdiction] LLP shall not make a distribution of partnership property if there are reasonable grounds to believe that after the distribution

(a) the partnership would be unable to pay its partnership obligations as they come due, or

(b) the value of the partnership property would be less than the partnership obligations.

Comment: As noted above, this subsection applies to LLPs that are not in the process of being wound up. For such ongoing enterprises, this subsection applies the dual liquidity-solvency test that is a common feature of business corporations statutes.

(3) Subsections (1) and (2) do not prohibit a payment made as reasonable compensation for current services provided by a partner to the [enacting jurisdiction] LLP, to the extent that the payment would be reasonable if paid to an employee who was not a partner as compensation for similar services.

Comment: This subsection is modeled closely on a provision of Colorado's LLP legislation: Colo. Rev. Stat. §7-64-1004 (1998). The idea behind this provision is that, rather than running down assets that would otherwise be available for payment of claims of other creditors, the firm is receiving fair value for the compensation it pays to the partner.

(4) An [enacting jurisdiction] LLP may base its determination of whether a distribution is prohibited by subsection (2)

(a) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances,

(b) on a fair valuation, or

(c) on another method that is reasonable in the circumstances.

Comment: This subsection is based on section 6-204 (d) of the U.S. Model Business Corporations Act 1984, which says that "the board of directors" may base its determination on such information. It gives the LLP a fair degree of latitude in valuing both its assets and its liabilities. In particular, it would allow an LLP to use either historical cost accounting or some other basis of valuation (fair market value), so long as the method chosen is reasonable in the circumstances.

Recovery of prohibited distributions

7(1) A partner in an [enacting jurisdiction] LLP who receives a distribution contrary to section 6 is liable to the partnership for

(a) the value of the property received by the partner, or

(b) the amount necessary to discharge partnership obligations that existed at the time of the distribution,

whichever is less.

Comment: This subsection makes a partner who has received an improper distribution liable to return the value of the property received to the partnership, where it will be available to answer the claims of creditors. It will be noted, though, that the amount for which the partner is liable is the lesser of the amount received or the amount necessary to satisfy partnership obligations that existed at the time of the distribution.

(2) Any partners in an [enacting jurisdiction] LLP who authorize a distribution contrary to section 6 are jointly and severally liable to the partnership for any amount for which a recipient is liable under subsection (1), to the extent that the amount is not recovered from the recipient.

Comment: The liability of the partners who authorized the distribution is secondary to that of the partner who received the distribution. As in subsection (1), liability is to the partnership, rather than directly to the creditors of the partnership. This means that the authorizing partners might be required to pay funds to a liquidator of the partnership, where it would be available for distribution to creditors.

(3) Proceedings to enforce a liability under this section may be brought by the [enacting jurisdiction] LLP, any partner in the partnership or any person to whom the partnership was obligated at the time of the distribution to which the liability relates.

Comment: Although individual partners or creditors of the LLP may initiate proceedings to enforce the liability, the liability is to the LLP. So any amount recovered will go to the LLP, where it will be available for distribution to creditors of the LLP.

(4) No proceedings to enforce a liability under this section may be commenced later than 2 years after the date of the distribution to which the liability relates.

Successor partnership

8(1) For the purposes of this Part, a new partnership is the successor partnership of an original partnership where

> **(a) at a particular time, the original partnership is registered as an [enacting jurisdiction] LLP,**
>
> **(b) immediately after that time a new partnership with different partners is carrying on the business of the original partnership,**
>
> **(c) one or more of the partners in the original partnership are members of the new partnership, and**
>
> **(d) there is an express or implied agreement between the partners in the original partnership and new partnership that the new partnership will assume all partnership obligations of the original partnership.**

Comment: The concept of a successor partnership is introduced here to deal with certain inconveniences that flow from the traditional common law doctrine that partnerships are not legal entities. One consequence of the traditional view of partnerships is that any change in the membership of a partnership, whether by addition, subtraction or substitution, constitutes a technical dissolution of the original partnership and the creation of a new partnership. Although from a commercial perspective there is one ongoing partnership (albeit with somewhat different membership), for at least certain legal purposes, there are two different partnerships.

Provided there is some overlap in their membership, the new partnership is deemed to be a successor partnership to the original partnership if the former has agreed to assume all the latter's obligations. On the other hand, even if there is only a minor change in the membership of the partnership, the new partnership is not considered to be a successor partnership unless it has agreed to assume all obligations of the old partnership. The principal consequence of the new partnership not being regarded as a successor partnership is to be found in section 9 (2).

(2) A successor partnership is deemed to be the same partnership as the original partnership for the purposes of this Part and, without limiting this, is subject to all the partnership obligations of the original partnership.

Comment: Subsection (1) says that the new partnership is a successor partnership if it agrees to assume all partnership obligations of the original partnership. Under ordinary principles of contract law, such an agreement would not necessarily be enforceable by creditors of the original partnership, since they are not parties to the assumption agreement. The concluding words of this subsection are intended to make it clear that, having agreed to assume all of the partnership obligations of the original partnership, the successor partnership is in fact subject to all of those obligations.

Dissolution of partnership

9(1) When an [enacting jurisdiction] LLP dissolves and its affairs are to be wound up, the partnership maintains its status as an [enacting jurisdiction] LLP while its affairs are being wound up.

Comment: This subsection is simply intended to make it clear that an LLP maintains that status while it is in the process of being wound up.

(2) An [enacting jurisdiction] LLP] is deemed, for the purposes of this section and section 6 (1), to have dissolved and to be winding up its affairs where

(a) the partnership ceases to carry on business, or

(b) there is any change in the membership of the partnership and there is not a successor partnership within the meaning of section 8.

Comment: Section 6 (1) states that an LLP shall not make a distribution in connection with the winding up of its affairs unless all of its obligations have been paid or satisfactory provision for their payment has been made. The principal purpose of subsection (2) is to make it clear that the restrictions on distributions in section 6 (1) apply whenever an LLP ceases to carry on business or there is a change in the membership of the firm, unless there is a successor partnership which is liable for the original partnership's obligations.

(3) When an [enacting jurisdiction] LLP has dissolved and its affairs are being wound up, the [Superior Court for the jurisdiction] may on the application of any interested person make any order with respect to the partnership that could be made with respect to a corporation under section [# of the XXX Act] ***[relevant section of the jurisdiction's legislation on business corporations].***

Comment: Amongst other matters, the relevant corporations legislation would allow a court to make orders designed to protect the interests of creditors of the LLP during the course of the winding up.

Extra-provincial LLPs

10(1) Except as expressly provided in another Act, the law of the governing jurisdiction of an extra-provincial LLP applies

(a) to the organization and internal affairs of the partnership, and

(b) to the liability of the partners for partnership obligations.

Comment: This provision is very similar to provisions found in US LLP statutes as well as existing Canadian LLP statutes. Although it is not in "another Act," section 79.996 (2) of Alberta's Partnership Act furnishes an example of a provision that qualifies the deference shown to the law of the "governing jurisdiction." It provides that, notwithstanding section 79.996 (1) [which is very similar to subsection (1) of this section], "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."

(2) For the purposes of this section, the governing jurisdiction for an extra-provincial LLP is the jurisdiction under the laws of which the partnership was formed.

Comment: The wording of this subsection, insofar as it defines the governing jurisdiction as the jurisdiction under whose laws the partnership was formed, is based on section 44.4 (4) of Ontario's *Partnership Act.*