LC Paper No. CB(2)344/10-11(03)

Bills Committee on
Legal Practitioners (Amendment) Bill 2010 ("Bill")

Problems, if any, encountered by Alberta, British Columbia and Manitoba which do not impose liability on a partner of a limited liability partnership ("LLP") based on his constructive knowledge of a default by other member(s) of the LLP

Purpose

At the meeting on 17 September 2010, the Bills Committee asked the Administration to provide a paper to illustrate the problems, if any, encountered by jurisdictions as mentioned in paragraph 11 of LC Paper No. CB(2)2233/09-10(02) (namely, Alberta, British Columbia and Manitoba) which do not impose liability on an LLP partner based on his constructive knowledge of a default by other member(s) of the LLP.

2. The LLP statutes in Alberta, British Columbia and Manitoba have only been introduced in recent years[1] and despite our repeated efforts in so doing, the Administration has not found any specific case from these 3 jurisdictions which is directly relevant to the subject as stated in paragraph 1 of this paper above.

Relevant Comments by Eminent Authors

3. However, relevant discussion is found in materials from the United States, namely, the authoritative work on LLP "Bromberg and Ribstein on Limited Liability Partnerships, The Revised Uniform Partnership Act, and The Uniform Limited Partnership Act (2001)", Wolters Kluwer (2009 Edition) and in journal articles.

Disincentive Effects for LLP Partners and its implications on consumer protection

4. As previously mentioned in paragraph 18 of LC Paper No. CB(2)2233/09-10(02), Bromberg and Ribstein are of the view that

1

LLP Statute	Year of Enactment	Citation
Alberta	1999	Sections 12, 81 – 104 of the *Alberta Partnership Act*
British Columbia	2004	Sections 94 - 129 of the *British Columbia Partnership Act*
Manitoba	2002	Sections 67 – 88 of the *Manitoba Partnerships Act*

confining an LLP partner's liability to matters that he has actual knowledge or under his direct supervision may provide disincentive for LLP partners to monitor their co-partners, because the partners' personal liability for participating in misconduct would exceed their partners' share of the firm's vicarious liability.[2]

5. This view is shared by Susan Fortney, another learned author on professional liability issues:

> "Conversion to a limited liability firm undercuts these incentives in two ways. First, it eliminates unlimited liability as an economic incentive to devote time and resources to monitoring the conduct of firm players. Second, lawyers may avoid managerial and supervisory roles and even assisting other lawyers because such activities may subject the lawyer to personal liability for the acts of others. ...
>
> Those limited liability statutes that impose supervisory liability ... actually create a disincentive, undermining partners' willingness to participate in firm management and supervisory activities. As a partner with no vicarious liability exposure, why should one get involved in firm management and supervision if those precise activities expose one's personal assets? Is the desire to protect the firm's reputation and assets enough to risk personal liability exposure?"[3] [emphasis added]

6. Fortney has also criticized that, apart from a minority of US jurisdictions which require that LLPs maintain an adequate level of insurance or assets on a per lawyer basis, no US legislation "addresses the other detrimental consequences of eliminating unlimited liability, including the risk that firm members will shirk responsibility for the conduct of other firm members".[4]

7. The "Disincentive Effects for LLP Partners" as outlined in paragraphs 4 to 6 above would erode consumer protection as, for example, LLP partners would "avoid managerial and supervisory roles and even assisting other lawyers because such activities may subject the lawyer to personal liability for the acts of others". The scenario as described by the learned author could be avoided if the proposed section 7AC(3)(a) (which provides that *"Subsection (1) does not protect a partner from liability if the partner- (a) knew or ought reasonably to have known of the default at*

---

[2] Bromberg and Ribstein, at p.128.

[3] Susan Saab Fortney, "Tales of Two Regimes for Regulating Limited Liability Law Firms in the US and Australia: Client Protection and Risk Management Lessons", *Legal Ethics* (United Kingdom), Volume 11, Issue 2, Winter 2008, 230 at 235.

[4] *Ibid* at 237.

the time of its occurrence") is maintained. In such case, it would not help an LLP partner by his avoiding managerial and supervisory roles and/or assisting other lawyers, if the circumstances are such that he ought reasonably to have known of the default by other members of his firm at the time of its occurrence. Hence, the proposed section 7AC(3)(a) is conducive to consumer protection.

Concerns over Lost Collegiality and its implications on consumer protection

8. According to an article named "The Economics of Limited Liability: An Empirical Study of New York Law Firms"[5] by Ms Kimberly D. Krawiec[6] and Mr. Scott Baker[7], partners of New York law firms[8] were interviewed on the factors affecting their decision to opt for the LLP status for their firms, and it was found out that "concerns over lost collegiality"[9] is one of the most frequently cited cases in deciding whether a general partnership should be converted to an LLP. The article has also provided the following elaboration on this point:

> "b. Collegiality
>
> Every partner we interviewed identified fears regarding a loss in firm collegiality as an issue that arose in their firms' debates over whether to become an LLP. ...
>
> ...
>
> ... A commonly asserted fear was that partners would hesitate to advise fellow partners or pitch in on matters if doing so would create

---

5 At page 107 of the 2005 University of Illinois Law Review

6 Professor of Law, the University of North Carolina

7 Associate Professor of Law, the University of North Carolina

8 New York's LLP legislation does not impose personal liability on the ground of constructive knowledge. Section 26(c) of the New York Partnership Law provides:
"Notwithstanding the provisions of subdivision (b) of this section,
(i) each partner, employee or agent of a partnership which is a registered limited liability partnership shall be personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services on behalf of such registered limited liability partnership and
(ii) each ... partner, employee and agent of a ... registered limited liability partnership, foreign limited liability partnership or professional partnership that is a partner, employee or agent of a partnership which is a registered limited liability partnership shall be personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services in his or her capacity as a partner, employee or agent of such registered limited liability partnership. ..." [emphasis added.]

9 See n5 at 145.

additional liability risk. A handful of partners at firms that had become LLPs believed that this fear had been well-founded at their firm and that certain partners now avoided helping out on other partners' projects, out of a desire to limit their personal exposure."[10] [emphasis added.]

9. As noted from the article quoted above, "loss of collegiality" would erode consumer protection as "certain partners now avoided helping out on other partners' projects, out of a desire to limit their personal exposure". Again, for reasons as explained in paragraph 7 above, this problem could be minimized by retaining the constructive knowledge element in the proposed section 7AC(3)(a) of the Bill. In such a case, an LLP partner shall not be able to limit his personal exposure if the circumstances are such that he ought reasonably to have known of the default by other members of his firm at the time of occurrence.

Conclusion

10. The relatively young history of LLPs in certain Canadian jurisdictions has made it difficult to locate a specific case from those jurisdictions to illustrate the problems encountered by the relevant LLP jurisdictions that do not impose liability on an LLP partner based on his having constructive knowledge of a default by other member(s) of the LLP. However, as shown in paragraphs 4 to 9 above, concerns were raised by eminent authors on LLPs over removing constructive knowledge on the part of an LLP partner as a basis for holding him liable for the default of other members of his firm. The Administration in its preparation of the Bill had sought to address the above concerns by including in the Bill the proposed section 7AC(3)(a) in its present form.

Department of Justice
November 2010

#357950-v11A

[10] See n5 at 146.