THE USE OF LIMITED LIABILITY ENTITIES FOR THE PRACTICE OF LAW: HAVE LAWYERS BEEN LULLED INTO A FALSE SENSE OF SECURITY?

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INTRODUCTION

This article examines certain implications of permitting U.S. attorneys to practice in limited liability entities. Because the right to organize and operate under the auspices of professional corporations (PCs), limited liability partnerships (LLPs), and limited liability companies (LLCs) is relatively new to lawyers, case law in this area is not well developed.[1] This is particularly true with respect to lawyers' vicarious liability for their colleagues' malpractice.[2] Divergent state statutes and individual judges' attitudes as to attorneys' vicarious liability may lead to inconsistent results in litigated cases.

In particular, some judges may take the position that by organizing in limited liability entities, attorneys are abdicating their responsibility to protect clients' interests. This may lead to an expansive view by some courts as to what constitutes a lawyer's direct liability.

The practice of law is a highly regulated profession. Courts have the authority to regulate lawyers. The states have adopted ethics codes often patterned on the work of the American Bar Association (ABA); the ABA, as well as the state bar associations, courts, and legislations that frequently refer to its work, are very sensitive to clearly setting out attorneys' obligations to their clients.[3] Lawyers who violate their fiduciary duties can (possibly along with their firms) be held accountable to their clients.[4]

This article contends that the protections offered by state legislation limiting an attorney's

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[1] Generally, LLP statutes provide for limited liability if the relevant obligation of the entity occurred when the LLP was in existence, irrespective of (1) when the negligence or wrongful act(s) took place or (2) whether it has been liquidated. *See* Allen G. Donn, Emerging Issues of LLPs/LLCs for Law Firms 4-6 (April 29, 2004) (unpublished work presented at the American Bar Association Committee on Lawyers' Professional Liability's National Legal Malpractice Conference, on file with the Texas Journal of Business Law). Many of these statutes protect partners from liability for all partnership debts and obligations ("full shield" protection), while others only protect an "innocent" partner from vicarious liability for negligence claims or misconduct of a partnership's agent ("partial shield" protection). According to Professor Susan Fortney, Associate Dean and Texas Tech University Professor of Law, partners in both partial and full liability statutes are liable for their own negligence as well as other improper acts and omissions. Susan Saab Fortney, *High Drama and Hindsight: The LLP Shield, Post-Andersen*, BUSINESS LAW TODAY, Jan.–Feb. 2003, at 128. Furthermore, Fortney notes that most LLP statutes also provide some degree of personal liability for supervisory partners; the extent of such "supervisory liability" remains to be seen.

[2] *See* RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE §§ 5.4-.6 (5th ed. 2000 & Supp. 2003). In this well-respected treatise on legal malpractice, Mallen and Smith discuss how many states regulate the practice of law within limited liability entities and relevant malpractice cases. The authors address the small number of reported cases in this area, the frequency that the relevant statutes are revised, and other uncertainties that could lead to unpredictable outcomes. *Id*. §§ 5.4-.5, at 479, 490, & 510-13. For example, when an "innocent" attorney leaves a law firm or his law firm is dissolved, the states may take different approaches concerning whether the attorney continues to benefit from limitations on his liability for legal malpractice committed by a former colleague. *Id*. § 5.3, at 471-73.

[3] In 1908, the American Bar Association issued the Canons of Ethics. In 1969, the ABA promulgated the Model Code of Professional Responsibility to replace the Canons. In 1983, the ABA came out with the Model Rules of Professional Conduct, which more clearly set out standards for attorney conduct. The ABA continues to amend this last document to address arising issues. In addition, the ABA issues non-binding ethics opinions. Courts, bar counsel, and other rule-establishing bodies are often influenced by these opinions. *See* Fred C. Zacharias, *The Quest for a Perfect Code*, 11 GEO. J. LEGAL ETHICS 787, 787-89 (1998).

[4] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, chs. 2, 5 (1998).

vicarious liability for legal malpractice are not as extensive as they may first appear. As a consequence, the potential liability of a partner in an LLP, a member of a PC, or a participant in an LLC (hereinafter referred to as a "partner") for the legal malpractice of another is probably underestimated.[5] This issue is most likely to arise where the amount of a malpractice claim is high (possibly exceeding a law firm's professional liability insurance policy's limits). As a result, it is the larger, multi-office law firms that need to be concerned about developments in this area; especially since some state courts are likely to change the rules in this area in favor of the consumers of legal services.[6]

I. AN OVERVIEW OF HOW THE LEGAL PRACTICE WAS ORGANIZED

Traditionally, most lawyers operated as solo practitioners.[7] To the extent that law firms existed, they were structured as small partnerships, where the partners knew and trusted one another on the basis of personal relationships built over time.[8] An implied social contract governed the operation of these law firms, with partners taking responsibility for the law firm's operations and benefiting from its successes.[9] Generally, the partners had a personal stake in the training of associate attorneys. After a number of years, associates who performed well were invited to become partners,[10] on the condition that the firm's existing partners felt confident in the associates' professional abilities and personal integrity.[11]

Some law firms found that they were incapable of providing the variety of services demanded by their clients. Though many lawyers preferred to work independently or within small law firms, some saw the benefits of creating large law firms to meet the increased demand for the breadth of legal services required by large companies.[12] Large law firms were formed through the merging of smaller firms or by adding attorneys that had particular areas of expertise.[13] As the number of lawyers within a firm increased, the partners created various

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5 *See* John S. Dzienkowski, *Legal Malpractice and the Multistate Law Firm: Supervision of Multistate offices; Firms as Limited Liability Partnerships; and Predispute Agreements to Arbitrate Client Malpractice Claims*, 36 S. TEX. L. REV. 967, 987 (1995) (discussing how a limited liability entity might enjoy protections in its home state but, due to case law, not have a similar status in another state).

6 A factor that may explain the paucity of reported cases in this area is that when there is a "high stakes" case (referring to the amount of claim as well as the potential risk of damage to a law firm's and its lawyers' reputation), the defendant(s) would seem to have significant incentives to settle the claim if it has some merit. Furthermore, law firm retainer agreements may specify that their clients must resolve all disputes over legal services by arbitration. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 54 cmt. b (2000).

7 Ted Schneyer, *Professional Discipline for Law Firms?*, 77 CORNELL L. REV. 1, 4 (1991) (noting that in 1951, a majority of lawyers were solo practitioners, whereas today, the majority of lawyers practice in law firms).

8 *Id*.

9 *See id.* at 5.

10 James A. George, *The "Rambo" Problem: Is Mandatory CLE the Way Back to Atticus?*, 62 LA. L. REV. 467, 469-70 (2002).

11 This article concerns malpractice issues relating to lawyers practicing in the law firm environment and not the numerous lawyers who work within corporations, non-profit organizations, or governmental bodies.

12 *See* Michael Ariens, *Know the Law: A History of Legal Specialization*, 45 S.C. L. Rev. 1003, 1019 (1994).

13 *Id.* at 1008-9.

committees to manage the firm itself.[14]

The need for more revenue came with increases in law firm size. As a result of higher compensation to lawyers and the costs of more prestigious office space and branch offices, there was greater pressure to generate more business.[15]

Technology also profoundly changed the way in which lawyers practiced. With the development of the personal computer and automated legal databases such as Lexis and Westlaw, lawyers not only were more easily able to stay current with developments in their own areas of the law, but were also able to learn reasonably quickly about new areas of the law.[16] In addition, lawyers' work product could be transmitted instantly to virtually anywhere in the world.

An increased concern about profitability, especially at the largest law firms in major U.S. cities, combined with the fact that these firms' clients were not especially price sensitive, created an environment in which law firms took on the characteristics of the large corporations they serviced.[17] The effect was to change the role of the lawyer at a law firm from "professional" to "service provider."[18]

Starting in the early 1990s, law firm partners became increasingly concerned about their potential vicarious liability for malpractice by their colleagues, some of whom they hardly knew personally or professionally in light of the firm's size.[19] In the last quarter of the 20th century, due to the confluence of a number of developments, the risk of legal malpractice increased significantly.[20] The Savings and Loan (S&L) crisis of the late 1970s and early 1980s

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14 *See* LAWRENCE M. FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 457-504 (2002) (offering a good overview of the U.S.'s "legal culture" and the evolution and dynamics of law firm practice, including the use of the billable hour).

15 *Id*.

16 *See* Daniel J. Pope & Helen Whatley Pope, "*Is It Safe . . .*", 64 DEF. COUNS. J. 138, 138-39 (1997).

17 *See* Lisa G. Lerman, *Blue-Chip Bilking: Regulation of Billing and Expense Fraud by Lawyers*, 12 GEO. J. LEGAL ETHICS 205 (1999) (presenting the results of a study suggesting a high level of "padding, manipulating, and fabricating time sheets and expense vouchers"). *See also* Daniel Schweimler & Reena Sengupta, *A Question of Time and Money: Billable House: The Clifford Chance Memo Has Thrown Harsh Light on Lawyers' Charging Practices*, THE FINANCIAL TIMES, Nov. 4, 2002, at 19; *but see* William J. Wernz, *The Ethics of Large Law Firms – Responses & Reflections*, 16 GEO. J. LEGAL ETHICS 175 (2002) (arguing that in-house counsel of corporate clients scrutinize legal bills, thus preventing fraudulent billing in most cases and ensuring that the overall quality of legal work today is excellent). In addition to wanting to add different areas of expertise or increase their ability to handle large or multi-jurisdiction matters, law firms sought to benefit from anticipated economies of scale and to have the possibility of partners to boost their income by having the potential to increase the size of the "attribution credits" or "origination fees" individual lawyers received for other lawyers as well as paralegals working on matters they generated for the firm.

18 *See* Thomas E. Lubnau, II, *From the President* . . ., WYO. LAW., Feb. 2004, at 4, 5 ("substantial economic pressures will always be there to drive the lawyer into a service provider instead of a professional.").

19 BLACK'S LAW DICTIONARY 1404 (5th ed. 1979) (defining "vicarious liability" as "indirect legal responsibility[,]" which is employer liability for the acts of an employee or a principal for the torts or contracts of an agent).

20 Dzienkowski, *supra* note 5, at 969.

was triggered by the burst of the Texas real estate bubble, which led to the failure of approximately 1,300 S&Ls holding $620 billion in assets.[21] The cost of clean-up has been estimated at $160 billion, of which federal taxpayers paid approximately $132 billion.[22]

The Federal Savings and Loan Insurance Corporation (FSLIC) sought to recoup a portion of these funds by suing a variety of defendants, including law firms.[23] The FSLIC's claims against firms and their attorneys were based on vicarious liability as well as direct liability.[24] As a consequence of FSLIC claims and other developments in the industry, malpractice insurance carriers began to issue only "claims made" policies rather than "occurrence" policies.[25]

II. THE RESPONSE OF THE LEGAL COMMUNITY TO ITS MALPRACTICE EXPOSURE

As a result of the S&L experience, a large segment of the Texas legal community saw a need to limit the liability of lawyers who had been neither negligent nor engaged in any wrongdoing. Texas became the first state to enact legislation permitting lawyers to operate under the auspices of a limited liability entity which was aimed at protecting individual attorneys whose only liability might be vicarious.[26] Such attorneys' financial exposure was thus limited to their capital contribution and undistributed revenues.[27]

The enactment of this legislation can be viewed as a demonstration of public choice theory. In Texas and other states, powerful members of the legal community sought protection from vicarious liability through the enactment of new special interest legislation.[28] The lawyers seeking such legislation—and their lobbyists—were generally well organized and, not surprisingly, were usually successful in obtaining favorable legislative outcomes.[29] In contrast, the consumers of legal services and other opponents of such legislation seemed to have lacked a sense of urgency or resources to organize on this issue.[30] Predictably, the better-

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[21] Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 355 n.590 (2002).

[22] *Id*.

[23] Ted Schneyer, *From Self-Regulation to Bar Corporatism: What the S&L Crisis means for the Regulation of Lawyers*, 35 S. TEX. L. REV. 639, 640 (1994) (reporting that law firms accused of malpractice or other wrongdoing during the S&L crisis paid out more than $400 million to settle claims by the federal government).

[24] *See* Dzienkowski, *supra* note 5, at 981 n.68 (providing a good example of the government pursuing a vicarious liability claim against a law firm).

[25] Dzienkowski, *supra* note 5, at 971.

[26] Dzienkowski, *supra* note 5, at 981 nn.66-68.

[27] *Id*. at 983.

[28] Charles W. Wolfram, *Inherent Powers in the Crucible of Lawyer Self-Protection: Reflections on the LLP Campaign*, 39 S. TEX. L. REV. 359, 381-82 (1998).

[29] *Id*. Accounting firms joined law firms in their effort to limit their vicarious liability for malpractice.

[30] There is a rich amount of literature on the application of public choice theory which is often helpful as a model for explaining legislative results. *See* Benjamin H. Barton, *An Institutional Analysis of Lawyer Regulation: Who Should Control Lawyer Regulation-Courts, Legislatures or the Market?*, 37 GA. L. REV. 1167 (2002) (applying public choice theory to the issue of whether the courts, legislatures, or the market should regulate the legal profession). *See also* J. William Callison, *Federalism, Regulatory, and the Limited Liability Movement: The Coyote Howled and the*

motivated and organized interest group prevailed in state legislatures.[31]

Now, every state and the District of Columbia has adopted legislation that permits attorneys to practice law under some limited liability form.[32] The specific wording of the statutes and the manner by which the courts apply them vary from state to state. Nonetheless, in no instance did a state grant lawyers protection from malpractice or other wrongful conduct.[33]

In most cases, the law firms were able to obtain the state tax advantage of qualifying as a partnership and as a Sub-Chapter "S" corporation under the Internal Revenue Code (*i.e.*, the tax burden would flow to individual shareholders rather than the corporation).[34] A large number of lawyers envisioned a significant benefit from limiting their personal liability to their capital contribution to, and undistributed revenue from, the law firm by creating limited liability entities.[35] Today, almost one-half of the nation's law firms are organized as limited liability entities, with the majority operating as PCs, probably because it was the first limited liability form available to law firms.[36]

Permitting lawyers to practice in limited liability entities represented a rejection of two

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Herd Stampeded, 26 J. CORP. L. 951 (2001) (using public choice theory to analyze the history and implications of unincorporated business entities obtaining legislation to operate as limited liability entities). *See also* Thomas E. Plank, *Bankruptcy Professionals, Debtor Dominance, and the Future of Bankruptcy: A Review and Rhapsody on a Theme*, 18 BANK. DEV J. 337 (2002) (book review) (invoking the interest group theory to describe the evolution of bankruptcy law in the United States); Saul Levmore, *The Public Choice Threat*, 67 U. CHI. L. REV. 941 (2000) (book review) (discussing the value of public choice theory as an analytical tool for understanding power distribution arrangements in the Constitution). For a good summary of the strengths and weaknesses of public choice and other theories of the legislative process, *see* WILLIAM N. ESKRIDGE, JR., ET AL, LEGISLATION AND STATUTORY INTERPRETATION 67-114 (2000).

31 Wolfram, *supra* note 28, at 382.

32 Allan G. Donn, *Limited Liability Entities for Law Firms*, ALI-ABA Video Law Review (Feb. 19, 2004). *See also* Donn, *supra* note 1.

33 On first impression, the states' actions were consistent with the ABA Model Code Disciplinary Rule (DR) §6-102(a) which provides that a lawyer "shall not limit his liability to his client for his personal malpractice." When the ABA adopted the Model Rules of Professional Conduct, it precluded a lawyer from limiting his exposure for malpractice. MODEL RULES OF PROF'L CONDUCT R. 1.8(h) (1995). *See also* GEOFFREY C. HAZARD & W. WILLIAM HODES, THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT § 12.18 (3d ed. 2004).

34 *See* Jerald David August, *Benefits and Burdens of Subchapter S in a Check-the-Box World*, 4 FLA. TAX REV. 287, 322-23 (1999).

35 *See* Robert W. Hillman, *Organizational Choices of Professional Service Firms: An Empirical Study*, 58 BUS. LAW. 1387, 1401 (2003); MALLEN & SMITH, *supra* note 2, at § 5.4, at 480.

36 Hillman, *supra* note 35, at 1399 (finding that although law firms have been reorganizing as limited liability entities, the pace is not as great as some expected). Many accounting firms also reorganized to gain the advantages of limited liability. *See* Dzienkowski, *supra* note 5, at 971. Although Arthur Andersen LLC was a U.S. legal entity, allegedly independent from other members of the "Arthur Anderson" network of accounting firms, the U.S. entity's work for Enron led to the disappearance of all Arthur Anderson entities throughout the world. *See* MICAEL B. BIXBY, THE ENRON/ARTHUR ANDERSEN DEBACLE: A CASE STUDY AND LEGAL IMPLICATIONS (Carol Zanio ed., 2003) (describing how the actions of a limited number of individuals working for Arthur Andersen LLC and working on matters at Enron led to the demise of one of the "Big Five" accounting firms).

central features of the attorney-client relationship:

> First, the [attorney-client] relationship ha[d] in most other contexts been claimed to be one in which the lawyer emphatically does not have the right to deploy all the weapons of economic and political warfare to advance the lawyer's economic advantage to the direct disadvantage of clients. To the contrary, the law of [attorney-client] relationships [could] accurately [be] characterized as client-centered, carefully and rigorously confining the extent to which lawyers may impose their economic will on them. Perhaps most obviously on point is the universally adopted provision of the lawyer codes prohibiting a lawyer from entering into an agreement with a client that would limit the lawyer's liability to the client. Second, judicial opinions in almost every state have insisted that only the state's highest court may regulate lawyers. That claim of exclusive "inherent powers" of courts is embodied in two principles. The milder version of the claim involves judicial assertion of a constitutional power to regulate lawyers even in the absence of legislation. Quite beyond that, most state supreme courts also claim the exclusive power to regulate lawyers as the court sees fit, even if the state's legislature has enacted legislation that on its face is applicable to lawyers. Under the latter claim, courts say they have both the power and the duty to strike down legislation interfering with the judicial power to regulate lawyers. Nor was the concept of inherent powers one forced on an unwilling profession. To the contrary, lawyers invented the concept and have been assiduous to assert it both to courts and to legislative and administrative pretenders who, in the view of the bar, would attempt to usurp the judicial power to regulate them.[37]

Although many lawyers have taken advantage of organizing their firms in accordance with the laws governing limited liability entities, the consequences for the attorney-client relationship remain uncertain. It is difficult to predict, for example, how fifty-one state court jurisdictions will regard a law firm's retainer agreement seeking to limit a client's remedies against those individuals who did not play a role in the alleged malpractice.[38] Inconsistencies in the interpretation and application of statutes concerning limited liability entities can be expected.

In the majority of cases, plaintiffs argue that most, if not all, lawyers within a law firm have some form of direct liability for professional services rendered by colleagues.[39] The potential success of these arguments (at least for surviving motions of summary judgment against particular individual defendants) will be explored below.

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[37] Wolfram, *supra* note 28, at 361-62, (questioning whether allowing lawyers to practice in limited liability entities was consistent with their ethical obligations to their clients. Generally, Wolfram saw the trend of law firms reorganizing in limited liability forms as a demonstration that lawyers were putting their interests before that of their client and the public).

[38] It is not entirely clear how this can be established in the absence of discovery.

[39] Ronald E. Mallen & Sheila M. Lamb, *The Liability of Partnerships and Professional Corporations*, 2 NO. 1 LEGAL MALPRACTICE REP. 9 (1990) ("The plaintiff in a legal malpractice action routinely names as defendants not only the lawyer who is the alleged wrongdoer, but also those who were, or appeared to have been, that lawyer's partners, as well as the 'firm' itself.").

It will take time for some courts to adopt the view that liability that is often characterized as "vicarious" is in fact a form of direct malpractice liability for many of a law firm's attorneys. Nonetheless, it would be unwise to overlook the fact that the courts make the final determination as to whether legislatures have the authority to protect lawyers (who are, after all, "officers of the court") from vicarious liability for legal malpractice.[40] Courts may view attorneys' attempts to limit their liability in this area as constituting a violation of their professional and ethical obligations. Lawyers, like doctors, are simply not the equivalent of most other service providers. In practice, it may prove easier for state supreme courts to develop nuanced distinctions in this area than for legislative bodies to do so.

III. WHEN A LAWYER'S FEAR OF EXCESSIVE VICARIOUS LIABILITY IS RELEVANT

The importance of lawyers having limited liability in the legal malpractice context comes into play in limited situations, such as (1) where the law firm does not have an active professional liability insurance policy in place (either it did not procure the necessary insurance or the company issuing the insurance is unable to pay); (2) where the financial consequences of the actions or omissions giving rise to the malpractice claim exceed the law firm's insurance policy's limits; or (3) where the relevant actions fall into one of the firm's malpractice insurance policy's exclusions.[41] Typically, most malpractice claims do not exceed policy limits. Consequently, where there is a malpractice claim for an amount within policy limits, the insurer and the insured need to assess whether legal malpractice indeed took place and whether to settle or take the case to trial.[42] In the typical legal malpractice case (i.e., for

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[40] *See* Casey L. Jernigan, *The Absolute Privilege is Not a License to Defame*, 23 J. LEGAL PROF. 359, 365-66 (1998-1999).

[41] It is not surprising that most insurance carriers are exceedingly careful to verify that a particular act of alleged malpractice by its insured is indeed covered under the relevant policy. Professional liability insurance policies generally require a law firm to provide timely notice to the insurance carrier of not only existing claims, but potential claims as well. A particular attorney may not be aware of a client's potential malpractice claim. Furthermore, such attorneys may be reluctant to report the potential claim to their colleagues. The law firm's management may not be aware that a potential claim may exist. Consequently, the law firm may not inform its insurer of a potential claim, which can serve as a basis for the denial of coverage. As a result, a lawyer cannot be absolutely confident that the mere fact that his law firm carries malpractice insurance means that he will indeed be covered under it. Not surprisingly, there is significant litigation in this area. *See* Steven M. Goldman & Danny M. Howell, *Treating Yourself as the Client: Surviving Allegations of Professional Misconduct* 11-20 (June 10, 2004) (unpublished manuscript, presented at a session of the D.C. Bar Association's Continuing Legal Education Program entitled "Ethics and the Management of Professional Liability Risk," on file with The Texas Journal of Business Law).

[42] Currently, Oregon is the only state to require attorneys practicing within the state to have professional liability insurance. Lawyers practicing in Alaska, New Hampshire, Ohio, and South Dakota are required to disclose to their clients whether or not they have liability insurance. Seven other states require their lawyers to report whether they maintain liability insurance on annual registration applications. The ABA House of Delegates, at its annual meeting held in August 2004, by a 213-202 vote, amended its Model Court Rules to establish this third approach. *See* James Podgers, *A Close Vote on Insurance Disclosure: ABA House OKs Model Rule Requiring Malpractice Coverage to be Reported*, ABA Journal (e-Report (August 13, 2004)), *at* http://www.abanet.org/journal/ereport/au13roundup.html. *See also* Hinshaw & Culbertson, LLP, *Illinois Adopts Rule Mandating Disclosure of Malpractice Insurance* (Aug. 19, 2004), *at* http://www.hinshawlaw.com/knowledge/clientalert_detail.aspx?id=468&type=5303. Unfortunately, these rules fail to adequately protect clients of attorneys or law firms for a number of reasons. For example, (1) an attorney or law firm may have adequate professional liability insurance in place at the time of retention by a client, but the

less than the policy's limits), the plaintiff sues both the attorneys allegedly at fault and the law firm. This can lead to the appearance of a divergence of interests:

1. the lawyers accused of malpractice may believe that no wrongful actions took place; preserving one's reputation may be a central concern and thus the lawyers do not want to settle the case;

2. the law firm's management is concerned with preserving the reputations of both the law firm and its attorneys. Nonetheless, it may be sensitive to the potential disruptive effects of litigation on the law firm's operations, morale, and the potential impact on its ability to attract (and retain) clients and personnel. In addition, law firm management may be concerned about exhausting its malpractice policy's limits on litigation, leaving less money for settlement. In this case, the law firm's management is seldom as concerned about the foreseeable consequences for the attorneys who have been sued; and

3. the insurer typically wants to minimize its costs and may be indifferent if policy limits are spent on litigation or settlement.[43]

Malpractices involving catastrophic events causing multiple deaths, or large transactions such as project finance deals, mergers and acquisitions, initial public offerings, or frauds involving securities are examples of claims that may exceed a law firm's insurance policy limits.[44] If the claim is in excess of the relevant insurance policy's limits, a different dynamic may occur. With respect to law firms organized as traditional partnerships, all the partners are usually equally concerned about their financial liability under the partnership agreement with respect to contribution or indemnification.[45]

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policy may lapse; (2) a particular claim may not be covered by the insurance company for a number of reasons (e.g., a failure to give notice to the insurer according to policy requirements, the claim falls within an exclusions under the policy, the alleged insured made certain misrepresentations when applying for the policy, etc.); and (3) the policy's limits may be exhausted to pay for legal expenses incurred while defending the attorney or law firm, thus leaving only a small amount of the policy's limits for the purposes of compensating a plaintiff with a valid claim. *See* Ronald E. Mallen, *Mandatory Insurance, Disclosure and Insurance Requirements – An Overview* (Aug. 7, 2004) (unpublished paper, presented at the Association of Professional Responsibility Lawyers' Annual Meeting, held in Atlanta, GA, on file with the Texas Journal of Business Law). *See also* James E. Towevery, *The Case in Favor of Mandatory Disclosure of Lack of Malpractice Insurance* (Aug. 7, 2004) (unpublished paper, presented at the Association of Professional Responsibility Lawyers' Annual Meeting, held in Atlanta, GA) (suggesting that since lawyers have a monopoly over the practice of law, they should be obliged to disclose to their clients whether they have insurance, on file with the Texas Journal of Business Law). *Cf.* Nicholas A. Marsh, Note, "*Bonded and Insured?": The Future of Mandatory Insurance Coverage and Disclosure Rules for Kentucky Attorneys*, 92 KY. L.J. 793 (2004) (analyzing the applicable rules in various states and concluding with a call for the establishment of "client security funds" to protect clients from uninsured, and presumably underinsured, attorneys).

[43] If these scenarios were to become actual cases, the outcome will partly depend on whether the relevant state statute offers a "full" or "partial" shield.

[44] *See* LAWYERS PROFESSIONAL LIABILITY COMMITTEE, THE COLORADO BAR ASSOCIATION: A CONSUMER'S GUIDE TO LEGAL MALPRACTICE INSURANCE, *at* http://www.cobar.org/group/display.cfm?GenID=361 (last visited October 28, 2004).

[45] *See* 1 J. CARY BARTON, TEXAS PRACTICE GUIDE: BUSINESS ENTITIES § 1.5 (2003) ("Generally, each partner in a general partnership is jointly and severally liable for the obligations of the partnership and is entitled to contribution

The situation is quite different if the law firm is organized as a limited liability entity. In this case, only the law firm and those individuals deemed to be directly liable face unlimited financial exposure.[46] The owners of the relevant entity only risk their respective shares of the law firm's assets and undistributed revenues.[47] As a result, if the LLP, LLC, or PC were properly formed and operated, those lawyers who would have formerly faced exposure due to vicarious liability are likely to feel more insulated than those directly implicated in the alleged malpractice.[48] Whether this complacency is justified is examined below.

IV. WHAT IS THE PRACTICAL MEANING OF "VICARIOUS LIABILITY"?

It is highly unlikely that any court would find a partner vicariously liable for torts or contract claims not involving the provision of legal services in any law practice organized with limited liability.[49] Clearly, a partner's liability is limited if a mailman is injured in the law firm's reception area after tripping over a rug.[50] The same is not automatically the case with respect to claims involving the rendering of legal services.

After noting that the ABA and most statutes would appear clear on this point, Professor Susan Fortney wisely observed that:

> [p]rofessional liability questions will depend on how courts approach the statutory shield against vicarious liability. Malpractice plaintiffs could attack the statutory limit of liability, assert that the shield does not apply to the alleged claim because the firm did not comply with statutory prerequisites for LLP status, or plead around the shield. Even in those states where LLP [LLC and PC] legislation expressly allows attorneys to use the [applicable legal] form, the courts can reject the statutory limit on vicarious liability by exercising the courts' inherent authority to regulate the legal profession.[51]

Professor Fortney notes that there are some reported cases involving PCs that would seem to support the position that courts will uphold a law firm partner's limited liability; however, she warns that it might be unwise to predict how a particular court would apply a specific statute to a given set of facts.[52] She insightfully points out that the Restatement (Third) of the

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and indemnity from the other partners for disproportionate liabilities.").

[46] *See, e.g.*, ILL. JUR. *Bus. Relationships* § 13:43 (2003).

[47] *See, e.g.,* UNIF. LTD. LIABILITY CO. ACT § 303 (1995); DEL. CODE ANN. tit. 6, § 18-303 (2003).

[48] Walter W. Steele, Jr., *How Lawyers Protect the Family Jewels . . . The Invention of Limited Liability Partnerships*, 39 S. TEX. L. REV. 621, 622 (1998) ("a limited liability partnership shields the personal assets of partners from clients' claims for malpractice").

[49] *See* Jennifer J. Johnson, *Limited Liability for Lawyers: General Partners Need Not Apply*, 51 BUS. LAW 85, 91 (1995).

[50] *See* Morris W. Macey & Frank R. Kennedy, *Partnership Bankruptcy and Reorganization: Proposals for Reform*, 50 BUS. LAW 879, 879-80 (1995).

[51] Susan Saab Fortney, *Professional Responsibility and Limited Liability Issues Related to Limited Liability Partnerships*, 39 S. TEX. L. REV. 399, 427-28 (1997-98) (citations omitted).

[52] *Id.*

Law Governing Lawyers would seem to provide some, but not extensive, guidance based on the principles of respondeat superior and enterprise liability.[53]

According to the Restatement, "[a] law firm is subject to civil liability for injury legally caused to a person by any wrongful act or omission of any principal or employee of the firm who was acting in the ordinary course of the firm's business or with actual or apparent authority."[54]

A plaintiff may look to agency law to circumvent the legislative intent to allow lawyers to limit their vicarious liability for legal malpractice by using limited liability entities.[55] But a partner in an LLP cannot automatically be assumed to be the functional equivalent of a shareholder in a corporation.[56] Although partners in law firms have become increasingly mobile in recent years, their relationships to their firms are not analogous to typical shareholders' relationships to a corporation (whose displeasure with management is more likely to be expressed by a decision to sell the corporation's shares than by seeking to obtain their objectives at shareholders' meetings).[57] In closely-held entities, the alienation of participatory interests and the bringing in of new participants are generally controlled by the company's by-laws or the partnership agreement.[58] This process is more complex due to the

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[53] *Id.* at 428, n.150. *See also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 58 cmt. b (1998). Note that the Restatement's Chapter 4, Topic 1 concerns a lawyer's liability for professional negligence and the breach of fiduciary trust.

[54] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 58 (1998). Comment c of § 58 of the Restatement provides, *inter alia*, that state legislation allows lawyers to practice law within LLCs, LLPs, and PCs. It provides further that:

> [l]egislation allows lawyers to practice in professional corporations and, in many states, in limited-liability general partnerships or limited-liability companies. Such legislation generally contains language excluding liability of principals of the entity for negligence or misconduct in which they did not participate directly or as supervisors. The effect of such statutory language on lawyers may be limited by the state supreme court's rules and by statutory provisions concerning professional regulation. Thus, rules in some states require lawyers in professional corporations or other entities to accept specified vicarious liability, to maintain specified liability insurance, or to give notice to clients of the nature of the firm.
>
> Whether the principals of a professional corporation or other entity, as well as the entity, are liable for other liabilities (such as the corporation's obligation to pay rent for its office), depends on the law of the jurisdiction. The firm may enter into contracts excluding or limiting vicarious liability in commercial transactions such as renting office space, but may not enter into agreements prospectively limiting the firm's liability to a client for malpractice (see § 54 [Defenses, Prospective Liability Waiver; Settlement with a client]).

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 58 cmt. c (1998).

[55] *See* Johnson, *supra* note 49, at 91 ("agency law holds 'actors . . . responsible for their personal actions even when carried out as agents for another entity.'").

[56] *See generally* Robert W. Hamilton, *The Legal Profession: The Impact of Law and Legal Theory*, 67 FORDHAM L. REV. 393, 397 (1998) (discussing how new partners in modern law firms often find themselves indistinguishable from senior associates in terms of management and equity interest).

[57] *See* ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE Ch. 2 (3d ed. 2004) (discussing the role of shareholders in the modern corporation).

[58] *See* UNIF. LIMITED PARTNERSHIP ACT § 301 (2001).

difficulty of valuing an individual's interest. Except under special circumstances, a lawyer leaving an LLP, LLC, or PC may need to obtain the consent of a majority of the other participants before selling such interest to the entity or another individual.[59] Generally, absent a separate agreement, a member is permitted to leave a closely-held entity after giving proper notice and upon the passage of a specified length of time.[60]

Even if an LLP partner did not take an active day-to-day role in an LLP's management, he probably participated in the selection of the firm's management, executive, recruiting, training, or other committees.[61] These committees might be viewed as performing services (almost certainly for compensation) on behalf of the firm's partners. Section 2 of the Restatement of the Law (Second) on Agency provides:

> (1) A master is a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service.[62]
>
> (2) A servant is an agent employed by a master to perform service in his affairs that physical conduct in the performance of the service is controlled or is subject to the right to control of the master.
>
> (3) An independent contractor is a person who contracts with another to do something for him but who is not controlled by the other or subject to the other's right to control with respect to the physical conduct in the performance of the undertaking. He may or may not be an agent.[63]

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[59] *See* Fallany O. Stover & Susan Pace Hamill, *The LLC Versus LLP Conundrum: Advice for Businesses Contemplating the Choice*, 50 ALA. L. REV. 813, 829 (1999). *See generally* THOMAS A. HUMPHREYS, LIMITED LIABILITY COMPANIES AND LIMITED LIABILITY PARTNERSHIPS Ch 4, 6 (1998). *See also* Fallany O. Stover & Susan Pace Hamill, *The LLC Versus LLP Conundrum: Advice for Businesses Contemplating the Choice*, 50 ALA. L. REV. 813, 829 (1999).

[60] *See generally* Fallany O. Stover & Susan Pace Hamill, *The LLC Versus LLP Conundrum: Advice for Businesses Contemplating the Choice*, 50 Ala. L. Rev. 813, 830-31 (discussing general disassociation practices of LLPs and LLCs).

[61] *See generally* James B. Porter, *Modern Partnership Interests as Securities: The Effect of RUPA, RULPA, and LLP Statutes on Investment Contract Analysis*, 55 WASH. & LEE L. REV. 955, 993 (1998) (discussing how limited liability may translate into partners taking a less active role in management affairs).

[62] To establish that an agent has apparent authority to act on the principal's behalf, it must be shown (1) that the principal has manifested his consent to the exercise of such authority or has knowingly permitted the agent to assume the exercise of such authority; (2) that the third person knew of the facts and, acting in good faith, had reason to believe, and did actually believe, that the agent possessed such authority; and (3) that the third person, relying on such appearance of authority, has changed his position and will be injured or suffer loss if the act done or transaction executed by the agent does not bind the principal. *See* 3 AM. JUR. 2D *Agency* § 80 (2002).
See also Staron v. Weinstein, 701 A.2d 1325, 1326 (N.J. 1997) (finding that plaintiffs made a sufficient showing that one lawyer's firm became counsel for plaintiffs by virtue of the retainer agreement and the fact that defendant had at least apparent authority to enter into such agreements on behalf of the firm).

[63] RESTATEMENT OF THE LAW (SECOND) OF AGENCY § 2 (1958).

While an individual law firm partner in most cases is not in a position to control a committee member's performance, usually the partners collectively have such power (and thus an individual partner may have a proportionate responsibility equal to his holdings to exercise his power).[64] In general, an agent acting on behalf of a principal within the scope of the agent's assigned duties gives rise to the principal's liability.[65]

Generally, a lawyer can be liable not only for his own malpractice, but also for negligent supervision.[66] "Supervision" is a flexible term; it could include not only direct supervision of another person but can also mean "oversight" in the sense of participating in law firm management bodies or even monitoring the activities of such bodies (such as receiving agendas and minutes).[67] Allowing an attorney to ignore occurrences in a law firm in which the attorney has an ownership interest could give rise to situations that are not only harmful to the public, but to the law firm as well (as management bodies may act without adequate scrutiny). The fear of supervisory liability creates an incentive for partners not to serve on any of the firm's governing bodies, since by doing so, they could be found to have direct liability for another's malpractice.[68]

V. IS AN ATTORNEY HIS PARTNER'S KEEPER?

Are lawyers within a law firm merely sharing space (and profits)? Are the relationships between lawyers within a law firm similar, if not identical, to those that exist in other for-profit entities organized in the same legal form?[69]

Traditionally, lawyers have viewed themselves as belonging to a profession and not merely individuals performing a job.[70] The practice of law involves observing certain ethical

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64 *See generally* RESTATEMENT OF THE LAW (SECOND) OF AGENCY § 7 (1958) (an agent has authority granted to it by its principal).

65 *See generally* RESTATEMENT OF THE LAW (SECOND) OF AGENCY §§ 1-3, 6, 7 (1958).

66 MALLEN & SMITH, *supra* note 2, at § 5.5, at 498.

67 *See* MALLEN & SMITH, *supra* note 2, at § 5.6, at 507. *See generally* RESTATEMENT OF THE LAW (THIRD) OF AGENCY § 7.05 (Tentative Draft No. 5, 2004) (detailing that when a principal conducts business through an agent, he is liable for any harm to a third party caused by the principal's negligence in "selecting, training, retaining, supervising, or otherwise controlling the agent.").

68 Keep in mind that some statutes or case law explicitly provide that general supervisory responsibilities are insufficient to give rise to malpractice liability. Many, if not most, of these statutes are variations on Rule 5.1 of the American Bar Association's Rules of Professional Conduct – Responsibilities of Partners, Managers, and Supervisory Lawyers. MODEL RULES OF PROF'L CONDUCT R. 501 (1983). While at first glance this Rule restricts the scope of who constitutes a supervisory lawyer, the proper application of the Rule and the accompanying comments should invite divergences of opinion and litigation.

69 *See* Douglas R. Richmond, *Subordinate Lawyers and Insubordinate Duties*, 105 W. VA. L. REV. 449, 451-452 (2003) (discussing the obligations of subordinate and supervisory attorneys under the ABA Model Rules and the Restatement). *See also* Susan Saab Fortney, *Are Law Firm Partners Islands unto Themselves? An Empirical Study of Law Firm Peer Review and Culture*, 60 TEX. B. J. 1056 (1997) (discussing the results of a survey of law firms' peer review policies and the reliance placed by managing partners and law firm principals on limited liability forms to reduce exposure for vicarious liability for the legal malpractice of others).

70 Such sentiments are grounded in the rich history of the legal profession. *See, e.g.,* Anthony T. Kronman, *Chapman University School of Law Groundbreaking Ceremony Friday, November 21, 1997*, 1 CHAP. L. REV. 1

norms and the upholding of fiduciary duties towards one's client, including preserving client confidences. If an attorney brings in a new client, is he only a client of the lawyer (and the others who work on his matter) or is the client a client of the entire law firm? If it is the former, is the client aware of that fact and what are the consequences if the client is not aware of the scope of his representation?

If an attorney discovers that a colleague is having personal problems that are interfering in rendering adequate services to a client of the firm, does this attorney have an ethical obligation to inform the appropriate individual or body within the law firm (or within the bar)? Must the former attorney directly confront the latter about his concern? Although the courts ultimately have responsibility to regulate the practice of law, the legal profession is deemed to be "self-regulating."[71] ABA Model Rule 8.3 requires "a lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects" to "inform the appropriate professional authority[,]" except as provided by Model Rule 1.6 – Confidentiality of Information.[72] The ABA Model Rules of Professional Conduct takes the position that a lawyer's non-compliance with its provisions does not constitute malpractice *per se.*[73]

This issue is not merely hypothetical; according to recent studies by the ABA, 15-18% of lawyers have problems with alcohol abuse (more than 50% higher than the general population).[74] In addition, stress may contribute to a significant level of drug dependency and mental health problems.[75] These factors may play a role in an attorney committing malpractice.

Similar issues present themselves if an attorney discovers that while his colleague is on vacation, a critical filing has been neglected or there is some development that, if not acted upon, will jeopardize the client's interest.[76] What are the implications if the attorney fails to take appropriate action? What is appropriate action under the circumstances?

Essentially, the issue is whether the courts will be willing to accept a situation where a lawyer might share in the law firm's profits without assuming any responsibilities for matters other than his own. Indeed, a law firm's internal procedures manual, code of conduct, or other documents may be viewed as establishing a standard of care within the law firm that creates for its attorneys and other employees requirements (and clients' expectations) that are far more encompassing than those required by statute or other applicable law.[77]

(1998).

71 MODEL RULES OF PROF'L CONDUCT R. 8.3 cmt. 1 (2004).

72 MODEL RULES OF PROF'L CONDUCT R. 8.3 (2004).

73 *Id*. *See also* Michelle Craven & Michael Pitman, *To the Best of One's Ability: A Guide to Effective Lawyering*, 14 GEO. J. LEGAL ETHICS 983, 996 (2001).

74 American Bar Association, *Commission on Lawyer Assistance Programs: Commission History*, *at* http://www.abanet.org/legalservices/colap/ (last updated October 20, 2004).

75 *Id*.

76 MODEL RULES OF PROF'L CONDUCT R. 8.3 (2004).

77 *But see* Ted Schneyer, *A Tale of Four Systems: Reflections on How Law Influences the "Ethical Infrastructure" of Law Firms*, 39 S. TEX. L. REV. 245, 254 (1998) ("and so it is that none of the many jurisdictions

Some lawyers benefit from practicing in a "full service" law firm as opposed to a boutique or smaller general practice. Some lawyers also benefit from having impressive facilities, a helpful support staff and other intangibles. If a lawyer's ability to attract clients is enhanced by these and other factors, should such a lawyer be permitted to enjoy this "benefit" without there being any legal significance (and responsibility) for practicing law under the auspices of a larger entity capable of providing these amenities?

The nature of these issues highlights the difficulty of predicting outcomes under a particular set of circumstances: if an attorney carries only direct liability for his malpractice or other wrongful acts, is the use of firm letterhead on which the names and bar affiliations of numerous lawyers appear arguably the basis for a constructive fraud claim? Similarly, if a law firm engages in collaborative marketing efforts, including the maintenance of a single website, are all these individuals who participated in the production of brochures, the offering of seminars, etc., also creating some basis for an argument that direct liability should exist? What are the implications of a lawyer appearing on a law firm webpage or letterhead? Will disclaimers on retention letters be upheld in court, and if so, under all circumstances? What obligations does an attorney have to his law firm and colleagues in the area of conflict checks: ensuring the observance of law firm rules and participating in the performance of due diligence on potential hires–are these obligations not "direct"? If a lawyer refers to a colleague as his partner when engaged in marketing, has a "partnership" been formed if the marketing effort results in a new client?

If a partner can enjoy the protections of a "full shield" from vicarious liability, is it not necessary to examine whether certain activities occurring within a law firm do not give rise to direct liability for those who benefit? These activities include:

1. a duty to supervise junior attorneys, paralegals, and other staff, even when the partner is not necessarily the partner in charge, to ensure that malpractice or other wrongful acts or omissions do not occur;[78]

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with [A.B.A. Model] Rule 5.1(a) in effect ever enforce the duty to maintain internal controls against lawyers in firms with more than two or three partners.").

[78] *See* Dzienkowski, *supra* note 5, at 972. According to Professor Dzienkowski, in the jurisprudence of attorney malpractice and discipline, there is relatively little literature on the duty of partners to supervise lawyers in the firm. The Model Code did not explicitly deal with the critical issue of the obligations of supervisory lawyers. In contrast, the Model Rules began to establish certain standards in this area. New York and New Jersey have sought to clarify the situation by formally establishing a duty of supervision on law firms. *See* N.J. R. PROF'L CONDUCT 5.1; N.Y. Judicial Law DR-104 (McKinney 2001), *cited by* Elizabeth Chamblis and David B. Wilkins, *The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms*, 44 ARIZ. L. REV. 559 n.22 (2002). The relevant New York rule provides:

> A. A law firm shall make reasonable efforts to ensure that all lawyers in the firm conform to the disciplinary rules.
>
> B. A lawyer with management responsibility in the law firm or direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the disciplinary rules.
>
> C. A law firm shall adequately supervise, as appropriate, the work of partners, associates, and non-lawyers who work at the firm. The degree of supervision required is that which is reasonable under the

2. a duty to ensure that the law firm's lawyers are competent to handle the matters they are working on.[79] (What is the obligation of an attorney within a law firm if he knows that a colleague is engaged in the improper practice of law in a state where the colleague is not admitted?);

3. a duty to ensure that corporate formalities and tax filings are in compliance with law in all jurisdictions where the law firm has offices;[80] and

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> circumstances, taking into account factors such as the experience of the person whose work is being supervised, the amount of work involved in a particular matter, and the likelihood that ethical problems might arise in the course of working on the matter.
>
> D. A lawyer shall be responsible for a violation of the Disciplinary Rules by another lawyer or for conduct of a non-lawyer employed or retained by or associated with the lawyer that would be a violation of the Disciplinary Rules if engaged in by a lawyer if:
>
> 1. The lawyer orders or directs the specific conduct or, with knowledge of the specific conduct, ratifies it; or
>
> 2. The lawyer is a partner in the law firm in which the other lawyer practices or the non-lawyer is employed, or has supervisory authority over the other lawyer or the non-lawyer, and knows of such conduct, or in the exercise of reasonable management or supervisory authority should have known of the conduct so that reasonable remedial action could be or could have been taken at a time when its consequences could be or could have been avoided or mitigated.
>
> E. A lawyer shall comply with these Disciplinary Rules notwithstanding that the lawyer acted at the direction of another person.
>
> F. A subordinate lawyer does not violate these Disciplinary Rules if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

N.Y. LAWYER'S CODE OF PROF'L RESPONSIBILITY R. 1-104 (2002), *available at* http://www.law.cornell.edu/ethics/ny/code/NY_CODE.HTM#1-104 (last modified January 1, 2002).
The New Jersey Rules of Professional Conduct provides:

> (a) Every law firm and organization authorized by the Court Rules to practice law in this jurisdiction shall make reasonable efforts to ensure that member lawyers or lawyers otherwise participating in the organization's work undertake measures giving reasonable assurance that all lawyers conform to the Rules of Professional Conduct.
>
> (b) A lawyer having direct supervisory Authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.
>
> (c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:
>
> (1) the lawyer orders or ratifies the conduct involved; or
>
> (2) the lawyer having direct supervisory authority over the other lawyer knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

N.J. RULES OF PROF'L CONDUCT R. 5.1 (1998), *available at* http://njlawnet.com/nj-rpc/index.html (last modified January 11, 2003).

[79] MODEL RULES OF PROF'L CONDUCT R. 101 (2004).

[80] *See* Dzienkowski, *supra* note 5, at 985. The failure to observe corporate formalities, particularly with offices

4. a duty to ensure that a "hotline" exists within the firm to permit partners, associates, and staff to report concerns about malpractice or misconduct, without any fear of retribution, and to ensure that "whistle blowing" indeed is encouraged.[81]

The range of unresolved questions is extensive. How a particular question may be resolved may differ from case to case. The difficulty of dealing with these issues increases when a law firm engages in a multi-state or foreign practice because it is exceedingly difficult with expansion to ensure quality control and maintain optimum risk management procedures.

VI. CONCLUDING OBSERVATIONS

It is reasonable to expect that following the public outrage over corporate scandals such as Enron, Adelphia, Worldcom, and Tyco, greater scrutiny will be given to the role of law firms and their lawyers (who allegedly facilitated corporate transgressions) in general.[82] The ABA is seeking to establish new ethical rules for lawyers in connection with corporate governance.[83] Where this process will lead is difficult to predict.

Indeed, the "ethic of technical compliance" with requirements that permit attorneys to use limited liability entities to cap their financial exposure may ultimately prove unsuccessful if courts (and juries) continue to expect the high standards of professional conduct and care that were expected in the past.[84] In a decision that no longer constitutes the current state of the law in Georgia, its Supreme Court in *First Bank & Trust Co. v. Zagoria* held that an apparently "innocent" attorney in a law firm with two shareholders organized as a PC was liable even though he, himself, had not committed any alleged acts of malpractice.[85] The Court explained

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abroad, can produce unforeseen liability problems, including the piercing of the corporate veil as part of a plaintiff's "unitary actor" theory for recovery of damages. The undercapitalization of both U.S. and foreign limited liability entities strengthens arguments to pierce the corporate veil in order to reach the assets of all the attorneys within a law firm.

81 *See generally* Deborah L. Rhode, *Institutional Ethics*, 44 CASE W. RES. L. REV. 665, 669-701 (1994) (discussing state legislatures' increased pressure on state bars to improve disciplinary outreach methods and that internal methods of securing compliance are often more effective than regulator methods).

82 *See* Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143 (2002). *See also* Miriam Rozen & Brenda Sapino Jeffreys, *Law Firm Fighting the Ghost of Enron; Two years later, Vinson & Elkins Soldiers On*, THE LEGAL TIMES, Dec. 29, 2003, at 1. Rozen and Jeffreys discuss how Enron was one of Houston-based law firm Vinson & Elkins's best paying clients, generating more than five percent of the firm's revenue in 2001 and a total of $161.2 million in fees from 1997 through the end of 2001. After the subject of Vinson & Elkins's role as Enron's counsel drew public attention, the firm lost the role as lead outside counsel to some Fortune 500 clients in 2003, including Dallas's Halliburton Corp., which had been the firm's oldest client and Houston's Dynegy Inc. *See also* Samantha Ahuja, *What Do I Do Now? A Lawyer's Duty Post-Sarbanes-Oxley*, 38 VAL. U. L. REV. 1263 (2004).

83 *See* AMERICAN BAR ASSOCIATION, *Report of the American Bar Association Task Force on Corporate Responsibility, at* http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf (Mar. 31, 2003).

84 *See* William H. Widen, *Enron at the Margin*, 58 BUS. LAW. 961 (2003).

85 *First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674 (Ga. 1983). *See also Henderson v. HSI Fin. Servs., Inc.*, 471 S.E.2d 885, 886-87 (Ga. 1996) (involving a legal malpractice case where the court overruled what it termed the "strict liability rule" because the legislature had provided that shareholders of professional corporations are not personally liable for corporate debts except by personal conduct. The court held that an attorney practicing limited liability to clients for legal malpractice did not violate the Canons of Ethics so long as the lawyer rendering the legal

that:

> [t]he professional nature of the law practice and its obligations to the public interest require that each lawyer be civilly responsible for his professional acts. A lawyer's relationship to his client is a very special one. So also is the relationship between a lawyer and the other members of his or her firm a special one. When a client engages the services of a lawyer, the client has the right to expect the fidelity of other members of the firm. It is inappropriate for the lawyer to be able to play hide-and-seek in the shadows and folds of the corporate veil and thus escape the responsibilities of professionalism.[86]

In the more than twenty years since the *Zagoria* decision, the financial stakes in some legal malpractice cases have increased considerably.

In a number of cases where the issue was whether state legislatures had the right to adopt legislation regulating the practice of law, the courts were adamant that they, and not the legislature, were the final arbiter on what a lawyer may or may not do. For example, in Hawaii,[87] Ohio,[88] Utah,[89] Florida[90] and Rhode Island,[91] the courts respectively held that the highest court in the state, and not the legislature, was ultimately the arbiter on the subject of how to regulate the legal profession (although the courts sought to avoid confrontations with the relevant legislature). Nonetheless, past may be prologue–the *Zagoria* decision should not be forgotten.[92]

If a court were to find the outcome in a particular case highly offensive because it lowered the quality of legal work or harmed clients seeking redress, particularly if they were unsophisticated "consumers" of the relevant legal services, the court could very well decide to

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services remained personally responsible to the clients).

86 *Zagoria,* 302 S.E.2d at 675.

87 *See In re Bar Association*, 516 P.2d 1267 (Haw. 1973) (denying state bar association's request to practice in a corporate form; the court instead ruled that Hawaii's "Professional Corporation Law" does not alter the attorney-client relationship).

88 *See Reiner v. Kelley*, 457 N.E.2d 946 (Ohio Ct. App. 1983) (holding, *inter alia*, that all shareholders of a professional association of lawyers guarantee all debts and judgments against such association and that rules governing the practice of law by lawyers in a legal form was a joint decision of the legislation and the state supreme court).

89 *See Stewart v. Coffman*, 748 P.2d 579, 581-82 (Utah Ct. App. 1988). Despite the earlier dismissal of a defendant partner based on the applicable statute, the court in *Stewart* reaffirmed that it regulated the practice of law in the state. The court based its decision, in part, on the proposed Rules of Professional Conduct adopted by Utah that set forth the supervisory responsibilities of attorneys and found that an attorney that does not order or condone improper actions of another attorney cannot be held vicariously liable.

90 *See Florida ex rel. The Florida Bar v. Meyers*, 133 So.2d 553 (Fla. 1961) (explaining the court's reasoning that it saw its role as merely ratifying the decision of the Board of Governors of the Florida Bar).

91 *See In re Rhode Island Bar Association*, 263 A.2d 692 (R.I. 1970) (involving the bar's attempt to seek permission of the court to permit lawyers to practice law in a corporate form after the legislature authorized it).

92 *See* Warren H. Johnson, *Limited Liability Companies (LLC): Is the LLC Liability Shield Holding Up Under Judicial Scrutiny?*, 35 NEW ENG. L. REV. 177 (2000) (describing how the courts have generally ruled respecting legislative intent on most issues involving LLCs).

exercise its right to regulate the legal profession and find a way to render justice rather than blindly apply the law.[93] An example of such a case might occur where a lawyer practices law as a personal corporation or under the auspices of a limited liability entity, both of which are thinly capitalized, and the client was never informed of the attorneys' limited liability for malpractice.[94] New rules governing the liability of lawyers within law firms for malpractice may prove necessary to maintain (or obtain) the public's trust in its lawyers.

[93] This view is shared by Georgian practitioner Mary Hawk. *See* Mary R. Hawk, *Liability Limbo: Are Incorporated Lawyers in Georgia Really Free from Personal Liability When Their Fellow Shareholders Misbehave?*, 15 GA. ST. U. L. REV. 1047. *See also* Thomas A. Denker, *Lawyers and Limited Liability for Arizona's Professionals: Deliverance or Damnation?*, 37 ARIZ. L. REV. 355 (1995).

[94] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 58 cmt. c (2000). The commentary to Restatement § 58 suggests that in certain jurisdictions whether an attorney may avoid vicarious liability can depend on whether the legal entity under which he practices maintains "specified liability insurance."