



State Law & State Taxation Corner



By Allan G. Donn

Limited Liability Entities for Law Firms—10 Years Later*

Introduction

Plaintiffs seek the most direct route to satisfy claims against a law firm for malpractice. They have recourse to liability insurance and a firm's assets. Consequently, in the normal case of a claim against professionals, the claim will be asserted against the firm; the firm and its insurers will make payment; and the firm owners need have no fear as to their personal assets. Even in the case of a general partnership, although all partners are jointly and severally liable for all obligations of the partnership,¹ generally a judgment creditor may not levy execution against the assets of partners to satisfy a judgment based on a claim against the partnership until the assets of the partnership have been exhausted.² In the event of a catastrophe, however, the personal assets of the innocent professionals are at risk because the partners are vicariously liable for the obligations of the partnership.

In the early 1990s, the focus was on actions against law and accounting firms that represented failed financial institutions.³ In the current decade, attention is directed to professional firms that advised failed corporations such as Enron and WorldCom. The names "Arthur Andersen"⁴ and "Enron"⁵ strike fear in the hearts of professionals, particularly those with larger firms. Forms of practice that may limit the risk of vicarious liability are again in the spotlight.⁶

Lawyers may not enter agreements prospectively limiting liability to a client for malpractice.⁷ However, they may enter contracts excluding or limiting vicarious liability in commercial transactions, such as office leases. The focus of this article will be on the present state of the law of vicarious malpractice liability.⁸

Developments in the Law

Ten years ago, the availability of a limited liability shield for lawyers was not as clear as it is today. In the April 7, 1994, draft of the RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, §79, stated that the

black letter law was vicarious liability for law firm principals regardless of form of organization.⁹ The draft noted a rejection by the ALI Council of a motion to prefix the Section with the phrase, "Except as otherwise provided by statute."¹⁰ According to the Comment, in the case of a professional corporation, its shareholder-principals were said to be vicariously liable in the same manner they would be in a partnership for the negligence or misconduct of principals or employees in the rendition of legal services.¹¹ At the 1994 annual meeting of the ALI, the section was recommitted to the Reporters for further study based on the argument that the draft was not an accurate statement of the law.¹²

After at least two additional drafts,¹³ Section 79 was substantially changed and included in revised form as Section 58 of the Official Text approved at the 1998 ALI annual meeting. Under that section, each principal of a law firm organized as a general partnership without limited liability is liable jointly and severally with the firm, but "[a] principal of a law firm organized other than as a general partnership without limited liability as authorized by law is vicariously liable for the acts of another principal or employee of the firm to the extent provided by law."¹⁴ In 1998, most states did not provide by law that a law firm principal was vicariously liable for the acts of others. Thus, the black letter rule was reversed from the 1994 draft.

During the years of the ALI debates, there were a number of states that had imposed vicarious liability on the principals of law firm limited liability entities or did not permit limited liability companies (LLCs) or limited liability partnerships (LLPs) to engage in law practice. There have been amendments to statutes or rules of court, or court decisions by 15 of those states to permit

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those forms of practice and to eliminate vicarious liability.¹⁵ The current general principle governing law firms in every state is that, subject to certain conditions, an owner of a limited liability entity is not, solely by reason of being an owner, personally liable for debts or claims against, or acts or omissions of, the entity or another owner or employee.

It should be noted that in the case of LLPs, 12 states¹⁶ afford only a “partial shield.” That means that the general LLP statute protects against claims arising only from “omissions, negligence, wrongful acts, misconduct or malpractice.”¹⁷ That leaves vicarious liability for general business obligations. For example, Arthur Andersen LLP was an Illinois partial shield LLP in which the partners had liability protection against professional liability claims

but not against claims from any other cause, including “ordinary commercial debt.”¹⁸

In the Andersen bankruptcy proceedings, the Committee of Unsecured Creditors asserted that the current payment by Andersen of its “ordinary commercial debt,” as well as current distributions be-

ing made by Andersen to its partners, may constitute fraudulent conveyances under applicable fraudulent conveyance laws.¹⁹ According to the claim, paying down ordinary commercial debts “would effectively reduce the potential liability of Andersen’s partners, at the expense of Anderson Malpractice Claimants who could only look to partnership assets, but not to assets of individual partners (other than those directly involved in malpractice) for satisfaction of any judgment.”

Availability of the Entity

The principal entities used by law firms are professional corporations or associations (PCs), LLCs and LLPs.²⁰ An LLP is a general partnership in which the general partners have limited liability.²¹ In the language of the Restatement, an LLP would be described as a general partnership with limited liability.

For many years, every state has permitted the use of professional corporations or associations for the practice of law. Every state except California²² now permits LLCs for the practice of law. Many LLC acts include express authorization of professional LLCs.²³ In a number of states with LLC statutes having broad general purpose provisions but no express professional LLC provisions, rules of court expressly permit law firm limited liability entities, including LLCs.²⁴

With the amendment of the Illinois Supreme Court Rule 721, effective July 1, 2003, LLPs for the practice of law appear to be permitted in every state.

Limitations on Vicarious Liability

State supreme courts generally assert inherent authority to regulate the legal profession.²⁵ Therefore, notwithstanding general statutes that grant limited liability to entity owners, the courts claim the authority to make that determination for law firms. According to a leading commentator, caution should be exercised until a particular state high court has spoken.²⁶ For example, the Georgia Supreme Court held that the shareholders of a law firm professional corporation were not entitled to the statutory limits on liability available to other professionals.²⁷ However, that court has overruled that case.²⁸ The state high courts that earlier had mandated vicarious liability have adopted rules of court expressly permitting limited vicarious liability.²⁹ Other courts in case law have recognized the liability limitation.³⁰

Illinois had been the only remaining state that expressly

imposed unlimited vicarious liability on lawyers practicing in limited liability entities. Illinois Supreme Court Rule 721(d) was amended, effective July 1, 2003, to eliminate the imposition of vicarious liability. New Rule 722 was added expressly to permit limited liability law practice, if the entity maintains the required minimum insurance or alternative financial responsibility. Effective in 2003, Illinois also adopted RUPA and changed from a “partial shield” to a “full shield” state.³¹ For existing partnerships, Illinois RUPA will not apply until 2008 unless the partnership elects earlier coverage. Widespread election of early application should be anticipated.

Requirements for Limited Liability

In a number of states, the general LLP statute requires the entity, at least for all professionals, to carry or maintain professional liability insurance.³² In some states, the rules of court applicable to all law firm limited liability entities require a law firm to carry prescribed amounts of professional liability insurance or alternative forms of “financial responsibility” in order to secure limited liability.³³ Maintaining insurance or alternative professional responsibility has been described as the *quid pro quo* for permitting the limited liability conferred by the enabling acts.³⁴

In the event of a catastrophe, however, the personal assets of the innocent professionals are at risk because the partners are vicariously liable for the obligations of the partnership.

It is surprising that lawyers would need an incentive to carry professional liability insurance, but apparently that is the case.³⁵

The rules of court in the states are not uniform, but they give rise to two common issues, namely, time of compliance and effect of noncompliance.³⁶ For example, what happens if a firm has procured the requisite insurance, but coverage is denied when a substantial claim is asserted? Do the entity owners lose both the insurance coverage and the entity liability protection?

Generally, professional liability policies are on a “claims-made” basis. They cover claims first made against the insured and reported to the company during the policy period regardless of when the act or omission giving rise to the claim occurred.³⁷ What if a “claims made” policy is in effect at the time of the alleged negligent act, but not in effect when the claim is asserted? A Colorado court held that its rule was not violated under those circumstances.³⁸

*First American Title Insurance Co. v. Lawson*³⁹ illustrates the risk inherent in a rule that conditions limited liability on insurance coverage. The law firm that was the subject of that case was a three-man New Jersey LLP. The firm’s managing partner had made material misrepresentations when he applied for malpractice coverage on behalf of the firm and its members. Two title insurance companies sued the firm and its partners to recover payments they had made to defrauded clients of the firm, and the professional liability insurer sought a determination that the policy was rescinded for fraud in the application.

The New Jersey Supreme Court held that the insurance carrier was entitled to rescind the policy in respect of the firm as an entity, the managing partner and another partner whose conduct was such that the court concluded that he knew or should have known that the information submitted to the carrier was false or misleading. As to the innocent partner, the court refused to permit the rescission of his coverage.

The Supreme Court noted that one of the plaintiffs had asserted in its complaint that the firm’s LLP status should be declared void for failure to maintain the professional liability insurance required by the rules of court. That issue was not addressed in the lower appellate court opinion.⁴⁰ Having held that the carrier was entitled to rescind its coverage of the firm as an entity, the court did not discuss the effect on the firm’s status as an LLP. The court did say that by organizing as an LLP, the innocent partner had every reason to believe his liability would be limited and that voiding his coverage solely because of his partners’ wrongful

conduct potentially would expose him to uninsured liability in a manner inconsistent with his expectations under the New Jersey LLP law. In effect, the innocent partner was spared the normal consequences of misbehavior of a partner in a matter relating to the ordinary course of the partnership’s business.

Perhaps the determination to revoke the LLP status was implicit in the Court’s opinion. Unless the LLP status had been deemed terminated, why would the innocent partner’s individual insurance coverage have been important? However, the Court also referred to protection as to matters that the innocent partner had handled for other clients, as to which he would have had personal liability whether or not the firm was an LLP. Because no claim involving other clients was before the Court, there would have been no reason for the Court to have discussed that issue. Alternatively, the Court may have concluded that it did not have to address the issue because the policy remained effective for the innocent partner.

The Illinois Supreme Court rule, which conditions liability protection on maintaining minimum insurance or alternative financial responsibility, attempts to address the problem. Rule 722(b)(1) provides that if evidence of the requisite insurance is provided with a registration or renewal application for LLP status, and “it is ultimately determined that the limited liability entity failed to maintain minimum insurance during the period covered by that registration or renewal, *unless* such failure is fraudulent or willful the joint and several liability of the owners for a claim arising out of wrongful conduct shall be limited to the minimum per claim amount of insurance applicable to the limited liability entity under this rule.” Thus, failure to have the requisite coverage is not fatal to the liability protection unless the failure is fraudulent or willful. The situation that was contemplated was a loss of coverage for reasons that are not the fault of the firm, such as the insurance carrier’s becoming insolvent.⁴¹ How does that concept apply to the facts of *First American Title*, in which the firm’s policy was nullified because of fraud in the application? Did that constitute a fraudulent failure of coverage, or is the concept limited to acts such as intentionally canceling the policy after filing the registration? Certainly, the loss of coverage could not be described as to having been not due to the fault of the firm.

In some states, vicarious liability for malpractice claims against lawyers continues, but only up to certain dollar amounts, or the amount of the deductible, or to the extent of the failure to maintain the required insurance or alternative financial responsibility.⁴²

Rules of Conduct⁴³

The Model Rules of Professional Conduct preclude a lawyer from limiting his liability for malpractice.⁴⁴ However, that constraint is not treated as prohibiting members of a law firm from limiting their vicarious liability through limited liability entities.⁴⁵ The ABA has issued a Formal Opinion to that effect,⁴⁶ as have a number of state and local bar committees.⁴⁷

Responsibility for Own Acts

Notwithstanding the general rule of limited liability, the shareholders of a corporation, members of an LLC and partners of an LLP remain responsible for their own acts or omissions.⁴⁸ Although some statutes and rules of court contain an express provision to that effect,⁴⁹ the result is the same under the common law in the absence of statute.⁵⁰ Direct liability results not from status as an owner of the firm but from the personal acts or omissions.

Supervisory Responsibility

Lawyers also retain supervisory responsibility of various kinds.⁵¹ Direct supervisory responsibility arises from two sources. First, under common law principles, a principal is subject to direct liability to a third party for injury caused by an agent's conduct when the principal is negligent in selecting, supervising or otherwise controlling the agent.⁵² In addition, some states expressly impose liability for negligence in supervising or controlling the agent.⁵³

There may also be no-fault supervisory responsibility. A number of LLP acts provide that the registration as an LLP "shall not affect the liability" of a partner either for his own negligence or "that of any person under his direct supervision and control."⁵⁴ In addition to the scope of "direct" supervision,⁵⁵ it is not clear under the "shall not affect" language whether the statute is intended to impose no-fault liability on the supervising partner or whether it is merely to continue any common law liability the partner may have had for negligence in supervising others.⁵⁶ Under a no-fault statute, it is not necessary for a claimant to establish negligence in supervision.

I have found no cases addressing that issue. Whether a lawyer has direct supervisory authority in a particular case is a question of fact. There are a few cases in which the responsible supervisory

relationship was not found to exist.⁵⁷ Whether the basis of the liability is no-fault or negligence, if it is viewed as a direct breach of duty by the supervising partner, then the claimant can seek to collect directly from that person without first having to obtain a judgment against the partnership and to exhaust the partnership's assets.⁵⁸

If the legislative intent is to impose no-fault vicarious liability, as distinguished from preserving common law liability for negligent supervision, more direct language would be appropriate. For example, New York and Maine appear affirmatively to impose liability on the supervising attorney without regard to fault. Under the LLP laws of those states, the entity owner is liable for any negligent or wrongful act or misconduct when committed "by any person under his direct supervision and control" while rendering professional services on behalf of the firm.⁵⁹

One interpretation of the "shall not affect" language that would result in no-fault liability of the supervising partner is as follows. Under the law of general

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partnerships, joint and several liability is the general rule. The LLP provision provides relief from joint and several liability in most cases, but that special relief does not apply, or, stated differently, does not affect, the liability of the supervising partner. In other words, the supervising

partner is not afforded the liability relief otherwise available to the other partners.⁶⁰ Although that argument is plausible in the context of an LLP statute, it is less persuasive when similar language is used in PC or LLC statutes.⁶¹

The Model Rules of Professional Conduct have an analogous supervisory rule making a lawyer responsible as a disciplinary matter for another's violation. However, what is described as the "duty to cure"⁶² rule does not impose no-fault responsibility; it applies if the lawyer knows of the conduct but fails to take remedial action.⁶³ On the premise that no-fault civil liability does not result from the mere failure to comply with the Model Rule duty to cure, there is even less reason to interpret an ambiguous statute to impose no-fault civil liability when under the facts, there would not be a violation of the Model Rule. Absent a clear statutory directive, it would seem reasonable to interpret the statutory standard in the same manner as the Model Rule, that is, not to impose no-fault liability.⁶⁴

It should be noted that, even within a single state, the statutory rules of supervisory responsibility may not be the same for all limited liability entities.⁶⁵ New York and a few other states have the same rule for PCs, LLCs and LLPs. In a number of states, however, for no apparent policy reason, the statutes differ not only as to the articulation of supervisory responsibility, but whether or not there is supervisory responsibility.⁶⁶

Wrongful Distributions

Corporate⁶⁷ and LLC⁶⁸ statutes prohibit distributions to shareholders and members that render the entity insolvent. RUPA and most LLP statutes do not impose a limitation on distributions; a few do.⁶⁹ Entity owners who receive distributions in violation of the limitation are liable to return them to the entity. In addition, even though the Illinois pre-RUPA LLP statute did not impose a limit on distributions, in the Andersen bankruptcy proceedings, an effort is being made to require the partners to repay partnership distributions in the context of a partial shield LLC statute.

In the corporate context, persons may be both an employee and a shareholder. Compensation for services generally takes the form of salary and bonuses to employees, and the distribution of dividends to shareholders. The statutory limits apply to dividends but generally not to reasonable compensation for services.⁷⁰

RUPA defines “distribution” generally as a transfer from a partnership to a partner in the partner’s capacity as a partner. According to the RUPA comment, transfer to a partner in the partner’s capacity as an “employee of the partnership” is not a distribution. There is no indication as to what is meant by a partner being an employee of the partnership. Partnership profits reflect the partnership net earnings from its business or investments, but a particular partner’s share may reflect both a return on capital, and, as in a professional practice, compensation for services. A number of states have modified their statutes to provide that “distribution” does not include reasonable compensation for services or payment pursuant to a bona fide retirement plan.⁷¹

When Is Liability Incurred?

The question of when an obligation is incurred is significant in a number of situations:

- Admission into an existing general partnership that is not an LLP⁷²
- The registration of a general partnership as an LLP⁷³
- A change in the LLP statute from “partial shield” to “full shield”

- Termination of LLP registration⁷⁴
- Partner dissociation from a general partnership that is not an LLP
- Conversion of a partnership into a limited liability entity⁷⁵
- Conversion of a limited liability entity into a nonlimited liability entity

A recent case illustrates the point. *Dow v. Jones*⁷⁶ involved a claim against a law firm for malpractice by a former partner that arose after the dissolution of the firm. The Court held that it would impose liability on the firm for legal malpractice claims arising after dissolution where the conduct at issue was appropriate for winding up the law firm partnership. For that purpose, cases that are pending at the time of dissolution are matters that must be wound up. Consequently, a former partner’s malpractice that occurs after dissolution in a case that was pending before dissolution can still bind the dissolved law firm partnership.

The limited liability entity statutes generally do not address the subject of when a liability is incurred. A RUPA comment states that other law determines when an obligation is incurred.⁷⁷ However, the RUPA comment does state principles as to when an obligation is incurred.⁷⁸ The Minnesota LLP statute is the only one that prescribes when a partnership debt or obligation is incurred, incorporating the language from the RUPA comment.⁷⁹ In the case of a tort, the partnership obligation is incurred when the tort occurs, not at the time of actual injury or harm.⁸⁰

Indemnification and Contribution

“Indemnification”⁸¹ is the term used to refer to the right of an agent to be reimbursed by the principal for liabilities incurred on behalf of the principal.⁸² In the partnership context, “contribution” refers to the obligation of partners to contribute to the partnership to enable it to meet its obligations, which may include an indemnity obligation to a partner.⁸³ Some organizational statutes mandate indemnification and others permit the parties to create rights to indemnification. For example, RUPA §401(c) provides that, unless otherwise stated, a partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred in the ordinary course of the business of the partnership or for the preservation of its business or property. There is, however, an important distinction between the indemnification right under the general rules of agency, on the one hand, and the partnership rule, on the other. A principal’s duty to indemnify does not extend to losses that result

from the agent's own negligence.⁸⁴ However, under RUPA §404(c), because a partner's duty of care is to refrain from gross negligence, a partner is entitled to indemnification for losses that result from the partner's simple negligence.

RUPA §306(c) reflects the assumption that by becoming an LLP, the partners intend to eliminate the contribution obligation. That section provides that the filing of a statement of qualification as an LLP overrides any inconsistent provisions of the partnership agreement, including contribution obligations that existed immediately before the vote to approve becoming an LLP.⁸⁵ However, a partner's right to indemnification under RUPA is not so affected by the partnership's becoming an LLP.⁸⁶

A frequently raised question in preparing the agreement among the owners of a limited liability entity is whether to have a provision obligating the entity owners to contribute to the liabilities incurred by certain of the members of the firm, such as managing partners or section heads, who have a greater risk of being subjected to vicarious supervisory liability, or to lawyers subject to claims for simple rather than gross negligence.⁸⁷ Those in supervisory positions are producing revenues that all the owners share, but are left to bear the risk alone. However, the parties should recognize that, to the extent that they agree to any contribution obligation, they are creating a hole in the liability protection shield.

More importantly, there is no assurance that the agreed-upon contribution payment will be applied as intended. As previously stated, in the Andersen bankruptcy proceedings, the creditors have asserted that payments by Andersen that reduced assets of the partnership that would otherwise be available to pay the claims for which the partners have limited liability is a fraudulent conveyance. Thus, if contributing owners transfer funds to the entity, which then disburses the funds to indemnify the lawyer who incurred the liability, the creditors of the entity can be expected to object. If those creditors succeed, then the contributing partners would have assisted unintended beneficiaries.

A variation of an agreement by the otherwise protected partners to contribute to the entity is an agreement among the partners to contribute directly to the partner who incurs the loss for which he is entitled to indemnification by the partnership. The

partners should be able to have a cross-indemnification agreement among themselves that is not treated as a constructive contribution agreement. However, even a cross-indemnity agreement may benefit someone other than the intended partner. For example, if a partner's loss is so great as to force that partner into bankruptcy, the right to contribution under the agreement will be viewed as an asset of the debtor partner to which his creditors may be expected to seek to avail themselves.

Choice of Entity

A recent analysis indicated that almost one-half of law firms in the United States use the PC form.⁸⁸ The reason for the predominance of PCs is because that form has been available considerably longer than the other limited liability entity forms. The risk of a substantial tax cost on converting to an unincorporated form is the principal deterrent to conversion to another form.⁸⁹

Although the LLC is very popular for commercial businesses, it is not so widely used by professionals.⁹⁰ The advantage of the LLC over the partnership

The advantage of the LLC over the partnership is that under every LLC act the LLC members have the same complete liability protection that is available to shareholders of a corporation.

is that under every LLC act the LLC members have the same complete liability protection that is available to shareholders of a corporation. By comparison, under the "partial shield" statutes of 12 states, liability protection is less complete than it is in "full shield" states. Nevertheless, according to the survey,

in law firms with more than 50 lawyers, the LLP is the most popular form, and the "preference of LLPs strengthens as firms grow in size."⁹¹ In view of the Arthur Andersen experience, it would be surprising to see the LLP form selected in a partial shield state. In the single-owner firm, an LLC, but not a partnership, may be used.

A number of reasons have been suggested for the relatively small number of law firms that practice as LLCs. First, that form is not available for California firms or foreign firms with California offices. Second, there is a concern that there is a greater risk that interests in an LLC will be treated as securities for securities law purposes. Third, the IRS has given no guidance as to whether Code Sec. 736, which permits retirement payments to be deductible to the firm, and which section refers to "general partners" but is silent as to LLC members, will be available for

LLCs. Fourth, there seems to be a feeling that in the case of an existing entity, because an LLC is different from an LLP partnership, the LLC agreement requires a restatement rather than merely amendment, inviting the reopening of business decisions thought to have been laid to rest.

Conclusion

With limited exceptions, lawyers are permitted in every state to organize law practices as PCs, LLCs and LLPs. Moreover, there is no state in which the current law, whether by statute, rule of court or decision, is that lawyers may not avail themselves of the protec-

tion against vicarious liability afforded by the PC, LLC and LLP statutes. There is reason to believe that law firms will continue to look to the limited liability entity together with professional liability insurance for protection against vicarious liability. The significant issue that will have to be addressed is the continued potential liability of the supervising lawyers at the same time that the other firm members have liability protection. Moreover, those persons should consider liability insurance for claims not covered by a professional liability policy, including employer's practice insurance for claims such as wrongful termination and discrimination, unemployment or fiduciary liability insurance.

ENDNOTES

* Thanks to Sheldon I. Banoff, Thomas G. Johnson, Jr., Robert R. Keatinge and John Y. Pearson for their valuable comments on drafts of this article.

¹ Revised Uniform Partnership Act (RUPA) §306(a).

² RUPA §307(d).

³ See AMERICAN BAR ASSOCIATION WORKING GROUP ON LAWYERS' REPRESENTATION OF REGULATED CLIENTS, *Laborers in Different Vineyards? The Banking Regulators and the Legal Profession*, Discussion Draft, Jan. 1993.

⁴ See *Roquet v. Arthur Andersen LLP*, DC Ill., 2004 U.S. Dist. LEXIS 5150 (2004). (Because of acute amount of client losses following indictment, mass layoffs held not reasonably foreseeable, and firm not liable under WARN Act.)

⁵ *In re Enron Corp. Securities, Derivative & ERISA Litigation*, DC Tex., 235 FSupp2d 549, 656–86, FED. SEC. L. REP. ¶92,239 (2002). *Final Report of Neal Batson, Court-Appointed Examiner, In re Enron Corp.*, Case No. 01-16034 (AJG), Bankr. NY, 48–52 (Nov. 4, 2003).

⁶ Jonathan D. Glater, *Fearing Liability, Law Firms Change Partnership Status*, N.Y. TIMES, Jan. 10, 2003, at C2.

⁷ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, at §54(2) ("RESTATEMENT LAWYERS").

⁸ The argument for and against vicarious liability is beyond the scope of this article. For references to the literature on the subject, see Larry E. Ribstein, *Limited Liability of Professional Firms After Enron*, J. CORP. LAW, Winter 2003, at 107, note 17. Available at <http://home.law.uiuc.edu/~ribstein/limitedliability.pdf>.

For regulatory imposition of duties on "supervisory attorney," violation of which subject attorney to civil penalties and remedies for violation of federal securities laws, see 17 CFR Chapter II, §§205.4 and 205.6(a).

⁹ RESTATEMENT LAWYERS, Tentative Draft No. 7, at 113 (Apr. 7, 1994).

¹⁰ *Id.*, at 113, note 5. According to the Reporter's Memorandum, a half-dozen-or-so states had enacted statutes for LLPs or the like, and the Council rejected an amendment intended to comment favorably on that legislation. *Id.*, at xxxii.

¹¹ *Id.*, at 115.

¹² 1994 ALI PROC., at 356–66.

¹³ RESTATEMENT LAWYERS, Preliminary Draft No. 12 (May 15, 1996); Tentative Draft No. 8 (Mar. 21, 1997).

¹⁴ RESTATEMENT LAWYERS, §58(2) and (3).

¹⁵ Arizona, Delaware, Georgia, Hawaii, Illinois, Indiana, Kentucky, Maryland, Nebraska, North Carolina, Ohio, Oregon, Rhode Island, Virginia and Wisconsin.

¹⁶ Kentucky, Maine, Michigan, Nevada, New Hampshire, Ohio, Pennsylvania, South Carolina, Tennessee, Utah, West Virginia and Wisconsin.

¹⁷ *E.g.*, Tenn. Code Ann. §61-1-306(c).

¹⁸ 805 Ill. Comp. Stat. 205/15(c).

¹⁹ *LLPs after Arthur Andersen*, ABA Section of Business Law, Committee on Partnerships Program Materials, at 117, 127 (Aug. 13, 2002). See Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1078–81 (1995).

²⁰ Del. S. Ct. Rule 67(a)(iii), Pa. S. Ct. Rule 5.4(d) and Comment permit limited partnerships, but that form is rarely used.

²¹ General partnership law applies to LLPs, including the authority of a partner to bind the partnership as its agent. *E.g.*, *Dow v. Jones*, DC Md., 311 FSupp2d 461 (2004).

²² Cal. Corp. Code §17375. (Neither domestic nor foreign LLC may render professional services in the state.) According to Robert G. Heyman, NEW MEXICO PRACTICE GUIDE A.7, 3 STATE LIMITED LIABILITY COMPANY AND PARTNERSHIP LAWS (2003–4 Supp.), New Mexico does not permit law firm LLCs, but the Martindale-Hubbell directory lists several.

²³ *E.g.*, N.Y. Ltd. Liab. Co. Act, at §§1201–16.

²⁴ *E.g.*, Del. S. Ct. Rule 67(a)(iv).

²⁵ RESTATEMENT LAWYERS, Section 1, Comment c, and Reporter's Note on Comment c.

²⁶ ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY: THE LAW AND ETHICS OF PARTNER WITHDRAWALS AND LAW FIRM BREAKUPS, at §6.5.1. (2d ed. 2004 Supp.).

²⁷ *First Bank & Trust Co. v. Zagoria*, 250 Ga. 844, 302 SE2d 674 (1983).

²⁸ *Henderson v. HSI Financial Services, Inc.*, 266 Ga. 844, 471 SE2d 885 (1996).

²⁹ Del. S. Ct. Rule 67(h); Hawaii S. Ct. Rule 6(g)(2); Ill. S. Ct. Rule 721; Ind. Admin. & Dis. Rule 27; Ky. SCR 3.024; Neb. C. St. Rule 1; Ohio S. Ct. Rule 111, Sect. 4(b); Wis. SCR 20:5.4(d) (intro) and SCR 20:5.7.

³⁰ *E.g.*, *Lewis v. Rosenfeld*, DC N.Y., 138 FSupp2d 466, 477 (2001), *dismissed on other grounds on reconsideration*, DC N.Y., 145 FSupp2d 341 (2001); *Kus v. Erving*, 46 Conn. Supp. 35, 736 A2d 946 (1999); *Vanderhoof v. Cleary*, 168 Vt. 555, 725 A2d 917 (1998); *F.D.I.C. v. Cocke*, CA-4, 7 F3d 396 (1993) (applying Virginia law). See Annot., *Liability of Professional Corporation of Lawyers, or Individual Members Thereof, For Malpractice or Other Tort of Another Member*, 39 ALR4th 556.

³¹ For a review of issues to consider, see Steven G. Frost, Terence T. O'Meara and Sheldon I. Banoff, *Limited Liability Practice: What Lawyers Should Consider, What Firms Should Do*, 91 ILL. B.J. 388 (Aug. 2003).

³² Cal. Corp. Code §16956(a)(2)(c); Conn. Gen. Stat. §34-327(e); Mass. Gen. Laws. ch. 108A, §45(8)(a); N.M. Stat. Ann. §54-1-47; Okla. Stat. tit. 54, §1-309(b) (a) and (3); R.I. Gen. Laws §7-12-58(a); S.C. Code §33-41-1130(a)(1); Tex. Rev. Civ. Stats. Ann. art. 6132b, §3.08(d); Wash. Rev. Code §25.05.125(4); W. Va. Code §47B-10-5.

³³ Colo. S.Ct. Rule 265.I.A.4; Del. S.Ct. Rule 67(h); Haw. S.Ct. Rule

- 6(g)(2); Ill. S. Ct. Rule 722(b)(1); Ind. Admis. & Dis. R. 27(g); Ky. Sup. Ct. R. 3.024; Neb. S.Ct. Rule Ltd. Liab. Prof. Org. Rule. I(C)(7)(b)(iv); N.J. Sup. Ct. R. 1:21-1C(3); Ohio Gov. Bar. R. III §4(A)(1); Wis. Sup. Ct. R. 20:5-7.
- ³⁴ Petition of The Chicago Bar Association and The Illinois State Bar Association to the Supreme Court of Illinois on Proposed Rules Regulating Vicarious Liability of Lawyers Practicing in Limited Liability Entities, Mar. 23, 2003 ("Petition"), at 2.
- ³⁵ According to the Petition, it was estimated that almost 20 percent of Illinois lawyers in private practice did not have liability insurance. Petition, at 10.
- ³⁶ ALAN R. BROMBERG and LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS, THE REVISED UNIFORM PARTNERSHIP ACT, AND THE UNIFORM LIMITED PARTNERSHIP ACT (2001), at §2.06 (2003 ed.) ("BROMBERG & RIBSTEIN LLPs").
- ³⁷ See Annotated Lawyers Professional Liability Policy in Program Materials for the 2004 ABA National Legal Malpractice Conference. By contrast, an "occurrence" policy is one that covers any event that occurs during the policy period, even if the claim is brought in later years.
- ³⁸ *Gutrich v. LaPlante*, 942 P2d 1266 (Colo. Ct. App. 1997), *aff'd on other grounds*, 961 P2d 1115 (1998) (*en banc*).
- ³⁹ *First American Title Insurance Co. v. Lawson*, 177 NJ 125, 827 A2d 230 (2003).
- ⁴⁰ *First American Title Insurance Co. v. Lawson*, 351 NJSuper 407, 798 A2d 661 (2002).
- ⁴¹ Petition, at 14.
- ⁴² Del. S. Ct. Rule 67 (h)(ii); Mass. S.J.C. Rule 306(3); Ohio Rule III, Sect. 4(b); ORS §58.185(3).
- ⁴³ For relation of rules of conduct and standard of care, see RESTATEMENT LAWYERS §52(2), and Comment f.
- ⁴⁴ MODEL RULES OF PROF'L CONDUCT R. 1.8(h).
- ⁴⁵ GEOFFREY C. HAZARD JR. and W. WILLIAM HODES, THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT, at §12.18, 12-56 (3d ed. 2004 Supp.).
- ⁴⁶ Lawyers Practicing in Limited Liability Partnerships, ABA Formal Opinion 96-401.
- ⁴⁷ E.g., ASS'N. OF THE BAR OF THE CITY OF NEW YORK. Formal Opinion No. 1995-7, May 31, 1995.
- ⁴⁸ RUPA §306, Comment 3.
- ⁴⁹ E.g., Del. Code, tit. 8, §102(b)(6) (Corp.); Cal. Corp. Code §17101(c)(1) (LLC); NY Partnership Law §26(c). Mass. SJC Rule 3:06(3)(a) (all professional limited liability entities).
- ⁵⁰ E.g., *M.R. Countryman Est. v. Farmers Cooperative Association*, 1a. SCt, 679 NW2d 598 (2004).
- ⁵¹ In addition to supervisory responsibility that may give rise to civil remedies, a principal in a law firm has a duty of supervision that is subject to professional discipline. RESTATEMENT LAWYERS, at §11. E.g., *In the Matter of Bailey*, Del. SCt, 821 A2d 851 (2003).
- ⁵² RESTATEMENT (THIRD) OF AGENCY §7.03(2) Tentative Draft No. 5 (Mar. 17, 2004).
- ⁵³ E.g., Kan. Stat. Ann. §17-2715 ("negligent in appointing or supervising"); Md. Corp. & Ass'ns Code §5-121(a)(2) (Corp.); §4a-301.1(a)(2) (LLC); §9a-306(c) (LLP); Ohio Rev. Code Ann. §1775.14(C)(1). See *Bianco Professional Ass'n v. Home Ins. Co.*, 144 NH 288, 740 A2d 1051 (1999) (held that sole shareholder of PC law firm with ultimate supervisory authority over the firm's cases was not vicariously liable as a matter of law for tortious conduct of other law firm employees because under the applicable statute an employee of a PC was liable only if "at fault in appointing, supervising, or cooperating with" wrongdoers).
- ⁵⁴ Alas. Stat. §32.05.100(c)(2); Ark. Code §4-42-307(b)(3); Conn. Gen. Stat. §34-327; Idaho Code §53-315.4; 805 Ill. Comp. Stat. 205-15(c); 805 Ill. Comp. Stat. 180/10-10; Iowa Code §486.15.2; Mich. Comp. Laws Ann. §449.46(2); Miss. Code Ann. §79-12-29(3); Mo. Rev. Stat. §358.150.3; Mont. Code Ann. §35-10-307(3); Nev. Rev. Stat. §87.150.3; N.H. Rev. Stat. Ann. §304-A:15.III; N.M. Stat. Ann. §54-1A-306(d); R.I. Gen. Laws §7-12-26(c); S.C. Code Ann. §33-41-370(C); Tenn. Code Ann. §61-1-306(d); Tex. Rev. Civ. Stat. Ann. Art. 6132b-3.08(a)(2); W.Va. Code §47B-3-6(d); Wis. Stat. §178.12(3)(b); Wyo. Stat. §17-21-306(c).
- ⁵⁵ See BROMBERG & RIBSTEIN LLPs, at §3.04(b), for examples.
- ⁵⁶ BROMBERG & RIBSTEIN LLPs, at §3.04(a). See also Susan Saab Fortney, *Professional Responsibility and Liability Issues Related to Limited Liability Law Partnerships*, 39 S. TEX. L. REV. 399. Under the view of the Comment to Ill. S. Ct. Rule 722, the objective is not to reduce liability that would otherwise exist.
- ⁵⁷ E.g., *Kus v. Irving*, 46 Conn. Supp. 35, 736 A2d 946 (1999) (partners in LLP were found not to have any supervision and control over wrongdoing partner). *Sucese v. Kirsch*, 199 AD2d 718, 606 NYS2d 60 (1993).
- ⁵⁸ BROMBERG & RIBSTEIN LLPs, at §3.04(d).
- ⁵⁹ Me. Rev. Stat. Ann. tit. 31, §295-A.3; N.Y. Bus. Corp. §1505(a); N.Y. Ltd. Liab. Co. §1205(b); N.Y. Partnership §26(c). See also Ind. Admis. and Dis. Rule 27(f).
- ⁶⁰ Conversation with Robert R. Keatinge. Mr. Keatinge is of counsel to the Denver firm of Holland & Hart LLP and co-author of the treatise RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES.
- ⁶¹ E.g., Del. Code tit. 8, §608 (PC), Wash. Rev. Code §25.15.045(1) (LLC), Denver, Colo. §18.100.070 (PC—"shall remain liable"); Mich. Comp. Laws §450.226, Sect. 6 (PC—"shall remain personally liable"). Rule of court applicable to all professional limited liability organizations. Neb. Rule on Prof. Orgs. I.C.7(a).
- ⁶² Robert R. Keatinge, *The Floggings Will Continue Until Morale Improves: The Supervising Attorney and His or Her Firm*, 39 S. TEX. L. REV. 279, 291 (1998).
- ⁶³ Rule 5.1(c)(2). Those rules have been held not to give rise to vicarious civil liability. *Stewart v. Coffman*, Utah CtApp, 748 P2d 579 (1988) *cert. granted*, Utah SCt, 765 P2d 1277 (1988), *cert. dismissed* (unpublished order Aug. 1988).
- ⁶⁴ *Supra* note 31, at 391.
- ⁶⁵ *Supra* note 62, at 294-98.
- ⁶⁶ E.g., compare Tex. Rev. Civ. Stat. Ann. Art. 6132 b-3.08(a)(2) (LLP) with Tex. Rev. Civ. Stat. Ann. Art. 1528e, §5 (Corp.). Texas LLC statute is silent on the subject. See *supra* note 62, at 295-98.
- ⁶⁷ Revised Model Business Corporation Act (RMBCA) §6.40(c).
- ⁶⁸ E.g., Del. Code tit. 6, §18-607(a).
- ⁶⁹ Cal. Corp. Code §16957(a); Colo. Rev. Stat. §7-64-1004; Del. Code tit. 6, §15-309; N.D. Cent. Code §45-22-10.1.
- ⁷⁰ For discussion of compensation v. dividends and statement that income tax cases are not relevant to the issue, see *The Mann-Paller Foundation, Inc. v. Econometric Research, Inc.*, DC D.C., 644 FSupp 92 (1986).
- ⁷¹ Colo. Rev. Stat. §7-64-1004; Del. Code tit. 6, §17-6079(a) (LP); Del. Code tit. 6, §18-607(a) (LLC); N.D. Cent. Code §45-22-10.3; Va. Code §13.1-1035.E. The Maryland LLC Act has no distributions limitation, but has similarly modified its fraudulent conveyance act. Md. Code §15-208(b)(1). The NY LLC Act has a limit on distributions and no specific provision on compensation, but a commentator has said that the same result should be obtained under the NY LLC Act. BRIAN L. SCHORR, NEW YORK LIMITED LIABILITY COMPANIES AND PARTNERSHIPS, at §5:08(b).
- ⁷² Person admitted into an existing partnership is not personally liable for partnership obligations incurred before admission. RUPA §306(b).
- ⁷³ Obligation incurred while the partnership is an LLP is solely the obligation of the partnership. RUPA §306(c). *Mudge Rose Guthrie Alexander & Ferdon v. Pickett*, DC N.Y., 11 FSupp2d 449, 452, note 18 (1998) (partners remain liable for obligation incurred before LLP registration).
- ⁷⁴ Liability incurred after termination is joint and several, except where incurred after administrative revocation, if reinstated within statutory period. RUPA §1003(f).
- ⁷⁵ *Hager v. Amiri*, 2001 Tex. App. LEXIS 3273, *unpublished op.* (law firm began representation while a general partnership, but shield applied to malpractice after it became an LLC).
- ⁷⁶ *Supra* note 21, 311 FSupp2d 461.

ENDNOTES

⁷⁷ RUPA §306, Comment 3.

⁷⁸ *Id.*

⁷⁹ Minn. Stat. §3232A.3-06(d).

⁸⁰ *Supra* note 77.

⁸¹ “Indemnity” is used when the liability in question, as between the parties, is altogether the responsibility of one of them. RESTATEMENT (THIRD) OF RESTITUTION §25 Comment a. Tentative Draft No. 2 (Apr. 1, 2002).

⁸² RESTATEMENT (THIRD) OF AGENCY §8.12 Preliminary Draft No. 8 (Apr. 15, 2004).

⁸³ RUPA §401 Comment 4. “Contribution” is used when one party has paid more than its share of a common liability that is allocated in some proportion among them. RESTATEMENT (THIRD) OF RESTITUTION §25 Comment a. Tentative Draft No. 2 (Apr. 1, 2002).

⁸⁴ RESTATEMENT (THIRD) OF AGENCY §8.12 Comment b. Preliminary Draft No. 8 (Apr. 15, 2004).

⁸⁵ For provision to override the override, see *Prototype Limited Liability Partnership Agreement*, 58 BUS. LAW. 689 (2003).

⁸⁶ RUPA §401, Comment 4.

⁸⁷ For analysis of this issue, see Robert R. Keatinge, Allan G. Donn, George W. Coleman and Elizabeth G. Hester, *Limited Liability Partnerships: The Next Step In The Evolution of the Unincorporated Business Organization*, 51 BUS. LAW. 147, 187–93 (1995).

⁸⁸ Robert W. Hillman, *Organizational Choices of Professional Service Firms: An Empirical Study*, 58 BUS. LAW. 1387, 1399 (2003).

⁸⁹ *Supra* note 88, at 1393 and note 36. *Cf.*, Sheldon I. Banoff and Alson R. Martin, *Goodwill and PSCs—Recent Cases Offer Planning Possibilities on Dissolution and Conversion*, 90 J. TAX’N 148 (1999).

⁹⁰ *Supra* note 88, at 1393.

⁹¹ *Supra* note 88, at 1395 and 1401.

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