

### MEE Question 6

Five years ago, Adam and Ben formed a general partnership, Empire Partnership (Empire), to buy and sell antique automobiles at a showroom in State A. Adam contributed \$800,000 to Empire, and Ben contributed \$200,000. Their written partnership agreement allocated 80% of profits, losses, and control to Adam and 20% to Ben. No filings of any type were made in connection with the formation of Empire.

Three years ago, a collector purchased one of Empire's antique cars for \$3,400,000. The collector was willing to pay this price because of Ben's false representation (repeated in the sales contract) that a famous movie star had once owned the car. Without the movie-star connection, the car was worth only \$100,000. One month later, when the collector discovered the truth, he sued Adam, Ben, and Empire for \$3,300,000 in damages. The lawsuit is still pending.

Two years ago, Adam and Ben admitted a new partner, Diane, to Empire in return for her contribution of \$250,000. The three agreed to allocate profits, losses, and control 75% to Adam, 10% to Ben, and 15% to Diane. Before joining the partnership, Diane learned of the collector's claim and stated her concern to Adam and Ben that she might become liable if the claim were reduced to a judgment.

Following Diane's admission to Empire, the three partners sought to convert Empire into a limited liability partnership (LLP). Adam's lawyer proposed to file with State A a "statement of qualification" making an LLP election and declaring the name of the partnership to be "Empire LLP." Ben's lawyer stated that this would not work and that a new LLP had to be formed, with the assets of the old partnership transferred to the new one. In the end, the conversion was done the way Adam's lawyer suggested with the approval of all three partners.

One year ago, a driver purchased a vintage car from Empire LLP, based on the representation that the car was "fully roadworthy and capable of touring at 70 mph all day." The driver took the car on the highway at 50 mph, whereupon the front suspension collapsed, resulting in a crash in which the car was destroyed and the driver killed. The driver's estate sued Adam, Ben, Diane, and Empire LLP for \$10,000,000. The lawsuit is still pending.

Although profitable, Empire LLP does not have resources sufficient to pay the collector's claim or the claim of the driver's estate.

Assume that the Uniform Partnership Act (1997) applies.

1. Before the filing of the statement of qualification,
  - (a) was Adam personally liable on the collector's claim? Explain.
  - (b) was Diane personally liable on the collector's claim? Explain.
2. After the filing of the statement of qualification, was Adam, Ben, or Diane personally liable as a partner on (a) the collector's claim or (b) the driver's estate's claim? Explain.

**6) Please type your answer to MEE 6 below**  
(Essay)

===== Start of Answer #6 (1261 words) =====

**I. Ben had the authority to bind the partnership in the transaction with the collector.**

The first issue is whether Ben, a partner, had the authority to make a contract to sell an antique automobile to the collector. A general partner has the ability to bind the partnership when the partner is carrying on in the ordinary course of business. A partner can have actual, implied, or apparent authority. A partner has actual authority where the other partner(s) or the partnership agreement specifically gives the partner the authority to act in a specific manner. A partner has implied authority to act in ways that are in the ordinary course of the business or that are incidental to the express authority of the partner. Apparent authority is not authority at all. Rather, it is a third party's perception of the authority of a partner. Apparent authority exists when a third party reasonable and without knowledge believes that a partner has authority to act in the manner in which he or she is acting. Where apparent authority exists, the partnership is bound to the third party.

Here, there is no partnership agreement. Ben only had 20% control of the partnership, but the business of the partnership was to buy and sell antique vehicles. Ben would likely have express and/or implied authority to enter into a contract with a collector for the sell of an antique car. It is doubtful, though, that Ben had the authority to lie in the

contract. However, apparent authority probably existed here. The collector was contracting with Empire through Ben to buy an antique car. He reasonably believed that Ben had the authority to act in the way in which Ben was acting. It is questionable whether the collector reasonably believed that the car was one that a famous movie car had driven or whether the collector had the duty to investigate the truth before buying the car. But he still reasonably believed that Ben had the authority to engage in the transaction based upon the nature of the business.

Accordingly, Ben had the authority to bind the partnership.

## **II. Adam can be held liable to the collector prior to the statement of qualification.**

The next issue is whether Adam can be held liable for the collector's claim against the partnership even though Adam was not personally involved in the transaction. All partners are jointly and severally liable for any obligation of the partnership. The partner can be individually liable for the obligations of his or her co-partners or the obligations of the partnership where the partner is joined and served in the lawsuit personally. A creditor can hold any partner liable for the entire amount of the damages individually, although a partner may have a right to contribution from the partnership or the other partner.

Here, Ben had authority to bind the partnership. Adam, as a partner in Empire, can be sued and held personally liable for all debts and obligations of the partnership and his

other partner, Ben. The only requirement is that the creditor sue Adam and provide service on Adam individually. The collector sued Adam, Ben, and the partnership. The facts do not indicate whether Adam was personally provided with service. If the collector sues Adam for the entire amount upon judgment, the collector will be able to recover the entire amount from Adam. Adam, though, can seek contribution from his co-partner and the partnership.

Assuming that Adam was personally served with the suit by the collector, he will be jointly and severally liable to the collector for any judgment arising from the obligation that resulted between Ben, Empire, and the collector for the purchase of the car.

**III. Diane is not personally liable for partnership obligations incurred prior to her joining the partnership.**

The next issue is whether Dianne will be personally liable for the collector's claim against the partnership, Adam, and Ben, that occurred prior to her joining the partnership. A new partner is not liable for the debts and obligations of the partnership or the other partnerships that arose prior to the partner joining the partnership. The time that matters is the time that the claim arose. Pendency of a lawsuit does not establish the liability for a new partner.

The collector's claim arose from a transaction that occurred between the partnership, Ben, and the collector three years ago. Dianne was not admitted as a new partner until

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two years ago. Dianne was not a partner when the debt or obligation arose.

Thus, Dianne will not be held individually liable for the collector's claim against the partnership.

**IV. The filing of the statement of the qualification was sufficient to establish Empire as an LLP.**

The next issue is whether the filing of the statement of qualification was sufficient to protect Empire's partners as an LLP. A general partnership can elect to convert into an LLP. The LLP must provide the necessary information to the state's Secretary of State. The name must include the designation "LLP" or words that are basically the same, such as limited liability partnership. As soon as the filing of the statement of qualifications has been accepted by the state's secretary of state, the partnership acquires LLP status and limited liability from that point forward, provided any franchise fees are paid and all yearly or other requirements are satisfied.

Here, Empire filed a statement of qualification with State A. This statement provided that the partnership was now Empire, LLP. Accordingly, the general partnership was converted into a limited liability partnership in State A.

**V. Adam and Ben only are individually liable on the collector's claim, even after attaining limited liability status.**

The next issue is whether Adam, Ben, and Dianne are individually liable on the collector's claim as they have now converted the partnership into an LLP. Limited liability partnerships have limited liability after the point of formation and continuing so long as the LLP status attaches to the partnership. The policy behind limiting liability only after the point of formation is to ensure that general partnerships do not incur significant debts and obligations and then escape from those obligations by simply converting to an LLP at any time. This would create havoc in the state.

The collector's claim arose three years ago when Ben made the fraudulent representation about the car to the collector. Although the suit is still pending, the claim arose at the time of the wrong. The partnership converted to an LLP two years ago, after the collector's claim had arisen. Accordingly, the LLP status will not protect those partners of Empire at the time of the misrepresentation by Ben. Dianne is protected for the reasons stated above; Adam and Ben, though, are still individually liable to the collector.

**VI. Only Empire LLP is liable for the driver's estate's claims.**

The last issue to consider is whether Adam, Dianne, and Ben are personally liable for the driver's estate's claims. An LLP protects partners from personal liability for the debts and obligations of the partnership. That is where the term limited liability derives from--the partners are not individually liable. Once the LLP is formed, the partners are

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