

SOME LACUNÆ IN THE LAW OF LIMITED PARTNERSHIPS

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The author identifies a number of areas where the law of limited partnerships in Canada is ambiguous or inadequate: separate legal personality; the circumstances under which a limited partner will lose limited liability for taking part in “control” of the business of the partnership; the legal consequences of a limited partner’s death; whether limited partnership units may be issued in classes or series. Looking to developments in the United States and the United Kingdom, the author proposes reforms which are necessary to maintain the competitiveness of Canadian jurisdictions in attracting investment through the formation of limited partnerships.

L’auteur cerne un certain nombre d’aspects en droit canadien des sociétés en commandite qui sont ambigus ou inadaptés : la personnalité juridique distincte; les circonstances dans lesquelles un commanditaire perdra le bénéfice de sa responsabilité limitée parce qu’il aura participé à la direction des activités de la société en commandite; les conséquences juridiques du décès d’un commanditaire; la question de savoir si les actions des commanditaires de la société peuvent être émises en classes ou en séries. En étudiant les derniers développements aux États-Unis et au Royaume-Uni, l’auteur propose des réformes qui sont nécessaires pour permettre au Canada de demeurer concurrentiel, tout en permettant aux provinces et aux territoires d’attirer de l’investissement au moyen de la création de sociétés en commandite.

The limited partnership has been part of the law of Ontario since 1849 and is widely used as an investment vehicle today, especially in the field of private equity.¹ The attraction of a limited partnership is

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¹ *An Act to authorize Limited Partnerships in Upper-Canada*, 12 Vict., c. 75 [Upper Canada LPA]. For the central place of limited partnerships in private equity, see e.g. James M. Schell, *Private Equity Funds: Business Structures and Operations*,

twofold. First, limited partnerships are given “flow through” treatment for tax purposes; they are not taxed at the partnership level, with the result that profits – and, sometimes more importantly, losses, which can be set off against other income – flow through to the individual partners. Secondly, a limited partner in Ontario is insulated from liability in excess of the amount of money and other property actually contributed or agreed to be contributed by the limited partner to the partnership.² The importance of this obviously increases with the risk inherent in the venture. The business of a limited partnership is managed by one or more general partners, whose liability is unlimited, the limited partner or partners being merely passive investors who typically have no more at risk than their respective contributions of capital.

This article will consider some areas where the law of limited partnerships in Ontario (and, by extension, in provinces with similar legislation) could benefit from clarification or wholesale amendment, if only to keep pace with other jurisdictions. Ontario runs the risk, if its legislative framework is markedly different from other common law jurisdictions, of losing both filing fees (although these are not large) and the broader benefits of revenue from professional services provided by lawyers and others in connection with the formation of limited partnerships in the province. In the economic climate prevailing at the time of writing, we can ill afford to retain disincentives to investment.

Two topics that have been the subject of fairly extensive discussion probably merit a few more words on that account: the vexed question of separate legal personality, and that of loss of limited liability by a limited partner who “takes part in the control of the business” of the partnership. The article will then consider the consequences of the death of a limited partner, an issue about which there appears to be some confusion, and also whether limited partnership units may be issued in classes or series, like shares of a corporation.

1. Separate Legal Personality

In spite of their popularity, limited partnerships are misunderstood. In part this stems from the failure of business people and – it must be said – lawyers to appreciate the fact that in Ontario a limited partnership, like any partnership formed in the province, is not a legal entity distinct from its members but rather a relation among persons who are carrying

looseleaf (New York: Law Journal Press, 2000) at §3.01; Yvette Morelli, “Structuring Venture Capital Funds” (2003) 51 Can. Tax J. 806 at 811-21.

² *Limited Partnerships Act*, R.S.O. 1990, c. L.16, as amended, s. 9 [Ontario LPA].

on a business together with a view to profit.³ The principal differences between a limited partnership and a general partnership lie in the fact that the former comes into being only once a declaration is filed with the government, and in the distinction made between the nature and legal consequences of the type of partnership interest held, whether general or limited. A limited partnership's lack of legal personality distinct from its partners is complicated by the fact that the law treats a limited partnership as having a separate legal existence for certain procedural purposes; these include bringing and defending an action, and registration and enforcement under personal property security legislation.⁴ Issues related to lack of legal capacity are well known and adequately discussed in the two leading texts on limited partnerships in Canada, so they do not warrant extensive treatment here.⁵

Whether Ontario's legislation ought to recognise the separate legal personality of limited partnerships (and presumably other types of partnership as well) is a different question. This is not a new debate; it goes back at least as far as the development of the *Uniform Partnership Law* of 1914 in the United States (US).⁶ Legislation in some other jurisdictions outside Canada does treat a limited partnership as a legal entity distinct from its constituent partners. The Delaware statute, for example, states that "[a] limited partnership formed under this chapter shall be a separate legal entity, the existence of which as a separate legal entity shall continue until cancellation of the limited partnership's certificate of limited partnership."⁷ In consequence, Delaware law has since 2004 allowed the merger and consolidation of limited partnerships with other limited partnerships or other entities, as well as the continuance of Delaware and non-US limited partnerships as another type of entity (and *vice versa*), all of which clearly reflects a view of the limited partnership as a body corporate.⁸

³ *Partnerships Act*, R.S.O. 1990, c. P.5, as amended, s. 2 [Ontario PA]. The Ontario PA and the common law of partnerships apply to limited partnerships by virtue of sections 2, 45 and 46 of the Ontario PA.

⁴ *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, s. 8.01; *Personal Property Security Regulations*, R.R.O. 1990, Reg. 912, s. 16(4).

⁵ Lyle R. Hepburn, *Limited Partnerships*, looseleaf (Don Mills, Ont.: ThomsonCarswell, 1983) at 2-39 to 2-62, 3-16 to 3-18; Alison R. Manzer, *A Practical Guide to Canadian Partnership Law*, looseleaf (Aurora, Ont.: Canada Law Book, 1994) at para. 9.370 to 9.440.

⁶ See Heather Heavin, "Reform of General Partnership Law: The Aggregate versus Entity Debate," paper submitted to the Uniform Law Conference of Canada, Edmonton, Alberta (August 2006) at note 8, online: <<http://www.ulcc.ca/en/poam2/index.cfm?sec=2006&sub=2006g>>.

⁷ *Delaware Code*, 6 Del. C. c. 17 §17-201(b).

⁸ *Ibid.*, §§17-211, 17-215 to 17-217.

The reasons most commonly advanced for the recognition of partnerships – including limited partnerships – as entities distinct from their members have to do with the holding of property and the default rules with respect to continuity of the partnership on the departure of a partner. Briefly stated, the objections on the score of property have been the following. Because firm property, in particular real property, is the property of all partners jointly, the registration of property interests in title-based systems may be problematic. Furthermore, the enforcement of rights to or against property can be complicated if the composition of the partnership changes. With respect to dissolution, the issue, at least as it relates to general partnerships, is that a firm is terminated when the composition of its members changes as a result of death or bankruptcy, unless there is a partnership agreement which provides for the firm's continuation; in the absence of any agreement amongst the partners on this point, the options are either to form a new partnership which will continue the original business or to wind up that business entirely.⁹ One particular issue related to the continuity of limited partnerships, the death of a limited partner, is discussed in section 3 of this article, where it will be seen that the solution could either be recognition of the limited partnership as an entity or, less drastically, a clarification of the default rules in the statute. Entity status would deal with title to partnership property, but would probably not resolve the question whether particular property belongs to the firm or to individual partners. Foreign investors and their counsel may find lack of entity status a stumbling block because of the issues mentioned here, a source of difficulty which may be compounded by lack of flexibility to enter into business combinations and, more critically, uncertainty about the extent of activity that may be undertaken by a limited partner without putting at risk the protection of limited liability.

As yet, English law does not recognise the separate legal personality of limited (or general) partnerships, but Scots law does. *The Partnership Act 1890*, which applies in all parts of the United Kingdom (UK) and to limited partnerships as well as general partnerships, recognises a different rule in Scotland with respect to entity status: "In Scotland a firm is a legal person distinct from the partners of whom it is composed..."¹⁰ The Law Commission of England and Wales and the Scottish Law Commission recommended in 2003 that the Scottish position on legal personality should apply with respect to all partnerships, with the exception that in the area of limited partnerships

⁹ The issues are outlined in Heavin, *supra* note 6 at paras. 6, 7, 67-77, 78-84. The Ontario *PA* provides in section 33(1) that the default rules may be overridden by contract.

¹⁰ *Partnership Act 1890*, 53 & 54 Vict., c. 39, s. 4(2) [UK *PA*].

it was suggested that a “special limited partnership” *without* separate legal personality could be made available where entity status would jeopardise a limited partnership’s tax treatment as a partnership in a foreign jurisdiction.¹¹ There is no consistency in the US; although Delaware has gone the entity route, as mentioned previously, New York, for example, has not.¹²

Recognition of separate legal personality would be useful in resolving questions about the continuity of a limited partnership after a change in membership and about some of the property issues. Business combinations involving partnerships could be permissible, which might prove attractive. Reform in this area would also bring what the English and Scottish law commissions called “conceptual clarity” to an area of law where statutory provisions have conferred entity status *ad hoc* for limited purposes, and where the legal position is at odds with the commercial view of partnerships essentially as bodies corporate.¹³ While the law has probably managed to deal adequately with most of these issues, recognition of entity status is, on balance, probably preferable. Whether or not there is a compelling case for separate legal personality on the merits, the general trend appears to be towards acceptance of the entity model, if developments in Delaware and the recommendations of the English and Scottish law commissions are indicative. This suggests that Canadian jurisdictions would be advised to follow foreign developments closely, with a view to determining whether the entity approach is appropriate and, perhaps more importantly, whether they can afford not to adopt it when others have done so.

¹¹ Law Commission of England and Wales & Scottish Law Reform Commission, *Report on Partnership Law* (London & Edinburgh: HMSO, 2003) at paras. 3.12 to 3.17, 3.46, 5.1 to 5.43, online: <<http://www.lawcom.gov.uk/docs/lc283.pdf>> or <<http://www.scotlawcom.gov.uk/downloads/rep192.pdf>> [*Report on Partnership Law*]. This report is the result of a number of earlier consultations by the two commissions on partnerships generally and limited partnerships in particular. The UK government announced in July 2006 that the commissions’ recommendations on limited partnerships would be adopted by way of a Regulatory Reform Order, but that the recommendations on the reform of the law of general partnerships would not be taken forward for the time being. This resulted in the publication in August 2008 of a consultation paper by the Department of Business Enterprise and Regulatory Reform, which proposed the repeal and replacement of the old legislation by way of a Regulatory Reform Order, effective October 2009. The government announced in March 2009 that in light of comments received it was not in a position to adopt the proposals in their current form but would consult with interested parties to implement most of the measures. See www.berr.gov.uk/whatwedo/businesslaw/partnership/page25911.html.

¹² NY CLS Partn art. 2 §10 (2009); art. 8 §90 (2009) [NY PA].

¹³ *Report on Partnership Law*, *supra* note 11 at paras. 5.25, 5.5-5.10.

2. *Loss of Limited Liability*

The Ontario *Limited Partnerships Act (LPA)* provides:

Liability of limited partner

9. Subject to this Act, a limited partner is not liable for the obligations of the limited partnership except in respect of the value of money and other property the limited partner contributes or agrees to contribute to the limited partnership, as stated in the record of limited partners.

Rights of limited partner

10. A limited partner has the same right as a general partner,

(a) to inspect and make copies of or take extracts from the limited partnership books at all times;

(b) to be given, on demand, true and full information concerning all matters affecting the limited partnership, and to be given a complete and formal account of the partnership affairs; and

(c) to obtain dissolution of the limited partnership by court order.

Share of profits

11. (1) A limited partner has, subject to this Act, the right,

(a) to a share of the profits or other compensation by way of income; and

(b) to have the limited partner's contribution to the limited partnership returned.

When profit may not be paid

(2) No payment of a share of the profits or other compensation by way of income shall be made to a limited partner from the assets of the limited partnership or of a general partner if the payment would reduce the assets of the limited partnership to an amount insufficient to discharge the liabilities of the limited partnership to persons who are not general or limited partners.

Business dealings by limited partner with partnership

12. (1) A limited partner may loan money to and transact other business with the limited partnership and, unless the limited partner is also a general partner, may receive on account of resulting claims against the limited partnership with

general creditors a prorated share of the assets, but no limited partner shall, in respect of any such claim,

(a) receive or hold as collateral security any of the limited partnership property; or

(b) receive from a general partner or the limited partnership any payment, conveyance or release from liability if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons who are not general or limited partners.

Rights of limited partner

(2) A limited partner may from time to time,

(a) examine into the state and progress of the limited partnership business and may advise as to its management;

(b) act as a contractor for or an agent or employee of the limited partnership or of a general partner; or

(c) act as a surety for the limited partnership.

Limited partner in control of business

13. (1) A limited partner is not liable as a general partner unless, in addition to exercising rights and powers as a limited partner, the limited partner takes part in the control of the business.

Additional rights and powers

(2) For the purposes of subsection (1), a limited partner shall not be presumed to be taking part in the control of the business by reason only that the limited partner exercises rights and powers in addition to the rights and powers conferred upon the limited partner by this Act.

Read together, these provisions suggest that a limited partner could preserve limited liability while engaging in areas of the partnership's business activity that go beyond those matters specifically enumerated in sections 10 and 12, provided this does not amount to "control" of the limited partnership's business. It should be obvious that the exercise of rights specifically conferred on limited partners by the statute will not put liability protection at risk. As the leading Canadian texts point out, however, it remains an open question where the line would be drawn in

any given case between acts which constitute control for these purposes and those which do not.¹⁴

The cases are not particularly useful in terms of defining the boundaries of a limited partner's permissible involvement in the business of the partnership without loss of limited liability. In a number of them, it is perfectly obvious from the facts that the limited partners controlled the partnership business. For example, in *Haughton Graphic Ltd v. Zivot* (which considered Alberta provisions identical to those under the Ontario *LPA*), the two limited partners managed every aspect of the day-to-day affairs of the partnership.¹⁵ They were described on its letterhead as president and executive vice-president respectively, Zivot admitted that he was the directing mind of the business and was ultimately responsible for all managerial decisions, both limited partners made managerial decisions and both signed cheques on behalf of the partnership or had the authority to do so.¹⁶

It is suggested in *Haughton Graphic*, however, that merely acting as an officer or director of a corporate general partner would not cause a limited partner to lose limited liability protection absent the additional element of control over the business of the limited partnership.¹⁷ This point is taken up elsewhere in the jurisprudence, but unfortunately without much elaboration. In *Stillwater Forest Inc. v. Clearwater Forest Products Limited Partnership*, the issue was whether a corporate limited partner had participated in the management and control of the limited partnership.¹⁸ The limited partner had the power to appoint three directors to the board of a corporate general partner and one of these, the limited partner's president, had arranged refinancing for the venture. Pritchard J. of the Saskatchewan Court of Queen's Bench found that while the limited partner had participated in the management of the business, this fell short of control (the trigger for liability in the Saskatchewan statute), and the refinancing activities were in any event

¹⁴ Hepburn, *supra* note 5 at 4-13 to 4-14; Manzer, *supra* note 5 at paras. 9.1790, 9.1850.

¹⁵ (1986), 33 B.L.R. 125 (Ont. H.C.), aff'd (1988), 38 B.L.R. xxxiii (Ont. C.A.), leave to appeal refused (1988), 38 B.L.R. xxxiii (S.C.C.) [*Haughton Graphic*].

¹⁶ See also *Foley v. The Queen*, 2003 D.T.C. 1320 (T.C.C.) (limited partners in control because they signed partnership cheques, were responsible for routine administration, instructed lawyers with respect to litigation, dealt with the partnership's bank, each operated one of the divisions of the partnership's real estate development projects); *Laplante v. The Queen*, [1995] 1 C.T.C. 2647 (T.C.C.) (limited partners were directors, officers and shareholders of the general partner; made all day-to-day business decisions of the partnership; had almost exclusive control of operations).

¹⁷ *Haughton Graphic*, *supra* note 15 at 137.

¹⁸ 2000 SKQB 571, [2000] S.J. No. 789 (Q.B.) (QL).

incidental to the timber salvage business of the limited partnership. The question of when limited partner participation becomes control was left – probably wisely, but not terribly helpfully – to be determined on the facts of individual cases. Acting as a director of a corporate general partner was also found not to constitute “control” of a limited partnership in *Nordile Holdings Ltd v. Breckenridge* – although this would clearly fall within the broader, more inclusive concept of “management,” which is the test for loss of liability protection under the British Columbia legislation at issue in that case.¹⁹

In the recent Ontario case of *Empire Life Insurance Co. v. Krystal Holdings Inc.*, Archibald J. noted that while the limited partners of the particular partnership were precluded by law “from taking an active role in the management of the business,” they were by the terms of the limited partnership agreement “expressly empowered to monitor their investment, and to make enquiries of those doing business with the partnership;” this included finding out whether property taxes on the venture were being properly paid by the general partner (which turned out not to be the case).²⁰ Given that a power to monitor the business is already conferred by section 12(2)(a) of the Ontario *LPA*, the agreement probably did not add much on that score; and, as the judge pointed out, the limited partners were always free to check with the city to see if taxes had been paid, without crossing the control line for the purposes of section 13.²¹ We are not much farther ahead on the issue of limited partner liability as a result.

It is very difficult to apply all of this in practice. Other decisions offer even less guidance, leaving one to agree with the statement made almost forty years ago by Osler J. in *Elevated Construction Ltd v. Nixon*:

The cases are of little assistance in determining where the line is to be drawn beyond which a limited partner is deemed to be taking part in the control of the business and each case will presumably have to be decided on its own facts.²²

¹⁹ [1991] B.C.J. No. 789 (S.C.) (QL), aff’d (1992), 66 B.C.L.R. (2d) 183 (C.A.) [*Nordile*]. The parties were found, in any event, to have excluded the control prohibition by contract. See also Lisa Philipps, “The Amazing Three-headed Limited Partner: Reflections on Old Loopholes and New Jurisprudence” (1993) 21 Can. Bus. L.J. 410, which is critical of the result in *Nordile*.

²⁰ (2008) 53 B.L.R. (4th) 234 (Ont. S.C.J.) at para. 181.

²¹ *Ibid.* at para. 197.

²² [1970] 1 O.R. 650 at 655 (H.C.). See also *Kucor Construction & Developments & Associates v. Canada Life Assurance Co.* (1998), [1999] 41 O.R. (3d) 577 (C.A.) at 590, aff’g (1997), 32 O.R. (3d) 548 (Gen. Div.) (limited partners unlikely

How, then, to advise investors who seek, on the one hand, to contain their exposure to liability in the event that something goes wrong with the venture but, on the other, to have some say in the overall direction of the business? This tension often manifests itself in the creation of an advisory committee of limited partners, which is typically given the ability to make recommendations on certain matters or even to approve or veto decisions of the general partner. To the extent that these are decisions which the Ontario *LPA* expressly allows limited partners to participate in, there will be no problem. It is probably acceptable for an advisory committee to have a say in matters relating to the structure or governance of the partnership; there is a good argument that these do not relate to its “business,” which is what limited partners in Ontario must avoid controlling. “Business” is defined in section 1 of the Ontario *LPA* as including “every trade, occupation and profession,” which suggests that the legislature did not have matters of internal firm governance in mind when it enacted the control liability provisions. Removal of the general partner (who is supposed to run the business) could amount to “control,” unless the partnership agreement provides a mechanism for removal or the general partner has acted in bad faith, breached the agreement or failed to fulfil fiduciary duties.²³ The ability of limited partners to approve or decide with respect to operational matters, as opposed to merely advising or recommending, raises concern. Quite where the line will fall in any given instance is difficult to say, and Lyle Hepburn is probably wise to urge “extreme caution” in drafting advisory committee powers.²⁴ The current Ontario statute is not much of an advance on the Upper Canada *LPA* of 1849 in providing guidance with respect to loss of limited liability.²⁵

to want to take title to partnership real estate in their own name, as this would risk exposure to unlimited liability); *Gemini Group Automated Distribution Systems Inc. v. PWA Corp.* (1993), 16 O.R. (3d) 239 (C.A.) at 241 (limited partners probably want to avoid “speaking on behalf of the partnership in any meaningful way,” including being examined for discovery); *Re Lehdorff General Partner Ltd* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.) at 40 (“limited partners should take a completely passive role (they must or they will otherwise lose their limited liability protection...)”).

²³ Manzer, *supra* note 5 at para. 9.1520 to 9.1560; Hepburn, *supra* note 5 at 3-12.

²⁴ Hepburn, *supra* note 5 at 4-23, 4-27 (noting a group of Upper Canada cases where advisory committees fell afoul of the control liability provisions). See also Robert D. Flannigan, “The Control Test of Investor Liability in Limited Partnerships” (1983) 21 Alta L. Rev. 303; Eric Apps, “Limited Partnerships and the ‘Control’ Prohibition: Assessing the Liability of Limited Partners” (1991) 70 Can. Bar. Rev. 611; Robert D. Flannigan, “Limited Partner Liability: A Response” (1992) 71 Can. Bar Rev. 552; Christopher J.H. Donald, “Limited Partnerships and the ‘Control’ Liability of Limited Partners” (2007) 44 Can. Bus. L.J. 398.

²⁵ Upper Canada *LPA*, *supra* note 1, section 14:

... a special partner [the equivalent of today’s limited partner] may from time

A judicial decision on facts less straightforward than those in the cases that have been cited in this article would be one way to clear up the uncertainty, but there is no guarantee that the right case will come along – or be decided in a way that would be helpful. It has already been many years since *Re Lehndorff General Partner Ltd*, and *Kucor Construction and Developments & Associates v. Canada Life Assurance Co.*, which last considered the question of separate legal personality in any depth,²⁶ and, given the reluctance of corporate actors in this country to litigate matters to the point of a judicial determination, it could be some time before the courts squarely address the issue of “control” in the context of limited partner liability.

Another approach to the problem is legislative, and here the US might provide guidance. The *Delaware Code*, for example, adopts the provisions of the *Uniform Limited Partnership Act*, which predicate loss of limited liability on both control *and* detrimental reliance by a person dealing with the partnership who is under the belief that the particular partner’s liability has no cap.²⁷ It is not clear that the addition of a “detrimental reliance” test along the lines of that found in Delaware or Manitoba would alleviate uncertainty for limited partners concerned about how active a part they can play in the partnership’s affairs. More detailed guidance on what constitutes “control” for these purposes would, however, be a significant improvement. Delaware also follows the *Uniform Act* in enumerating a number of activities which, on their own, will not amount to participating in the control of the partnership’s business, notably the ability to

consult with or advise a general partner or any other person with respect to any matter, including the business of the limited partnership, or to act or cause a general partner to take or refrain from taking any action, including by proposing, approving, consenting or disapproving, by voting or otherwise, with respect to any matter, including the business of the limited partnership...²⁸

to time examine into the state and progress of the partnership concerns, and may advice [*sic*] as to their management; but he shall not transact any business on account of the partnership, nor be employed for that purpose as Agent, Attorney or otherwise; and if he shall interfere, contrary to these provisions, he shall be deemed a general partner.

²⁶ *Supra* note 22.

²⁷ *Delaware Code*, *supra* note 7 §17-303(a); *Uniform Limited Partnership Act* (1976), as amended (1985) [*Uniform Act*], §303(a). In *Haughton Graphics*, *supra* note 15 Eberle J. rejected the argument that detrimental reliance by third parties was part of the analysis under the Alberta statute (identical to the Ontario *LPA* in this regard), in the absence of reference to reliance in the legislation. Compare the Manitoba statute, cited *infra* at note 34.

²⁸ *Delaware Code*, *ibid.* §17-303(b)(2); *Uniform Act*, §303(b)(2).

The “safe harbours” under the Delaware statute also include:

- acting as an independent contractor or transacting business with the partnership
- being an officer, director or stockholder of a corporate general partner or a partner of a partnership which is a general partner
- acting as a surety or guarantor for the limited partnership or a general partner
- calling, requesting or attending a meeting of the partners or limited partners
- winding up the limited partnership
- bringing, pursuing or settling a derivative action in the right of the limited partnership
- serving on a committee of the limited partnership or of limited partners
- proposing, approving, disapproving or consenting to various transactions, including the dissolution or winding-up of the partnership; a sale, exchange, lease, mortgage, assignment, pledge of or granting of a security interest in partnership assets; refinancing the partnership; a change in the nature of the partnership’s business; the admission, removal or retention of a general partner or limited partner; transactions involving conflicts of interest; amendments to the partnership agreement or the certificate of the limited partnership; merger or consolidation of the limited partnership; indemnification of any partner or other person; capital contributions; investment decisions; and other matters as stated in the partnership agreement or in any other agreement or in writing
- advising, serving as an officer or director or being a stockholder of or contractor for a person in which the partnership has an interest or which provides management or other services to the partnership.²⁹

The 2001 revision of the *Uniform Act* (which Delaware has not adopted so far) goes even further:

²⁹ *Delaware Code, ibid.*, §17-303(b)(1), (3)-(10).

A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership.³⁰

The commentary to the 2001 revision suggests that control liability is simply “an anachronism.”³¹

The Law Commission of England and Wales and the Scottish Law Commission took a different view of business involvement by limited partners in their recent joint report on partnership law. The report concludes that while the “basic rule ... appears sound,” the existing liability provisions of the UK legislation are deficient because they offer no real guidance for limited partners.³² In the view of the two commissions, loss of liability should not be contingent on third-party reliance; and a non-exhaustive, modifiable list of activities which would not constitute “management” of the partnership should be set out in the legislation, along the following lines:

- (1) Taking part in a decision about the variation of the partnership agreement;
- (2) Taking part in a decision about whether to approve, or veto, a class of investment by the limited partnership;
- (3) Taking part in a decision about whether the general nature of the partnership business should change;
- (4) Taking part in a decision about whether to dispose of the partnership business or to acquire another business;
- (5) Taking part in a decision about whether a person should become or cease to be a partner;
- (6) Taking part in a decision about whether the partnership should end;
- (7) Taking part in a decision about how the partnership should be wound up;
- (8) Enforcing his rights under the partnership agreement (unless those rights are to carry out management functions);
- (9) Approving the accounts of the limited partnership;

³⁰ *Uniform Limited Partnership Act* (2001) §303 [*ULPA* 2001].

³¹ *Ibid.*, “Prefatory Note,” “Liability Shield for Limited Partners.”

³² *Report on Partnership Law*, *supra* note 11 at para. 16.20.

(10) Being engaged under a contract by the limited partnership or by a general partner in the limited partnership (unless the contract is to carry out management functions);

(11) Acting in his capacity as a director or employee of, or a shareholder in, a corporate general partner;

(12) Taking part in a decision which involves an actual or potential conflict of interest between a limited partner (or limited partners) and a general partner (or general partners);

(13) Discussing the prospects of the partnership business;

(14) Consulting or advising a general partner, or general partners, about the activities of the limited partnership or about its accounts (including doing so as member of an advisory committee of a limited partnership).³³

Until greater certainty is provided for limited partners in Canada, either by way of legislative amendments or some solid jurisprudence on control liability, another option would be to engage in some domestic forum-shopping. The test for loss of limited liability is significantly different under the laws of Manitoba from that in other Canadian provinces:

Loss of limited liability by a limited partner

63(1) Where a limited partner takes an active part in the business of the partnership, he is liable as if he were a general partner, to any person with

whom he deals on behalf of the partnership and who does not know that he is a limited partner for all debts of the partnership.³⁴

This offers more room for manoeuvre than in Ontario, since a limited partner taking an “active” role in the business of the partnership becomes liable as a general partner in Manitoba only where persons doing business with that partner are unaware that they are dealing with a partner whose liability is limited – in other words, the detrimental reliance approach adopted in the United States. The Federal Court of Appeal suggested in *Robinson (Trustee of) v. The Queen* that taking an “active part in the business of the partnership” was equivalent to managing it.³⁵ This is presumably a lower threshold for limited partner

³³ *Ibid.* at paras. 17.4, 17.7, 17.15, 17.17. On the eventual adoption of these recommendations, see *supra* note 11.

³⁴ *Partnership Act*, C.C.S.M. c. P30, as amended, s. 63(1) [Manitoba PA].

³⁵ [1998] 2 F.C. 569 at 575-76 (C.A.). See also *Nordile*, *supra* note 19 on the

activity than Ontario's requirement for "control." While the level of business involvement that will result in loss of limited liability therefore appears to be lower than in Ontario, disclosure of one's status as a limited partner will preserve limited liability in Manitoba for limited partners who take part in the management of the venture.

Choosing the Manitoba statute as a vehicle is not without risk, however – especially for someone from outside the province who might easily forget to keep up with statutory filings. There are these pitfalls for the unwary:

Partnership not formed until registered

55 A limited partner is not entitled to the limited liability afforded by this Act until a declaration has been made and registered as required under *The Business Names Registration Act*; and where a false statement is made in the declaration which has been relied on by a person who suffers injury or loss by reason of the false statement, all of the partners are liable to that person as general partners, for the loss or injury suffered by that person.

Declaration of continuance

56(1) Where the declaration mentioned in section 55 shows that the partnership is for a fixed duration, any continuance beyond that duration shall be registered and published as required for the original formation of the partnership; and every partnership otherwise continued shall be deemed a general partnership.

Failure to renew

56(2) Where the registration of a limited partnership has expired and the partnership continues to carry on business without renewing its registration as required under *The Business Names Registration Act*, it shall, for so long as it fails to renew the registration, be deemed a general partnership.³⁶

Inadvertent non-compliance with filing requirements could have the same consequences for limited partners as exercising control over the business in Ontario – the very result which formation of the limited partnership in Manitoba was intended to avoid.

difference between "control" and "management."

³⁶ Section 55 of the Manitoba *PA*, *supra* note 34, spells out in explicit terms what is implicit in Ontario *LPA*, *supra* note 2, section 3(1).

Even Manitoba's more flexible régime is not ideal. Canadian jurisdictions must offer clear rules for limited partners, preferably through the adoption of a list of permitted activities. This is the biggest lacuna in the law of limited partnerships, and it needs to be addressed. Uncertainty over the extent of a limited partner's potential exposure to liability may make investors (both foreign and domestic) nervous about employing Canadian limited partnerships when other jurisdictions offer greater assurance.

3. Death of a Limited Partner

Does the death of a limited partner bring about the dissolution of the partnership (unless there is a limited partnership agreement that provides otherwise)? This might seem like an arcane point, but it has come up in the author's experience.

The general position in partnership law is that a partnership terminates on the death of any partner, unless there is an agreement amongst the partners to the contrary.³⁷ This is reflected in section 33 of the Ontario *PA*, which provides that "every partnership is dissolved as regards all the partners by the death or insolvency of a partner." Limited partnerships being merely a sub-species of partnerships, the same rule will apply to them unless the applicable limited partnerships statute derogates from the default position.

The Ontario *LPA* says this about death:

Dissolution of limited partnership

21. The retirement, death or mental incompetence of a general partner or dissolution of a corporate general partner dissolves a limited partnership unless the business is continued by the remaining general partners,

- (a) pursuant to a right to do so contained in the partnership agreement; and
- (b) with the consent of all the remaining partners.

Death of limited partner

22. (1) The executor or administrator of the estate of a limited partner has,

³⁷ R.C. I'Anson Banks, *Lindley & Banks on Partnership*, 18th ed. (London: Sweet & Maxwell, 2002) at 688 (position at common law codified by UK *PA*); Hepburn, *supra* note 5 at 4-31.

- (a) all the rights and powers of a limited partner for the purpose of settling the estate of the limited partner; and
- (b) whatever power the limited partner had under the partnership agreement to constitute the limited partner's assignee a substituted limited partner.

This seems to imply that the death of a limited partner would *not* result in the dissolution of the partnership; section 21 refers only to the death of a general partner as a specific trigger for automatic dissolution, and section 22 treats the death of a limited partner as a matter distinct from the dissolution provisions. The fact that section 22(1)(b) goes on to provide for the substitution of the deceased limited partner's assignee as limited partner also suggests the survival of the limited partnership – unless the operation of section 22(1)(b) is predicated on the assumption that the agreement referred to in that paragraph expressly displaces the general rule about dissolution on death.

Canadian texts are not illuminating on this point. Alison Manzer suggests that “matters relating to the status of limited partners are not relevant to the partnership because the general partner has all of the powers and capabilities of undertaking the on[-]going partnership affairs and carries all of the liability as to third[-]party relations,” but does not address death specifically.³⁸ Hepburn has a brief section entitled “Death of a Limited Partner” where he states the “general rule ... that, subject to any contrary agreement, a partnership is dissolved upon the death of any partner,” which suggests that this would be applicable in the case of a limited partner's death as well.³⁹ More useful is an older US text, *Crane and Bromberg on Partnership*, which notes that the provisions of the *Uniform Act* (as then drafted) were sparse and inconsistent on the question, but nevertheless concludes:

Death of a general partner dissolves [the limited partnership] unless the agreement or certification provides otherwise or all the members consent to continuation. *By implication, the death of a limited partner does not dissolve.*⁴⁰

Section 21 of the *Uniform Act*, upon which *Crane and Bromberg* bases its conclusion, is identical to – and indeed the model for – section 22 of the Ontario *LPA*, so the slight layer of dust on the US text's top edge does not compromise the analysis for our purposes.⁴¹

³⁸ Manzer, *supra* note 5 at para. 9.1390.

³⁹ Hepburn, *supra* note 5 at 4-31.

⁴⁰ Alan R. Bromberg, *Crane and Bromberg on Partnership* (St Paul, Minn.: West Publishing, 1968) at §90B [emphasis added].

⁴¹ Section 22 of the Ontario *LPA* was added by S.O. 1980, c. 48, s. 21 and

While there appear to be no cases on section 22 of the Ontario *LPA* and its predecessor provisions, the issue of a limited partner's death was considered by the Alberta Court of Queen's Bench in *Marigold Holdings Ltd v. Norem Construction Ltd.*⁴² The case turns on Alberta provisions which (as they relate to death and dissolution) are identical to those in Ontario, although the main partnership issue in *Marigold* is the legal capacity of a limited partnership to bring an action. Conrad J. stated the traditional position that a partnership is not a separate legal entity, but went on to say that a limited partnership is "a hybrid of sorts," concluding:

The limited partnership is a creature of statute and offers a unique organization whereby income accrues to limited partners and liability is limited. In addition, while an ordinary partnership is dissolved when the composition of the firm changes, ss. 64, 65 and 67 of the Partnership Act contemplate the addition, substitution or death of a limited partner without the concomitant dissolution of the firm per se. A change in limited partners does not, as in [i.e., in contrast to] an ordinary partnership, change the identity of the firm. Section 65 reads in part:

65(1) A limited partner's interest is assignable.

(2) A substituted limited partner is a person admitted to all the rights of a limited partner who has died or has assigned his interest in the limited partnership.

(3) An assignee who does not become a substituted limited partner has no right

(a) to require any information or account of the partnership transactions, or

(b) to inspect the partnership books,

but is entitled only to receive the share of the profits or other compensation by way of income, or the return of his contribution, to which his assignor would otherwise be entitled.

Section 67 reads:

67(1) The executor or administrator of the estate of a deceased limited partner has

(a) all the rights and powers of a limited partner for the purpose of settling the estate of the deceased limited partner, and

(b) whatever power the deceased had to constitute his assignee a substituted limited partner.

consolidated as R.S.O. 1980, c. 241, s. 21.

⁴² [1988] 5 W.W.R. 710 (Alta Q.B.) [*Marigold*].

(2) The estate of a deceased limited partner is liable for all his liabilities as a limited partner.

*Whatever method of change of limited partner ownership, there is no instantaneous dissolution and recomposition of the firm. The firm continues.*⁴³

The reference to the substitution provisions of the Alberta statute suggests that they are to be interpreted as implicitly derogating from the general rule about death in a partnership. This strongly suggests that only the death of a general partner would result in the dissolution of a limited partnership in Ontario as well.

The UK limited partnerships statute has always avoided the inconsistencies present in the Uniform Act and its progeny in Ontario, expressly providing, in a section headed “Modifications of general law in case of limited partnerships” that “[a] limited partnership shall not be dissolved by the death or bankruptcy of a limited partner...”⁴⁴ This result is possibly more in keeping with the nature of a limited partner’s interest in the partnership, which is traditionally described as passive or sleeping – although, as was discussed in section 2 of this article, a limited partner may wish to be more than merely passive in relation to the affairs of the partnership, provided limited liability can be preserved. In any event it ought not to matter that one investor in a limited partnership has reached the ultimate point of passivity and simply drops out of the picture, perhaps with no appreciable effect on the partnership as a whole. This is in contrast to a general partnership, where the loss of one member is more likely to affect actual relations among firm members and their common venture, because all partners are actively engaged in the business, unconstrained by concerns about loss of limited liability.⁴⁵

⁴³ *Ibid.* at para. 239-40 [emphasis added]. *Marigold* was approved on this point in *Devon Canada Corp. v. PE-Pittsfield LLC*, 2008 ABCA 393 (2008), 446 A.R. 62, 303 D.L.R. (4th) 460 (Alta. C.A.). Manzer, *supra* note 5, makes no reference at all to *Marigold*; Hepburn, *supra* note 5 at 2-40.1, 2-49, refers to it only in the context of the legal capacity of limited partnerships in the context of litigation.

⁴⁴ *Limited Partnerships Act 1907*, 7 Edw. 7 c. 24 s. 6(2) [UK *LPA*]. See also Banks, *supra* note 37 at 876-77. To the same effect as UK *LPA*, s. 6(2) is Manitoba *PA*, s. 63(3).

⁴⁵ Note, however, that the Ontario *PA*, *supra* note 3, provides in section 19 that guarantees to a firm or a third party in respect of the firm’s transactions are, in the absence of any agreement to the contrary, revoked as to future transactions by any change in the constitution of the firm. The Ontario *LPA*, *supra* note 2, does not appear to derogate from this position. In any event, lenders to partnerships will want to have carefully drafted guarantees.

Another option to resolve any ambiguity about the effect of a limited partner's death would be to recognise the separate legal personality of limited partnerships; if the limited partnership is a distinct entity like a corporation, then the death of one of its members is a non-event as regards the entity's continued existence. The most recent revisions to the *Uniform Act* in the United States, which propose to confer entity status on limited partnerships, make the death of either a limited or a general partner an act of "dissociation" from a limited partnership, but dissociation does not logically result in the dissolution of the entity itself, just as the death of one of its shareholders does not affect the continued existence of a corporation.⁴⁶ In light of the recognition of the limited partnership as an entity in Delaware, the death of any type of partner is likewise not something that triggers a dissolution.⁴⁷

This issue is probably not the most pressing one in the law of limited partnerships, but clarification of the position in Ontario would at least promote certainty for investors and their legal advisers, whether from Ontario or elsewhere.

4. Units in Classes or Series

A question that US counsel sometimes ask is whether as a matter of law the units of an Ontario limited partnership may be issued in classes or series. The Delaware *LPA* permits limited partnership units in series:

§ 17-218. Series of limited partners, general partners, partnership interests or assets.

(a) A partnership agreement may establish or provide for the establishment of 1 or more designated series of limited partners, general partners, partnership interests or assets. Any such series may have separate rights, powers or duties with respect to specified property or obligations of the limited partnership or profits and losses associated with specified property or obligations, and any such series may have a separate business purpose or investment objective.

Classes of limited partners and general partners are also permitted.⁴⁸ Other provisions permit, amongst other things, a limited partnership

⁴⁶ *ULPA 2001*, *supra* note 30 §§601(6), 602, 603(7)(a), 605.

⁴⁷ See *Delaware Code*, *supra* note 7 §§17-505, 17-801-806. In spite of the recognition in Scotland of all forms of partnership as legal entities, the death of a general partner of a Scottish partnership does trigger dissolution (in the absence of agreement to the contrary); see Banks, *supra* note 37 at 688.

⁴⁸ *Ibid.* at §§17-302, 17-405.

agreement to set out rules with respect to the enforceability of the liabilities of a designated series or general partner against the assets of that series or general partner and not against the limited partnership generally; the ability of a series to carry on business, enter into contracts and hold assets in its own name; voting rights; withdrawal of a limited partner from a series; distributions; termination of a series without dissolution of the partnership as a whole; and withdrawal of a general partner associated with a particular series. New York's legislation also now permits the issuance of limited and general partner units in series, but sets out much less detail than the comparable provisions of the Delaware *LPA*.⁴⁹

There is nothing nearly so detailed in the Ontario *LPA*; in fact, there is no mention of units in classes or series at all. There appear to be no Canadian cases where classes or series of units are discussed. The author understands, however, that as a matter of practice Canadian lawyers have advised clients that classes or series of units are probably permissible under the applicable legislative provisions which give limited partners the ability to define their rights *inter se* as a matter of contract.⁵⁰ In Ontario, these provisions are as follows:

Limited partners' rights as between themselves

14. (1) Subject to subsection (2), limited partners, in relation to one another, share in the limited partnership assets,

(a) for the return of contributions; and

(b) for profits or other compensation by way of income on account of their contributions,

in proportion to the respective amounts of money and other property actually contributed by the limited partners to the limited partnership.

Priority agreement

(2) Where there are several limited partners, the partners may agree that one or more of the limited partners is to have priority over other limited partners,

(a) as to the return of contributions;

⁴⁹ NY *PA*, *supra* note 12 art. 8-A, §§121-302, 121-405.

⁵⁰ A search in DisclosureNet revealed a number of 2009 annual information forms of issuers holding interests in Manitoba limited partnerships with multiple classes of units. Let's hope the Manitoba general partners keep up with annual filings.

(b) as to profits or other compensation by way of income; or

(c) as to any other matter,

but the terms of this agreement shall be set out in the partnership agreement.

It would probably be desirable, however, if the Ontario *LPA* expressly provided for classes or series of limited partnership units, either along the lines of the broadly permissive New York provisions or the more detailed Delaware model, in order to help Ontario remain a jurisdiction of choice for limited partnership formation. If legislators in New York and Delaware have decided that allowing limited partnership units in series would be commercially advantageous, then it probably is – or at least not having them could make Ontario look like a less desirable jurisdiction by comparison. A further advantage is that prospective limited partners could be offered a wider variety of options in terms of making their investment in a particular venture, to the extent that classes or series of interests conferred different rights and obligations, or exposed the investor to more or less risk.

5. *Conclusion*

While limited partnerships continue to appeal as a business vehicle, it is clear from these few examples that their legislative framework has significant gaps that could usefully be filled either by the courts or, preferably, by the legislature. Foreign models are not worth following merely for the sake of it, but could offer useful guidance to Canadian jurisdictions seeking to modernise their partnerships statutes. The cost of not keeping up with developments elsewhere could be a flight to jurisdictions where the legal structure of limited partnerships offers greater certainty, greater flexibility or both. It would be desirable to provide greater certainty in Canadian jurisdictions with respect to the separate legal personality of limited partnerships and the circumstances of their dissolution or continued existence. More important is the clarification of the degree of participation in the business of the partnership that will cause a limited partner to lose the protection of limited liability. This is (or ought to be) one of the primary considerations in deciding to invest in a particular enterprise, and a continued gap in this area could cause investors to choose limited partnerships formed in foreign jurisdictions that provide clearer guidance and greater certainty. If the Law Commission of Ontario and its counterparts in other provinces are looking for a project in the field of commercial law, the reform of the legal framework for limited partnerships would be ideal.