

9-1-1997

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### Recommended Citation

Patrick Cammarata, *Allowing Attorneys to Swing for the Fences: The Massachusetts Limited Liability Partnership Act*, 38 B.C.L. Rev. 949 (1997), <http://lawdigitalcommons.bc.edu/bclr/vol38/iss5/4>

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# ALLOWING ATTORNEYS TO SWING FOR THE FENCES: THE MASSACHUSETTS LIMITED LIABILITY PARTNERSHIP ACT

## INTRODUCTION

The registered limited liability partnership, otherwise known as a "limited liability partnership" ("LLP") is a form of business enterprise which has experienced tremendous growth and popularity since its inception by the Texas State Legislature in 1991.<sup>1</sup> To date, a total of forty-eight states, along with the District of Columbia and Puerto Rico, have passed some form of LLP legislation.<sup>2</sup> On November 29, 1995, Massachusetts joined this nationwide trend and became the forty-eighth state to enact its own registered limited liability partnership laws.<sup>3</sup>

This Note examines the salient features of Massachusetts General Laws chapter 108A, section 2 et seq. (the "Massachusetts LLP Act"), the potential effects that it might have on the practice of law within the commonwealth, and where it fits in the national scheme of LLP statutes. Part I of this Note examines the fundamental principles of general partnership law under the Uniform Partnership Act (the "UPA").<sup>4</sup> Part II examines the history of the LLP form, specifically the events leading up to its creation, as well as the state-specific versions of the LLP form.<sup>5</sup> Part III examines some additional reasons behind the LLP's popularity as well as other alternative forms of limiting liability, particularly for lawyers.<sup>6</sup> Part IV analyzes the recently enacted Massachusetts LLP legislation and compares some of its provisions to those of other states.<sup>7</sup> Finally, Part V addresses some of the various ethical concerns created by the advent of LLPs.<sup>8</sup>

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<sup>1</sup> See ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS AND THE REVISED UNIFORM PARTNERSHIP ACT 2 (1995).

<sup>2</sup> See *Limited Liability Partnerships—A Reality*, MASS. LAW. WKLY., Dec. 4, 1995, at 10 [hereinafter *LLPs—A Reality*].

<sup>3</sup> See MASS. GEN. LAWS ANN. ch. 108A, § 2 et seq. (West Supp. 1996).

<sup>4</sup> See *infra* notes 9–42 and accompanying text.

<sup>5</sup> See *infra* notes 43–90 and accompanying text.

<sup>6</sup> See *infra* notes 91–126 and accompanying text.

<sup>7</sup> See *infra* notes 127–77 and accompanying text.

<sup>8</sup> See *infra* notes 178–244 and accompanying text.

## I. GENERAL PARTNERSHIP PRINCIPLES

In 1982, in *Mt. Wheeler Power, Inc. v. Gallagher*, the Nevada Supreme Court held that a plaintiff electric company could bring a claim for non-payment against the non-bankrupt general partners of a bankrupt company.<sup>9</sup> In *Mt. Wheeler*, the plaintiff, an electric company, brought suit against the partners of a bankrupt company seeking payment for electricity supplied while the bankrupt company had been a debtor-in-possession under chapter XII of the Bankruptcy Act.<sup>10</sup> The court reasoned that had the debtor-in-possession properly paid the electric bill prior to the close of the bankruptcy proceeding, the burden of payment would have been placed upon the non-bankrupt partners of the company.<sup>11</sup> As a result, the court concluded that, as between the plaintiff electric company and the defendant partners, the latter should absorb the cost of the electrical power in question.<sup>12</sup> Thus, the court held that where a plaintiff's claim for payment was improperly ignored prior to the closure of bankruptcy, the plaintiff could bring a claim for payment against the non-bankrupt partners of the bankrupt company.<sup>13</sup>

In 1984, in *Dayco Corp. v. Fred T. Roberts & Co.*, the Connecticut Supreme Court held that where the plaintiff obtained an arbitration award against a partnership, the plaintiff could maintain an action against the individual partners to recover damages once the plaintiff discovered that there was no partnership property available to satisfy the arbitration award.<sup>14</sup> In *Dayco*, the plaintiff obtained a two hundred thousand dollar arbitration award against the defendant partnership for violations of patent licensee agreements.<sup>15</sup> Having discovered that the partnership assets were insufficient to satisfy the award, the plaintiff instituted a recovery action against the partners themselves.<sup>16</sup> The court reasoned that where an action is brought against a partnership and the result is a judgment against the partnership, a plaintiff must first seek to satisfy the debt with the partnership's assets.<sup>17</sup> The court further reasoned that this, however, does not prevent a plaintiff from

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<sup>9</sup> 653 P.2d 1212, 1213-14 (Nev. 1982).

<sup>10</sup> *Id.* at 1213. This case was governed by the "old" Bankruptcy Act, 11 U.S.C. § 1 et seq., which was repealed in 1978. *See id.* at n.1.

<sup>11</sup> *Id.* at 1215.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 1213-14.

<sup>14</sup> 472 A.2d 780, 784 (Conn. 1984).

<sup>15</sup> *Id.* at 782.

<sup>16</sup> *See id.*

<sup>17</sup> *Id.* at 784.

instituting suit against the individual partners to hold them liable for the debt when the plaintiff finds the partnership without assets and its judgment unsatisfied.<sup>18</sup> The court concluded that to hold otherwise would insulate partners from their joint liability for a partnership debt.<sup>19</sup> Thus, the court held that the plaintiff, having obtained an arbitration award against a partnership, could bring suit against the individual partners if the partnership assets were insufficient to satisfy the judgment.<sup>20</sup>

In 1996, in *Kansallis Finance Ltd. v. Fern*, the Massachusetts Supreme Judicial Court held that each of the partners in a partnership may be held vicariously liable for the unauthorized acts of a fellow partner if that partner acts with the apparent authority of the partnership or if that partner acts to benefit the partnership.<sup>21</sup> In *Kansallis Finance*, a partner in a law firm intentionally misrepresented certain aspects of a non-firm-related transaction in a letter written on firm letterhead.<sup>22</sup> The court reasoned that although the transaction arose out of the partner's personal business affairs and thus, was completely outside the business of the partnership, the partnership could nevertheless be held vicariously liable for apparently authorized conduct of its partner even if the fellow partners were entirely unaware of and uninvolved with that conduct.<sup>23</sup> The court reasoned that so long as a reasonable person could find that the partner acted either under apparent authority of the partnership or for the purpose of benefiting the partnership, the general proposition that partners in a general partnership are jointly and severally liable for the acts of their fellow partners should apply.<sup>24</sup> Thus, the court held that non-culpable partners may be held vicariously liable for intentional misrepresentations made by their fellow partners, provided those misrepresentations take place under the apparent authority of the partnership or for the purpose of benefiting the partnership.<sup>25</sup>

Commentators have concluded that these cases illustrate one of the perilous realities that accompany attorneys who practice in general partnerships.<sup>26</sup> Examining the facts of cases like *Kansallis Finance*, it is

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<sup>18</sup> *Id.*

<sup>19</sup> *Dayco*, 472 A.2d at 784.

<sup>20</sup> *Id.* at 784-85.

<sup>21</sup> 659 N.E.2d 731, 739 (Mass. 1996).

<sup>22</sup> *Id.* at 732.

<sup>23</sup> *See id.* at 732, 739.

<sup>24</sup> *Id.* at 739.

<sup>25</sup> *Id.*

<sup>26</sup> *See* Michael Orey, *The Lessons of Kaye, Scholer: Am I My Partner's Keeper?*, AM. LAW., May

easy to understand how the concept of limiting some or all of the vicarious liability which general partners have for one another's actions proves to be an attractive option for many attorneys.<sup>27</sup> To understand exactly how a LLP accomplishes this purpose, it is first necessary to examine some of the features of the business form from which it has evolved—the general partnership.<sup>28</sup>

A partnership is “an association of two or more persons to carry on as co-owners a business for profit.”<sup>29</sup> It is also the form of business that is created when two or more people conduct business together without any formalities.<sup>30</sup> There are no statutory requirements for the formation of a partnership.<sup>31</sup> As a result, it is the default form of organization for any business consisting of more than one owner.<sup>32</sup> The relationship between partners in a general partnership is strictly one of co-ownership and, absent contractual stipulations to the contrary, each partner has the power to make controlling decisions involving the business.<sup>33</sup>

Commentators have noted that aside from the relative simplicity with which partnerships can be formed and operated, the general partnership proves an attractive form of business organization for income tax purposes.<sup>34</sup> Under the Internal Revenue Code (the “IRC”), a general partnership itself does not pay taxes.<sup>35</sup> Instead, it merely passes its tax liability on to its individual partners who pay taxes only on the income they specifically receive from the partnership.<sup>36</sup>

Commentators have also suggested that the lack of formal separation between the partners and the partnership entity itself, while beneficial for tax and operational purposes, is detrimental when it comes

1992, at 3; Thom Weidlich, *Limiting Lawyers' Liability: LLPs Can Protect the Assets of Innocent Partners*, NAT'L L.J., Feb. 7, 1994, at 1.

<sup>27</sup> See 659 N.E.2d at 732.

<sup>28</sup> See UNIF. PARTNERSHIP ACT § 15 (1914), 6 U.L.A. 456 (1995). Because of the virtual nationwide adoption of the Uniform Partnership Act, there has been little reason for courts to consider whether there is an internal affairs choice of law rules for partnerships. See Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1075 n.28 (1995).

<sup>29</sup> UNIF. PARTNERSHIP ACT § 6, 6 U.L.A. 256.

<sup>30</sup> See *White Consol. Indus., Inc. v. Waterhouse*, 158 F.R.D. 429, 435 (D. Minn. 1994) (under state law, no filing requirement for general partnerships); ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG AND RIBSTEIN ON PARTNERSHIPS*, § 2.01(a) (1988 & Supp. 1997).

<sup>31</sup> See *White Consol.*, 158 F.R.D. at 435; BROMBERG, *supra* note 30, § 2.01(a).

<sup>32</sup> See, e.g., James W. Dodge, *A Brief Survey of Limited Liability Law in Illinois*, 20 S. ILL. U. L.J. 247, 248 (1996); Hamilton, *supra* note 28, at 1075.

<sup>33</sup> See 8 THE GUIDE TO AMERICAN LAW 135 (West 1985).

<sup>34</sup> See BROMBERG, *supra* note 30, § 1.03(c)(9).

<sup>35</sup> See *id.* (citing 26 U.S.C. § 751(a) (1994)).

<sup>36</sup> See *id.*

to potential liability.<sup>37</sup> As *Kansallis Finance* illustrates, under the UPA "all partners are jointly and severally liable for any wrongful act or omission of any partner acting in the ordinary course of business of the partnership and for all other debts and obligations of the partnership."<sup>38</sup> In other words, when someone sues a traditional general partnership on account of the acts or omissions of one or more of its partners, not only are the partnership's assets subject to liability, but so is the personal wealth of each of the partners themselves.<sup>39</sup>

Leading commentators have surmised that partnerships involving attorneys have been particularly susceptible to the increasing number of malpractice claims and judgments occurring throughout the country.<sup>40</sup> As a result, attorneys have been at the forefront of the LLP movement since its adoption by the Texas State Legislature in 1991.<sup>41</sup> To fully understand the underlying policies which have spurred legislatures across the country to adopt this business organizational form, it is necessary to examine the history and context which led up to the creation of LLPs.<sup>42</sup>

## II. THE HISTORY OF THE LLP FORM

In 1988, in *Federal Savings & Loan Insurance Corp. v. Laurence B. Vineyard, Jr.*, the Federal Savings and Loan Insurance Corporation (the "FSLIC") and the Dallas law firm of Jenkens & Gilchrist entered into an eighteen million dollar settlement agreement in which the firm did not admit liability.<sup>43</sup> The FSLIC sought damages of one hundred million dollars, alleging that a former partner of the firm had used his position as a savings and loan ("S&L") attorney to obtain loans that contributed to the collapse of two separate S&Ls.<sup>44</sup> The FSLIC claimed that each of the named defendants were vicariously liable for the acts of their fellow partner.<sup>45</sup> Instead of trying the case on the merits,

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<sup>37</sup> See Orey, *supra* note 26, at 3; Weidlich, *supra* note 26, at 1.

<sup>38</sup> MASS. GEN. LAWS ch. 108A, §§ 13-15 (Supp. 1995); see *Kansallis Finance*, 659 N.E.2d at 739.

<sup>39</sup> See MASS. GEN. LAWS ch. 108A, § 15(b) (Supp. 1995); *Kansallis Finance*, 659 N.E.2d at 739.

<sup>40</sup> See Jennifer J. Johnson, *The Oregon Limited Liability Partnership Act*, 32 WILLAMETTE L. REV. 147, 147 (1996); Manuel R. Ramos, *Legal Malpractice: The Profession's Dirty Little Secret*, 47 VAND. L. REV. 1657, 1664-70 (1994).

<sup>41</sup> See BROMBERG, *supra* note 1, at 2; Hamilton, *supra* note 28, at 1069-71.

<sup>42</sup> See *infra* notes 43-90 and accompanying text.

<sup>43</sup> See Diane Burch & Amy Boardman, *FDIC Opens New Front in S&L War: Aggressive Suit Filed in Wake of J&G's \$6 Million Malpractice Loss*, TEX. LAW., Mar. 26, 1990, at 1.

<sup>44</sup> See *Suit Seeks \$100 Million From Attorneys Who Represented Failed Thrifts*, UPI, June 18, 1987, available in, LEXIS, Nexis Library, UPI File.

<sup>45</sup> See *id.*

Jenkins & Gilchrist and the FSLIC entered into an eighteen million dollar settlement agreement, in which the firm did not admit to any wrongdoing.<sup>46</sup>

The FSLIC also brought suit against other law firms.<sup>47</sup> By the end of 1989, the FSLIC had initiated actions against more than a dozen law firms which had represented various collapsed S&Ls across the nation. In one case, the FSLIC won a thirty-five million dollar verdict against a Louisiana law firm.<sup>48</sup>

In each of these cases the FSLIC was able to tap into the multi-million dollar insurance policies and assets of the various firms under the theory that all partners are vicariously liable for the acts and omissions of their fellow partners.<sup>49</sup> In *United States v. Vineyard*, for example, only one Jenkins & Gilchrist partner, Laurence B. Vineyard, was responsible for malpractice in his dealings with two separate S&Ls.<sup>50</sup> Furthermore, Vineyard had left Jenkins & Gilchrist in 1983, a full three years before either of the S&Ls in question collapsed.<sup>51</sup> Nevertheless, forty-six present and former Jenkins & Gilchrist partners, many of whom had no involvement in or even knowledge of Vineyard's dealings, were forced to pay eighteen million dollars to settle the suit with the government.<sup>52</sup>

It was against this backdrop that three Texas lawyers, James H. Milam, Philip W. Johnson and Robert L. Duncan proposed, and State Senator John Montford introduced, Senate Bill 302 in the 72nd Texas Legislature.<sup>53</sup> The bill called for the amendment of the joint and several liability portion of Texas' version of the UPA to give partners permanent protection from vicarious liability.<sup>54</sup> After some debate, an amended version of this bill passed both the Texas Senate and House of Representatives.<sup>55</sup>

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<sup>46</sup> See Burch, *supra* note 43, at 1; Mark Tatge, *FSLIC, Jenkins & Gilchrist Settle Lawsuit*, DALLAS MORNING NEWS, Aug. 15, 1989, at 1D.

<sup>47</sup> See Linda P. Campbell, *U.S. Suing to Recoup S&L Losses*, CHI. TRIB., Nov. 20, 1989, at 3; Wayne E. Green, *Alleging Negligence, the FSLIC Is Suing Many of the Attorneys for Failed Thrifts*, WALL ST. J., Mar. 16, 1989; Marianne Lavelle, *For the Sins of Their S&L Clients: 15 FSLIC Lawsuits Name Firms*, NAT'L L.J., May 8, 1989, at 3.

<sup>48</sup> See *FSLIC v. John A. Mmahat*, No. 86-5160, 1988 U.S. Dist. LEXIS 14374 at \*2 (E.D. La. Dec. 14, 1988).

<sup>49</sup> See Campbell, *supra* note 47, at 3.

<sup>50</sup> *United States v. Vineyard*, 699 F. Supp. 103, 104 (N.D. Tex. 1988).

<sup>51</sup> See Green, *supra* note 47.

<sup>52</sup> See Burch, *supra* note 43, at 1.

<sup>53</sup> See BROMBERG, *supra* note 1, at 2.

<sup>54</sup> See *id.* at 4; Hamilton, *supra* note 28, at 1073.

<sup>55</sup> See Hamilton, *supra* note 28, at 1073.

This original version of the Texas statute provided that:

A partner in a registered limited liability partnership is not individually liable for debts and obligations of the partnership arising from errors, omissions, negligence, incompetence, or malfeasance committed in the course of the partnership business by another partner or a representative of the partnership not working under the supervision or direction of the first partner at the time the errors, omissions, negligence, incompetence, or malfeasance occurred . . . .<sup>56</sup>

The statute provided that these provisions did not affect the joint and several liability of a partner for debts and obligations of the partnership arising from any cause other than those previously specified and did not affect the liability of partnership assets for partnership debts and obligations.<sup>57</sup> Furthermore, the original Texas LLP statute required that any registered limited liability partnership must include the letters "LLP" in its name and must carry, "if reasonably available," one hundred thousand dollars worth of malpractice insurance.<sup>58</sup>

While this original version of the Texas LLP statute was extremely popular, it was soon revised in order to address some of the difficulties which the language of the statute created in practice.<sup>59</sup> The revised statute mainly dealt with the insurance provision.<sup>60</sup> Specifically, it took out the phrase "if reasonably available" and provided that a LLP may establish a trust or fund in lieu of an insurance policy which could be used to satisfy the one hundred thousand dollar liability coverage requirement.<sup>61</sup>

The revised statute also amended the original with respect to the concept of supervisory liability.<sup>62</sup> The original statute mandated that a partner who had knowledge or notice of another partner's misconduct would be held vicariously liable for an action that arose from that

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<sup>56</sup> TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(2) (West Supp. 1997).

<sup>57</sup> See *id.*

<sup>58</sup> See *id.* §§ 45-B, 45-C.

<sup>59</sup> See *id.* § 3.08(a)(1) (West Supp. 1997); BROMBERG, *supra* note 1, at 6. Specifically, the insurance provision of the original statute needed to be reworded because the insurance policies often used language different from the exclusive list of actions in the statute. See BROMBERG, *supra* note 1, at 6.

<sup>60</sup> See TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(15)(d) (West Supp. 1997).

<sup>61</sup> See *id.*

<sup>62</sup> See *id.*



conduct.<sup>63</sup> The revised version of the statute amended this rule so that partners who had knowledge of the errors or omissions of another would not be held liable if that partner took reasonable steps to prevent or cure them.<sup>64</sup>

While Texas was in the process of revising the 1991 version of its LLP legislation, Louisiana, North Carolina, Delaware and the District of Columbia all adopted LLP statutes based upon the Texas model, each with its own variations.<sup>65</sup> Several observers noted that the Delaware statute's variations provided the most significant alterations to the Texas model.<sup>66</sup> This statute added several provisions that provided more protection to non-culpable partners.<sup>67</sup>

The Delaware statute extended the amount of protection afforded to non-culpable partners in several ways.<sup>68</sup> First, it used the terms "wrongful acts or misconduct" to describe the types of partner wrongdoing for which non-culpable partners were not liable.<sup>69</sup> This stood in contrast to the narrower terms of the Texas act which protected non-culpable partners from only the "errors, omissions, negligence, incompetence, or malfeasance" of fellow partners.<sup>70</sup> Second, the Delaware statute limited which partners may be held liable for supervising those persons who committed wrongful acts.<sup>71</sup> Specifically, the act mandated that such partners be in a position of "direct supervision or control" to expose themselves to any vicarious liability, rather than simply in a position of "supervision or direction," as provided in the Texas statute.<sup>72</sup> Third, the Delaware statute specifically authorized its LLPs to act out of state, expressing the policy that in such cases Delaware law should govern.<sup>73</sup> No similar provision appeared in the Texas act.<sup>74</sup>

In 1994, the Delaware State Legislature amended its LLP statute, providing even more protection for non-culpable partners.<sup>75</sup> First, they

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<sup>63</sup> See *id.* § 15(2)(b) (West Supp. 1997).

<sup>64</sup> See *id.* § 3.08(1)(a).

<sup>65</sup> See BROMBERG, *supra* note 1, at 9.

<sup>66</sup> See *id.*; Hamilton, *supra* note 28, at 1078-79.

<sup>67</sup> See DEL. CODE ANN. tit. 6, § 1502 et seq. (1993).

<sup>68</sup> See *id.*

<sup>69</sup> See *id.* § 1515(b).

<sup>70</sup> Compare *id.*, with TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (West Supp. 1997).

<sup>71</sup> See DEL. CODE ANN. tit. 6, § 1515(c) (1993).

<sup>72</sup> Compare *id.*, with TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(2).

<sup>73</sup> See DEL. CODE ANN. tit. 6, § 1547(b) (1993). Commentators have stressed the importance of this provision because, under traditional partnership principals, a partnership that enters into a transaction is subject to the partnership laws of the state in which the transaction occurred. See *State v. Ritholz*, 100 N.W.2d 722, 729 (Minn. 1960).

<sup>74</sup> See TEX. REV. CIV. STAT. ANN. art. 6132b, § 15.

<sup>75</sup> See DEL. CODE ANN. tit. 6, § 1515 (Supp. 1996).

broadened the protected activity to include misconduct "whether characterized in tort, contract or otherwise."<sup>76</sup> Second, the revision clarified the extent of non-culpable partners' protection from indirect liability by mandating that such partners are not liable "either directly or indirectly, by way of indemnification, contribution, assessment or otherwise" for the otherwise protected misconduct.<sup>77</sup>

Also, during 1994, thirteen more states adopted LLP provisions.<sup>78</sup> Most of these were modeled closely after either the Texas or Delaware model.<sup>79</sup> Two states, however, New York and Minnesota, adopted LLP statutes which made major alterations to the original LLP models.<sup>80</sup> These changes centered around a provision in the New York and Minnesota statutes which not only protects non-culpable partners from the wrongful acts or omissions of their fellow partners, but also shields *all* partners from vicarious liability for virtually all ordinary business obligations of the partnership entity itself.<sup>81</sup>

The New York statute provides:

[N]o partner . . . is liable or accountable, directly or indirectly (including by way of indemnification, contribution or otherwise), for any debts, obligations or liabilities of, or chargeable to, the registered limited liability partnership or each other, whether arising in tort, contract or otherwise . . . solely by reason of being such a partner . . . .<sup>82</sup>

Commentators have suggested that, while this language provides broader protection for partners than either the Texas or Delaware statutes, a partner in a New York LLP still remains liable for his or her own wrongful acts as well as those of persons under his or her direct supervision or control.<sup>83</sup> Finally, the New York statute allows only for general partnerships which engage in the rendering of professional services to register as LLPs.<sup>84</sup>

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<sup>76</sup> See *id.* This provision prevented clever plaintiffs from successfully circumventing the statute by characterizing a malpractice claim as an implied breach of contract, rather than as a tort such as negligence. See Hamilton, *supra* note 28, at 1078.

<sup>77</sup> See DEL. CODE ANN. tit. 6, § 1515.

<sup>78</sup> See BROMBERG, *supra* note 1, at 11.

<sup>79</sup> See *id.*

<sup>80</sup> See *id.*

<sup>81</sup> See MINN. STAT. ANN. § 323.14(2) (West 1995); N.Y. PARTNERSHIP LAW § 26(b) (McKinney Supp. 1997); BROMBERG, *supra* note 1, at 11-12.

<sup>82</sup> N.Y. PARTNERSHIP LAW § 26(b).

<sup>83</sup> See BROMBERG, *supra* note 1, at 12; Hamilton, *supra* note 28, at 1089.

<sup>84</sup> See BROMBERG, *supra* note 1, at 12. Compare N.Y. PARTNERSHIP LAW § 26(b), with TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08 (West Supp. 1997).

Like the New York statute, the Minnesota statute provides partners with protection against ordinary debts and business obligations of the partnership.<sup>85</sup> Unlike the New York statute, however, the Minnesota statute provides that this protection can be overridden by "piercing the veil" on the same grounds used in corporate law.<sup>86</sup> The Minnesota statute also imposes liability on partners who receive distributions greater than would have been allowed if the LLP were a corporation subject to prohibition of distributions when insolvent.<sup>87</sup>

During the past two years over thirty states have adopted some form of LLP legislation.<sup>88</sup> The expanded protection which the New York and Minnesota statutes provide has dramatically affected the ways in which these states have developed their own statutes.<sup>89</sup> The New York and Minnesota statutes are credited with beginning a trend in LLP law towards providing partners with broader protection than the original Texas and Delaware models.<sup>90</sup>

### III. POPULARITY AND GROWTH OF THE LLP

The LLP is not the only liability limiting form of business organization available to attorneys practicing in general partnerships.<sup>91</sup> The number of law firms switching over to the LLP form, however, has increased exponentially in the past few years.<sup>92</sup> Commentators have credited the LLP's popularity with law firms to the fact that it allows partners to receive all the benefits that they were accustomed to receiving as a general partnership, while it eliminates most of the liability exposure which they faced as partners in a general partnership.<sup>93</sup>

The primary benefit of general partnerships which LLPs share is a favorable tax status with the federal government.<sup>94</sup> In fact, for federal income tax purposes, the I.R.S. considers an LLP as a continuation of

<sup>85</sup> See MINN. STAT. ANN. § 323.14(2); N.Y. PARTNERSHIP LAW § 26(b).

<sup>86</sup> Compare MINN. STAT. ANN. § 323.14(3), with N.Y. PARTNERSHIP LAW § 26(b).

<sup>87</sup> See MINN. STAT. ANN. § 323.14(5) (referring to § 302A.551, permitting distributions "only if the board determines . . . that the corporation will be able to pay its debts in the ordinary course of business after making the distribution").

<sup>88</sup> See Hamilton, *supra* note 28, at 1065 (as of beginning of 1995, 25 states had enacted LLP legislation); *LLPs—A Reality*, *supra* note 2, at 10 (as of December 1995, 47 states had enacted LLP legislation).

<sup>89</sup> See BROMBERG, *supra* note 1, at 13-14.

<sup>90</sup> See *id.*

<sup>91</sup> See BROMBERG, *supra* note 30, § 1.01(b); Hamilton, *supra* note 28, at 1066 n.3.

<sup>92</sup> See Hamilton, *supra* note 28, at 1065.

<sup>93</sup> See, e.g., Mark A. Cohen, *Law Firms Registering as LLPs in Droves: Attorneys Cite Broad Benefits of Status*, MASS. LAW. WKLY., June 10, 1996, at 1.

<sup>94</sup> See BROMBERG, *supra* note 1, at 192-93 (citing Internal Revenue Code provisions).

the general partnership from which it converted.<sup>95</sup> Thus, partners in LLPs are not taxed on income earned in the partnership—rather, partners incur a tax on liability only on their portion of the distributions.<sup>96</sup>

The second aspect of LLPs which has helped to contribute to their growth and popularity with law firms is the fact that they allow the partners to maintain the same management structure as they had as a general partnership.<sup>97</sup> Managing partners of law firms have stated that one of the biggest reasons firms had not previously chosen to adopt a liability limiting organizational form was the fear that the change in structure might disrupt the collegiality and working relationships that members of a general partnership have come to enjoy.<sup>98</sup> Because registering as a LLP does not affect the management structure of the law firm, these partners report that the switch to LLP status goes virtually unnoticed by both the partners and the employees of the partnership.<sup>99</sup>

Examining the salient features of some of the other liability limiting business organizational forms which general partnership law firms could adopt helps illustrate why many law firms have chosen to adopt the LLP form.<sup>100</sup> Specifically, the corporation, limited partnership and limited liability company are all viable alternatives for a law firm seeking to limit its vicarious liability for the acts and omissions of its partners.<sup>101</sup> While the availability of some of these options varies from state to state, law firms in virtually every state have the option of adopting a liability limiting form of business organization other than the LLP.<sup>102</sup>

Seeking to avoid the potential limitless liability inherent in the general partnership, a law firm could incorporate.<sup>103</sup> Unlike a partner-

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<sup>95</sup> See Priv. Ltr. Ruls. 94-48-025 (Aug. 31, 1994), 94-23-040 (Mar. 19, 1994), 94-20-028 (Feb. 18, 1994); *New York Registered LLP Given Partnership Treatment for Federal Tax*, J. TAX'N, Oct., 1995, at 232 [hereinafter *New York Registered LLP*].

<sup>96</sup> See Priv. Ltr. Ruls. 94-48-025, 94-23-040, 94-20-028; *New York Registered LLP*, *supra* note 95, at 232.

<sup>97</sup> See Cohen, *supra* note 93, at 1.

<sup>98</sup> See *id.*

<sup>99</sup> See *id.*

<sup>100</sup> See *infra* notes 103-26 and accompanying text.

<sup>101</sup> See Dodge, *supra* note 32, at 248-50.

<sup>102</sup> See N. Scott Murphy, Note, *It's Nothing Personal: The Public Costs of Limited Liability Law Partnerships*, 71 IND. L.J. 201, 208 n.42 (1995).

<sup>103</sup> See MASS. GEN. LAWS ch. 156A, § 2 et seq. (1994 & Supp. 1995). Certain states, such as Massachusetts, require businesses wishing to incorporate to do so as either a standard business corporation or as a professional corporation (the "PC"). See MASS. CONTINUING LEGAL EDUC., HOW TO INCORPORATE AND COUNSEL A BUSINESS, 27-34 (1996) [hereinafter MICLE]. In these states, law firms wishing to incorporate must adopt the form of a PC. See *id.* While in most respects

ship, a corporation is an entity which rests apart from its owners.<sup>104</sup> This separation between the owners and the partnership provides a benefit to the owners by limiting, in most cases, the amount of the owner's liability to the amount that he or she has invested in the business.<sup>105</sup> As a result, the personal assets of the corporation are usually not within the reach of anyone seeking to sue the corporation.<sup>106</sup> Commentators have noted that this insulation from liability, however, comes with two significant drawbacks.<sup>107</sup> First, corporations require a different management structure than partnerships.<sup>108</sup> Because most law firms have traditionally practiced as general partnerships, partners have been wary that such a change in management structure would disrupt the social dynamic and working relationships of those at the firm.<sup>109</sup> Second, commentators have suggested that a corporation's separate existence from its owners proves detrimental for tax purposes.<sup>110</sup> A corporation which does not meet the I.R.S.'s strict definition of an "S" corporation must report and pay taxes on its income *before* it distributes that income to its owners.<sup>111</sup> In turn, the shareholders themselves must report their share of the earnings as income which itself is taxed.<sup>112</sup> While the structure of a corporation provides some benefits to its owners in terms of limiting the owners' liability, it comes at the price of changing a law firm's management structure and in many instances incurring "double taxation."<sup>113</sup>

Another business entity which addresses the issue of potential limitless liability inherent in a general partnership is the limited partnership ("LP").<sup>114</sup> The LP is different from a general partnership or a

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these two entities are similar, commentators have noted that the PC is slightly more restrictive in terms of shareholder liability. *See id.* The PC, like the standard business corporation, shields shareholders from liability for the wrongful acts of other shareholders. *See id.* Shareholders in professional corporations, however, who are engaged in the rendering of professional services, remain liable for their own professional malpractice. *See id.* For purposes of this Note, the term "corporation" refers to both standard business corporations as well as professional corporations.

<sup>104</sup> *See* BROMBERG, *supra* note 30, § 1.01(b).

<sup>105</sup> *See id.*

<sup>106</sup> *See id.*

<sup>107</sup> *See* Murphy, *supra* note 102, at 210-11.

<sup>108</sup> *See* MCLE, *supra* note 103, at 27-33.

<sup>109</sup> *See id.*; Mark A. Cohen, "Limited Liability" Option for Firms Near: Could Replace P.C. as Preferred Statute, MASS. LAW. WKLY., July 3, 1995, at 1.

<sup>110</sup> *See* Dodge, *supra* note 32, at 249; Cohen, *supra* note 109, at 1.

<sup>111</sup> 26 U.S.C. § 1361(b)(1) (1994). In general, "S" corporations may not have more than thirty-five shareholders, all shareholders must be individuals, shareholders may not be non-resident aliens and the corporation must have only one class of stock. *See id.*

<sup>112</sup> *See id.* § 301(a), (c) (1994).

<sup>113</sup> *See id.*; Dodge, *supra* note 32, at 249.

<sup>114</sup> *See* BROMBERG, *supra* note 30, § 1.01(b)(3).

corporation in that it has a two-tiered ownership structure.<sup>115</sup> The first class of partners, the general partners, maintain the same personal liability as partners in a general partnership. In other words, these partners remain jointly and severally liable for all debts of the partnership.<sup>116</sup> These general partners also control most or all of the LP's day-to-day operations.<sup>117</sup> The second class of partners, the limited partners, remain insulated from liability in much the same way as shareholders in a corporation.<sup>118</sup> The limited partners, however, have little or no control over the operation of the LP.<sup>119</sup> Commentators have suggested that, because general partners are typically the active managers of the LP and the limited partners are typically passive investors, the relationship between the two classes of partners tends to be more financial and less personal than the relations among partners in general partnership law firms.<sup>120</sup>

The registered limited liability company ("LLC") is still another form of business organization available in several states.<sup>121</sup> The LLC derives many of its characteristics from a range of other business enterprises.<sup>122</sup> It can most accurately be described as a hybrid between a corporation and a limited partnership.<sup>123</sup> Unlike a LP, a LLC has only one class of ownership.<sup>124</sup> In terms of liability, however, the LLC insulates these owners in much the same way as a corporation does for its shareholders.<sup>125</sup> Moreover, for federal income tax purposes, LLC's have the opportunity to receive the beneficial tax treatment afforded to general and limited partnerships provided that the LLC abides by certain I.R.S. operational guidelines.<sup>126</sup>

#### IV. THE MASSACHUSETTS STATUTE

On November 29, 1995, Massachusetts Governor William Weld signed House Bill number 4045 (codified by Massachusetts General

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<sup>115</sup> See *id.*

<sup>116</sup> See *id.*

<sup>117</sup> See *id.*

<sup>118</sup> See *id.*

<sup>119</sup> See BROMBERG, *supra* note 30, § 1.01(b)(3).

<sup>120</sup> See *id.*

<sup>121</sup> See *id.* Unlike corporations or limited partnerships, the LLC was not available in Massachusetts prior to the commonwealth's adoption of its LLP laws. See MASS. GEN. LAWS ch. 156C, § 2 (1995). Nevertheless, had the LLP legislation not been introduced, LLCs may well have proven an attractive option for some law firms. See Murphy, *supra* note 102, at 211.

<sup>122</sup> See BROMBERG, *supra* note 30, § 1.01(b)(3).

<sup>123</sup> See *id.*

<sup>124</sup> See *id.*

<sup>125</sup> See *id.*

<sup>126</sup> See Rev. Rul. 88-76, 1988-2 C.B. 360; Dodge, *supra* note 32, at 250.

Laws chapter 108A, section 6 et seq.) into law, making Massachusetts the forty-eighth state to enact some form of LLP legislation.<sup>127</sup> The bill was sponsored by the Boston Bar Association (the "BBA"), an organization that had attempted to bring LLPs to the commonwealth as early as 1993.<sup>128</sup> Previous to the enactment of this LLP bill, the only liability limiting option available to law firms in Massachusetts was the professional corporation ("PC").<sup>129</sup>

The BBA's argument in favor of adopting LLPs in the commonwealth was that Massachusetts needed such a form to stay competitive with the forty-seven other states which had already enacted some form of LLP legislation.<sup>130</sup> The BBA claimed that because Massachusetts lacked LLPs and LLCs, businesses were hesitant to establish strong business ties in the commonwealth.<sup>131</sup> Because the addition of these liability limiting forms would potentially make Massachusetts a more attractive state in which to operate a business, many of the bill's supporters predicted that the legislature's adoption of H.B. No. 4045 would have a positive effect on the Massachusetts economy.<sup>132</sup>

#### A. Structure of the Statute

Like the majority of states which have passed LLP legislation, Massachusetts created its LLP legislation by both amending and adding to the provisions of the commonwealth's version of the UPA.<sup>133</sup> Commentators have suggested that incorporating the LLP provisions into the same body of statutory law which governs partnerships in general establishes the fact that the LLP form is firmly rooted in the principals of traditional partnership law.<sup>134</sup> Consequently, issues associated with the LLP form are analyzed through the general framework of partnership law itself.<sup>135</sup>

#### B. Nature of a Partner's Liability

The main exceptions to the UPA, of course, are the provisions governing the nature of partner liability in a LLP.<sup>136</sup> These provisions

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<sup>127</sup> See MASS. GEN. LAWS ANN. ch. 108A, § 2 et seq.; Cohen, *supra* note 109, at 1; *LLPs—A Reality*, *supra* note 2, at 10.

<sup>128</sup> See *LLPs—A Reality*, *supra* note 2, at 10.

<sup>129</sup> See Cohen, *supra* note 109, at 1.

<sup>130</sup> See *id.*; *LLPs—A Reality*, *supra* note 2, at 10.

<sup>131</sup> See Cohen, *supra* note 109, at 1.

<sup>132</sup> See *id.*

<sup>133</sup> See MASS. GEN. LAWS ch. 108A, § 2 et seq; BROMBERG, *supra* note 1, at 26.

<sup>134</sup> See BROMBERG, *supra* note 1, at 14.

<sup>135</sup> See *id.*

<sup>136</sup> See MASS. GEN. LAWS ch. 108A, § 15; BROMBERG, *supra* note 1, at 15.

limit, but do not eliminate, the personal liabilities of Massachusetts attorneys practicing under the LLP form.<sup>137</sup> Partners in Massachusetts LLPs remain directly liable for their own personal negligence, wrongful acts and omissions.<sup>138</sup> In other words, partners in a LLP who commit malpractice, or some other wrongful act, are compelled to pay the damages award with funds drawn from their personal wealth.<sup>139</sup> Unlike the LLP laws of many other states, however, the Massachusetts statute does not contain a provision holding partners liable for the acts and omissions of employees over which they had direct or supervisory control.<sup>140</sup>

The bulk of the protection provided by the Massachusetts LLP legislation comes in the form of protection from vicarious liability for the negligent or wrongful acts of other partners.<sup>141</sup> This provision contains the language which underscores the entire philosophy behind the LLP.<sup>142</sup> The relevant section states in part that "a partner in a limited liability partnership shall not be personally liable directly or indirectly, including, without limitation . . . for debts, obligations and liabilities of or chargeable to such partnership whether in tort, contract or otherwise . . . ."<sup>143</sup> This provision illustrates the fact that, in adopting its LLP legislation, the Massachusetts legislature followed the New York and Minnesota model instead of the original model pioneered by Texas and Delaware.<sup>144</sup>

Consequently, this section shields partners not only from malpractice and other wrongful acts of fellow partners, but also frees all partners from contributing to the ordinary business debts and obligations of the partnership.<sup>145</sup> Such broad protection, not only against malpractice and other such claims but also against debts of the partnership itself accrued during the course of operating the business, was not included in the original LLP statutes passed by Texas and Delaware in the early nineties.<sup>146</sup>

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<sup>137</sup> See MASS. GEN. LAWS ch. 108A, § 15.

<sup>138</sup> See *id.*

<sup>139</sup> See *id.*

<sup>140</sup> See *id.*; see, e.g., DEL. CODE ANN. tit. 6, § 1515 (1993 & Supp. 1996) (partners liable for acts and omissions of employees over which they had direct control); MINN. STAT. ANN. § 323.14(2) (West 1995) (same); N.Y. PARTNERSHIP LAW § 26(b) (McKinney Supp. 1997) (same); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08 (West Supp. 1997) (same).

<sup>141</sup> See MASS. GEN. LAWS ch. 108A, § 15.

<sup>142</sup> See *id.*

<sup>143</sup> *Id.*

<sup>144</sup> See *id.*; Cohen, *supra* note 109, at 1.

<sup>145</sup> See MASS. GEN. LAWS ch. 108A, § 15(2).

<sup>146</sup> See *supra* notes 53-77 and accompanying text.



Specifically, the Massachusetts LLP act is most closely modeled on the Minnesota LLP act, for it contains a provision limiting partners in professional service partnerships, such as law firms, from using this additional protection afforded by the statute to deliberately withhold payment of ordinary business obligations.<sup>147</sup> The impact of this provision, which deals directly with law firms organized as LLPs, will be discussed in more detail later on in this Note.<sup>148</sup>

It is also important to note that the liability shield of the LLP applies only to obligations incurred while the partnership is actually registered as an LLP.<sup>149</sup> Partners continue to have the same general partnership liability over matters that occurred before the partnership registered as an LLP, and for events which occur after the partnership ceases to practice as a LLP.<sup>150</sup>

### C. Formation of a LLP in Massachusetts

Massachusetts LLPs are subject to regulation by the Secretary of State's office.<sup>151</sup> A general partnership can register with the Secretary of State's office as a LLP by filling out and submitting forms providing, among other things, the name of the partnership, a list stating the names of all the partners rendering professional services, the street address if the partnership's principal office is within the commonwealth and a brief statement of the business or profession in which the partnership engages.<sup>152</sup> One or more of the partners, approved by a majority vote, must personally execute the registration.<sup>153</sup> Along with

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<sup>147</sup> Compare MASS. GEN. LAWS ch. 108A, § 15(4), with MINN. STAT. ANN. § 323.14(3). Section 15 of Massachusetts LLP Act states: "the personal liability of a partner in a limited liability partnership engaged in the rendering of professional services shall not be less than the personal liability of a shareholder in a professional corporation . . . engaged in rendering the same professional services." MASS. GEN. LAWS ch. 108A, § 15(4).

<sup>148</sup> See *infra* notes 237-41 and accompanying text. As with other ethical considerations that attorneys encounter in everyday practice, the "law" only sets the outer boundaries as to what is permissible. See MASS. SJC R. 3:06 (1996). In the case of limited liability partnerships, the extent that a Massachusetts law firm can limit its own liability is determined by the Massachusetts Supreme Judicial Court. See *id.* In 1996, the court updated court rule 3:06, dealing with limited liability entities, to include limited liability partnerships and limited liability companies. See *id.* In this opinion, the court did not seem to place any significant restrictions above and beyond the language of the actual statute. See *id.* As a result, all of the potential problems that may arise with the broad protection provided by the Massachusetts legislation are directly applicable to Massachusetts law firms. See *id.*

<sup>149</sup> See MASS. GEN. LAWS ch. 108A, § 15(2).

<sup>150</sup> See *id.*

<sup>151</sup> See *id.* § 45.

<sup>152</sup> See *id.*

<sup>153</sup> See *id.*

the registration, the partnership must provide a registration fee of five hundred dollars.<sup>154</sup>

To maintain the status of the partnership as a LLP, the partnership must file an annual report by the last day of February of each year.<sup>155</sup> The annual report does not differ significantly in form or substance from the original registration and it too must be accompanied by a five hundred dollar administrative fee.<sup>156</sup> This provision proves, in effect, to amount to an annual re-registration.<sup>157</sup> If the partnership fails to submit an annual report and fee by the filing date, the Secretary of State must provide sixty days notice of the State's intention to revoke the partnership's LLP status.<sup>158</sup> If upon the passing of the sixty day period the partnership has not submitted the report and paid the corresponding fee, the Secretary of State's office may revoke the partnership's LLP standing.<sup>159</sup>

Aside from failing to submit an annual report and fee with the Secretary of State's office, a partnership may withdraw its LLP status by a two-thirds majority vote of the partners.<sup>160</sup> To execute a valid withdrawal, one or more of the partners must file a written notice of withdrawal with the Secretary of State's office.<sup>161</sup> A fee of one hundred dollars must accompany the execution of the withdrawal notice.<sup>162</sup>

The Massachusetts statute provides that once a partnership registers as a LLP with the Secretary of State's office, the name of the partnership must reflect this fact.<sup>163</sup> Specifically, section 47 of the Massachusetts LLP Act mandates that "the name of every registered limited liability partnership shall end with the words 'registered limited liability partnership,' 'limited liability partnership,' or the abbreviation 'L.L.P.' or 'LLP.'"<sup>164</sup> This provision, which appears in the LLP statutes of every state, gives notice to outside parties as to the partnership's status as an LLP.<sup>165</sup>

Like the Texas and Delaware statutes, the Massachusetts LLP act contains a provision requiring that the LLP carry a designated amount

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<sup>154</sup> See MASS. GEN. LAWS ch. 108A, § 45.

<sup>155</sup> See *id.*

<sup>156</sup> See *id.*

<sup>157</sup> See *id.*

<sup>158</sup> See *id.*

<sup>159</sup> See MASS. GEN. LAWS ch. 108A, § 45.

<sup>160</sup> See *id.*

<sup>161</sup> See *id.*

<sup>162</sup> See *id.*

<sup>163</sup> See *id.* § 46.

<sup>164</sup> MASS. GEN. LAWS ch. 108A, § 46.

<sup>165</sup> See *id.*

of insurance designed to cover the types of claims from which the statute shields the partners from personal liability.<sup>166</sup> This provision, however, only applies to partnerships which provide professional services as defined in Massachusetts General Laws chapter 156A.<sup>167</sup> The statute mandates that the particular amount of insurance necessary in each case shall be determined by the regulating boards which regulate the particular professional services rendered.<sup>168</sup>

#### D. *Multi-State Practice*

Many businesses, including many law firms, conduct business in several different offices located in various states. Because each state's LLP laws vary to some degree, especially in those states which, as of yet, have not enacted some form of LLP legislation, conflicts of laws issues arise.<sup>169</sup> The Massachusetts LLP provisions address these issues with respect to LLPs based here in Massachusetts, as well as with LLPs formed under the laws of another state.<sup>170</sup>

Section 2 the Massachusetts LLP Act defines a foreign limited liability partnership as "a registered limited liability partnership or limited liability partnership formed pursuant to an agreement governed by the laws of another jurisdiction."<sup>171</sup> The Massachusetts statute requires all foreign limited liability partnerships doing business within the commonwealth to register with the Massachusetts Secretary of State's office in the same manner as Massachusetts-based LLPs.<sup>172</sup> The "internal affairs" of such foreign limited liability partnerships are to be governed by the laws of the jurisdiction where the foreign limited liability partnership is registered.<sup>173</sup> Foreign LLPs are, however, subject to the Massachusetts identification requirement, or the identification requirement of the state in which it is registered if such a requirement exists on the books.<sup>174</sup>

Similarly, section 47 of the Massachusetts LLP Act intends that any Massachusetts LLP engaging in business outside the state should be recognized as a LLP pursuant to the full faith and credit clause of the

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<sup>166</sup> See DEL. CODE ANN. tit. 6, § 1546 (1993); MASS. GEN. LAWS ch. 108A, § 45; TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(15) (Supp. 1997).

<sup>167</sup> See MASS. GEN. LAWS ch. 108A, § 45(8).

<sup>168</sup> See *id.*

<sup>169</sup> See BROMBERG, *supra* note 1, at 150-51.

<sup>170</sup> See MASS. GEN. LAWS ch. 108A, § 47.

<sup>171</sup> *Id.* § 2.

<sup>172</sup> See *id.* § 47(4).

<sup>173</sup> See *id.* § 47(6).

<sup>174</sup> See *id.* § 47(5).

United States Constitution.<sup>175</sup> Furthermore, the Massachusetts statute also mandates that the "internal affairs" of any LLP formed pursuant to this legislation be exclusively subject to the laws of this commonwealth.<sup>176</sup> These provisions all but eliminate any issues over which law should govern both Massachusetts-based LLPs operating in other states as well as foreign LLPs operating in Massachusetts.<sup>177</sup>

## V. ANALYSIS

Examining the provisions of the various LLP statutes, it is easy to see why they have been received with such enthusiasm by the legal community, especially partners in law firms.<sup>178</sup> While the amount of protection provided by LLPs varies from state to state, in virtually all cases, partners in LLPs are in a better position (from a liability perspective) than they were when organized as a general partnership.<sup>179</sup> The only real costs that these attorneys must bear in return for this increased protection are, in most states, annual filing and administrative fees.<sup>180</sup> These benefits, however, pose serious and less advertised costs on society.<sup>181</sup> In order to determine how much protection LLPs should grant non-culpable partners, it is necessary to examine more closely how the LLP shield operates in a situation where the firm faces a potentially disastrous malpractice judgment.<sup>182</sup>

### A. *Consequences of a Lawsuit Under the Texas/Delaware Provisions*

The original conception behind the LLP embodied in the Texas and Delaware statutes was to provide non-culpable partners protection against losing their personal assets in one particular circumstance.<sup>183</sup>

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<sup>175</sup> See MASS. GEN. LAWS ch. 108A § 47(2).

<sup>176</sup> See *id.* § 47(3).

<sup>177</sup> See *id.* § 47.

<sup>178</sup> See Lisa Isom-Rodriguez, *Limiting the Perils of Partnership*, AM. LAW., July-Aug. 1998, at 30.

These days big-firm partners are looking to registered limited liability partnerships . . . with an enthusiasm perhaps more appropriately reserved by the Holy Grail, says Michael Bolnen, a partner at Boston's 117-lawyer Nutter, McClennen & Fish, who has written an LLP bill that is pending in the Massachusetts legislature. The Grail may have promised ultimate wisdom, but LLPs . . . promise to protect a partner's personal assets from claims levied against another partner down the hall, or on the other side of the world.

*Id.*

<sup>179</sup> See Hamilton, *supra* note 28, at 1065.

<sup>180</sup> See MASS. GEN. LAWS ch. 108A, § 45.

<sup>181</sup> See Hamilton, *supra* note 28, at 1093-94.

<sup>182</sup> See *infra* notes 56-77 and accompanying text.

<sup>183</sup> See *id.*

That circumstance dealt exclusively with a situation where a malpractice judgment was entered against another of their partners.<sup>184</sup> In this respect the LLP was originally viewed as a kind of "death insurance," only to be used to protect partners' personal assets upon the financial collapse of the partnership.<sup>185</sup>

Because LLP statutes constructed under the Texas/Delaware model are narrowly tailored to protect only non-culpable partners, when a LLP organized under one of these statutes faces a malpractice suit, the different partners have different liabilities.<sup>186</sup> As a result, it is natural to assume that each group of partners will want to defend a suit in a way which best addresses its own concerns.<sup>187</sup> Consequently, the fact that each group of partners is likely to look out for its own best interests causes disunity and tension among the attorneys, making it extremely difficult for the firm to defend such a suit.<sup>188</sup>

To understand exactly how the different interests of the partners come into tension and conflict with one another, it is necessary to examine the extent to which the LLP shield affects the different partnership and the partnership entity itself. First, non-culpable partners only receive protection from debts directly or indirectly attributed to another partner's or representative's malpractice.<sup>189</sup> Second, the shield does not protect partners who have control over or knowledge of another's wrongful acts and fail to prevent or cure the problem.<sup>190</sup> Third, the assets of the partnership entity itself are *always* available to satisfy a judgment.<sup>191</sup> Finally, upon the exhaustion of the firm's assets, culpable partners must use their own personal wealth to satisfy the balance of the malpractice claim.<sup>192</sup>

It is important to note that by the time culpable partners are forced to satisfy a claim out of their own wealth, the firm itself will have in most cases already collapsed.<sup>193</sup> The limited amount of insurance provided by the LLP form served its purpose by saving the personal wealth of the non-culpable partners.<sup>194</sup> Because it has done nothing,

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<sup>184</sup> See *id.*

<sup>185</sup> See Hamilton, *supra* note 28, at 1077; Weidlich, *supra* note 26, at 1.

<sup>186</sup> See Hamilton, *supra* note 28, at 1079.

<sup>187</sup> See *id.*

<sup>188</sup> See *id.*

<sup>189</sup> See DEL. CODE ANN. tit. 6, § 1515(b) (1993); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(a) (West Supp. 1997).

<sup>190</sup> See DEL. CODE ANN. tit. 6, § 1515(c); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(a).

<sup>191</sup> See DEL. CODE ANN. tit. 6, § 1515(c); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(a)(2)(B).

<sup>192</sup> See DEL. CODE ANN. tit. 6, § 1515(c); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(a).

<sup>193</sup> See Hamilton, *supra* note 28, at 1077.

<sup>194</sup> See *id.*

however, to prevent the loss of the entire firm, the non-culpable and culpable partners alike lose the source of their livelihood until they can find other employment.

Regardless of what happens to the law firm after it satisfies the malpractice judgment, *all* the partners, culpable and non-culpable alike, are still jointly and severally liable for any other business obligations of the firm.<sup>195</sup> As a result, *all* of the partners may be compelled to contribute to the partnership's capital account, either to stay in business or to satisfy contractual claims with various creditors.<sup>196</sup> Such contributions, while traceable to the malpractice claim, are technically contributions to the partnership and not to the plaintiff in the malpractice case. Thus, they may not be covered by the LLP statute since they are not payments of the malpractice claim itself.<sup>197</sup>

Faced with these issues, consider first the incentives of the culpable partners. Obviously, they desire that the partnership reserve the majority of its assets in order to satisfy the malpractice judgment.<sup>198</sup> This may increase the amount of ordinary business expenses left unpaid when the partnership assets are exhausted. Since all of the partners, however, are equally liable for these expenses, each will have to contribute towards them.<sup>199</sup> To the extent that this happens, the personal wealth of the non-culpable partners is reduced as an indirect, but wholly tangible result of the malpractice claim.<sup>200</sup>

As one might expect, the non-culpable partners involved in this scenario have quite a different set of objectives. Faced with the possibility of a significant malpractice judgment, the non-culpable partners would in all likelihood want to cover and in some cases even prepay the bulk of the partnership's ordinary business obligations with the firm's assets *before* dealing with the malpractice issue.<sup>201</sup> Consequently, if after paying off the partnership's ordinary business obligations, there is a deficiency of partnership funds to satisfy the malpractice judgment, the culpable partners would have the responsibility of paying it off with their own personal wealth.<sup>202</sup> Furthermore, as partnership policy, non-culpable partners may prefer to have the bulk of the partnership's

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<sup>195</sup> See DEL. CODE ANN. tit. 6, § 1515(a); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(b).

<sup>196</sup> See DEL. CODE ANN. tit. 6, § 1515(a); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(b).

<sup>197</sup> See DEL. CODE ANN. tit. 6, § 1515(a); TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(b); Hamilton, *supra* note 28, at 1077.

<sup>198</sup> See Hamilton, *supra* note 28, at 1079–80.

<sup>199</sup> See *id.*

<sup>200</sup> See *id.*

<sup>201</sup> See *id.* at 1080.

<sup>202</sup> See *id.*

assets distributed among the partners instead of being retained by the partnership to cover expenses on the theory that once the assets have been distributed to the individual partners they are out of the grasp of potential malpractice plaintiffs.<sup>203</sup>

Regardless of how the partners choose to allocate the partnership assets under this scenario, there is always the possibility that one or more of the partnership's creditors will suffer an injustice. Arguably, this would most often occur in the case where the non-culpable partners seek to expend all the partnership assets on business expenses and partner distributions to avoid paying a malpractice judgment. The plaintiff would probably only have access to the partnership's malpractice insurance and the personal assets of the culpable partner or partners.<sup>204</sup> It is not difficult to imagine a situation in which this proves too shallow a pocket to justify a plaintiff's loss. In this way, it is easy to see that while LLP legislation protects non-culpable partners from an obvious injustice, it also can create an injustice for creditors of the partnership. Consequently, whenever the situation arises where partners are to determine whether partnership assets are to be used in order to satisfy both a malpractice claim and the ordinary business obligations of the partnership, tensions between competing interests will inevitably arise.<sup>205</sup>

### B. *Consequences of a Lawsuit Under the New York/Minnesota Model*

While the Texas/Delaware style LLP statutes could potentially leave legitimate victims of attorney malpractice without a sufficiently "deep pocket" to cover their loss, the New York/Minnesota style statutes raise even greater ethical concerns.<sup>206</sup> In an attempt to limit the partner conflicts which inevitably arise under the Texas/Delaware model, the New York/Minnesota statutes include an added provision which shields all partners from any form of liability incurred solely by reason of being a partner.<sup>207</sup> Thus, in addition to the protection which

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<sup>203</sup> See Hamilton, *supra* note 28, at 1080.

<sup>204</sup> See *id.*; see also *U.S. v. Vineyard*, 699 F. Supp. 103 (N.D. Tex. 1988) (defendant partner ordered to pay restitution).

<sup>205</sup> See Hamilton, *supra* note 28, at 1079. Outside of judicially created rules to govern a fair and equitable division of partnership assets, there seems to be no easy answer to this problem. Unfortunately, since, for all intents and purposes, these situations are resolved through settlement, such rules have not been created. See generally Murphy, *supra* note 102, at 202.

<sup>206</sup> See Hamilton, *supra* note 28, at 1103.

<sup>207</sup> See MINN. STAT. ANN. § 323.14(2) (West 1995); N.Y. PARTNERSHIP LAW § 26(b) (McKinney Supp. 1997). Specifically, this provision states:

[N]o partner of a partnership which is a registered limited liability partnership is liable or accountable, . . . for any debts, obligations or liabilities of, or chargeable

non-culpable partners receive from malpractice judgments levied against the partnership, *all* partners receive protection from personal liability for the ordinary business debts and obligations of the partnership.<sup>208</sup> In effect, this added provision turned partnership law as governed by the UPA upside-down.<sup>209</sup>

As with the Texas/Delaware model, the New York/Minnesota LLP model does not protect the assets of the partnership entity.<sup>210</sup> It does, however, insulate all of the partners from personal liability for any ordinary business debts or obligations which have not yet been paid.<sup>211</sup> As a result, this added provision could potentially leave many of the firm's creditors without any means of recovering payment of outstanding firm debts.<sup>212</sup>

Consequently, non-culpable partners have gone from a situation where they were jointly and severally liable for *all* debts chargeable to the partnership, to a situation where they have little personal exposure.<sup>213</sup> While all of this protection comes at an extremely minimal cost to the partners themselves, it does, however, impose a serious cost upon parties who conduct business with such a LLP.<sup>214</sup> Thus, potential creditors of LLPs bear a substantial risk that they will be unable to recover their debts if the partnership should collapse.<sup>215</sup>

### C. *The Massachusetts Solution*

Because the Massachusetts Legislature chose to follow the New York/Minnesota model, Massachusetts attorneys practicing in the LLP form are insulated from personal liability both for the wrongful acts of fellow partners and representatives of the firm as well as for the ordinary business obligations of the LLP itself.<sup>216</sup> To determine whether the Massachusetts statute provides a workable solution to the problem of

to, the registered limited liability partnership or each other, whether arising in tort, contract or otherwise, which are incurred, created or assumed by such partnership . . . solely by reason of being a partner . . .

N.Y. PARTNERSHIP LAW § 26(b).

<sup>208</sup> See MINN. STAT. ANN. § 323.14(2); N.Y. PARTNERSHIP LAW § 26(b).

<sup>209</sup> See *supra* notes 81-87 and accompanying text.

<sup>210</sup> See DEL. CODE ANN. tit. 6, § 1515(b) (1993); MINN. STAT. ANN. § 323.14(2); N.Y. PARTNERSHIP LAW § 26(b); TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(a) (West Supp. 1997).

<sup>211</sup> See MINN. STAT. ANN. § 323.14(2); N.Y. PARTNERSHIP LAW § 26(b).

<sup>212</sup> See Hamilton, *supra* note 28, at 1103.

<sup>213</sup> Compare N.Y. PARTNERSHIP LAW § 26, with § 26(b).

<sup>214</sup> See Hamilton, *supra* note 28, at 1094.

<sup>215</sup> See *id.* For this reason virtually every LLP statute contains a provision requiring the LLP to indicate its status on firm letterhead and other official documents. See, e.g., MASS. GEN. LAWS ch. 108A, § 46 (Supp. 1995).

<sup>216</sup> See MASS. GEN. LAWS ch. 108A, § 15(b)(2).



unlimited attorney liability, it is necessary to examine three aspects of the Massachusetts statute which raise questions as to whether it provides a workable solution to the problem of unlimited lawyer liability.

The first ethical shortcoming of the Massachusetts statute is that, unlike most other LLP statutes, it fails to contain a provision holding partners liable for the negligence or wrongful acts of persons over which they had direct control.<sup>217</sup> Some states not only contain such a principle, but in fact have even extended it to situations where a partner may not have direct control over the culpable employee, *but does* have knowledge of the wrongdoings and fails to take reasonable action to remedy them.<sup>218</sup> While such a rule may create problems of degree as to what constitutes "direct control" or "reasonable action," such standards of reasonableness have been readily applied in other areas of law with a great deal of success by using judicial interpretation.<sup>219</sup> Thus, it seems plausible that a workable rule could and probably will be established in the future by judges in those states which employ such language in their statutes.<sup>220</sup>

The costs of such an omission in the text of the statute could potentially prove extremely high. Holding partners liable for the negligence of those who work for or with them encourages diligent supervision on the part of the partners, thus reducing the potential for malpractice.<sup>221</sup> It therefore seems anomalous that the Massachusetts LLP act purposely fails to include such a provision.<sup>222</sup>

The second ethical shortcoming with the Massachusetts LLP act is the major provision which shields partners from personal liability for the ordinary business obligations of the partnership.<sup>223</sup> This provision, created by the New York/Minnesota LLP model, has become extremely popular.<sup>224</sup> While this provision makes the LLP an even more attractive business option for Massachusetts' partnerships, it is difficult to find a compelling justification for it.

The principal problem with this provision is that the solution it proposes proves far broader than the problem itself.<sup>225</sup> Specifically, this

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<sup>217</sup> See *id.* § 15.

<sup>218</sup> See DEL. CODE ANN. tit. 6, § 1515(c) (1993); MINN. STAT. ANN. § 323.14(2) (West 1995); N.Y. PARTNERSHIP LAW § 26(b); TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(b) (West Supp. 1997).

<sup>219</sup> See generally *Kansallis Finance Ltd. v. Fern*, 659 N.E.2d 731 (Mass. 1996).

<sup>220</sup> See *id.*

<sup>221</sup> See *Murphy*, *supra* note 102, at 215.

<sup>222</sup> See, MASS. GEN. LAWS ch. 108A, § 15(b)(2).

<sup>223</sup> See *id.*

<sup>224</sup> See MINN. STAT. ANN. § 323.14(2) (West 1995); N.Y. PARTNERSHIP LAW § 26(b) (McKinney Supp. 1997).

<sup>225</sup> See MASS. GEN. LAWS ch. 108A, § 15(b)(2); Hamilton, *supra* note 28, at 1090-91.

increased shield from liability protects not only innocent partners from the misdeeds of other "bad apple" partners, but it also protects the entire partnership from itself.<sup>226</sup> Inherent in the text of the Massachusetts statute is the assumption that the majority of partnerships that collapse do so because of malpractice and other similar lawsuits directed against a partner or partners.<sup>227</sup> It would be more accurate, however, to assume that the collapse of most partnerships happens under the weight of problems not associated with a malpractice claim.<sup>228</sup> This Massachusetts legislation would allow all of the partners in a collapsed partnership to avoid personal liability for over-hiring, overextending, entering into a disastrous long term lease or a myriad of other poorly conceived business decisions.<sup>229</sup> Such a result cannot adequately be supported by either the underlying theory of LLP law or common sense in general. As a result, it seems that this provision of the Massachusetts LLP legislation proves to be a pretext for quietly allowing all partners to obtain limited liability for their own business mistakes without having anyone find out about it.<sup>230</sup>

Another injustice created by this provision is the impact that it has on parties who contract with LLPs.<sup>231</sup> Commentators have suggested that experienced and sophisticated lenders such as banks and real estate developers will probably be able to contract for personal liability of the partners.<sup>232</sup> A problem with this analysis arises in the context of parties who are not nearly as sophisticated.<sup>233</sup> For every commercial lender and real estate developer there are just as many unsophisticated businesses, such as the local hardware store or cleaning service, that will enter into contracts with LLPs unaware of the fact that the three letters "LLP" have completely changed the allocation of the risk that the partnership will prove unable to satisfy its debt.<sup>234</sup> This will become even more prevalent as the popularity of LLPs spreads beyond the realm of law and accounting firms and into the millions of small general partnerships who will be able to attain this protection from liability for a mere five-hundred dollars a year.<sup>235</sup>

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<sup>226</sup> See Hamilton, *supra* note 28, at 1091.

<sup>227</sup> See MASS. GEN. LAWS ch. 108A, § 15.

<sup>228</sup> See Hamilton, *supra* note 28, at 1091 (suggesting other reasons why a partnership may collapse).

<sup>229</sup> See MASS. GEN. LAWS ch. 108A, § 15; Hamilton, *supra* note 28, at 1091.

<sup>230</sup> See MASS. GEN. LAWS ch. 108A, § 15; Hamilton, *supra* note 28, at 1091.

<sup>231</sup> See *supra* notes 80-87 and accompanying text.

<sup>232</sup> See Hamilton, *supra* note 28, at 1092; Cohen, *supra* note 109, at 1.

<sup>233</sup> See Hamilton, *supra* note 28, at 1093.

<sup>234</sup> See *id.* at 1093-94.

<sup>235</sup> See MASS. GEN. LAWS ch. 108A, § 45(3).

There is, however, a third aspect of the Massachusetts LLP legislation which helps to counterbalance some of the inequity it creates in practice.<sup>236</sup> The Massachusetts LLP statute holds partners in LLPs to the same standard as shareholders in a professional corporation, by mandating that partners cannot distribute the firm's profits to themselves unless they have enough partnership capital available to satisfy the partnership's ordinary business obligations.<sup>237</sup> This provision basically ensures that professionals, such as lawyers and accountants, will not use their knowledge and sophistication to manipulate the partnership assets in a way that could intentionally or knowingly defraud a creditor.<sup>238</sup> This provision, however, does nothing to remedy situations where creditors go unpaid because the partnership has collapsed for legitimate reasons.<sup>239</sup> While this provision does not cure the fundamental flaws inherent in this LLP legislation, it does at least address the fact that intentional abuse of the LLP shield will not be tolerated.<sup>240</sup>

In sum, the Massachusetts LLP legislation proves far too broad a solution for addressing the problem of unlimited attorney liability in the commonwealth.<sup>241</sup> The legislature erred in adopting this expansive New York/Minnesota style LLP statute because it unnecessarily and unjustly shifts the risk that the collapse of the partnership will prevent the payment of ordinary business obligations from the partners to the firm's creditors.<sup>242</sup> Massachusetts would have been wiser to base its LLP legislation on the Texas/Delaware model.<sup>243</sup> While this model does not fully protect non-culpable partners from the indirect effects of a malpractice judgment levied against the firm, it does, however, more equitably balance the allocation of the risk between the firm's partners and its creditors should a partnership prove unable to satisfy its debt.<sup>244</sup>

### CONCLUSION

The number of law firms which have chosen to adopt the LLP form is steadily increasing.<sup>245</sup> Invariably, as more and more firms realize the benefits of organizing under the LLP form this trend will only

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<sup>236</sup> See *supra* note 148 and accompanying text.

<sup>237</sup> See MASS. GEN. LAWS ch. 108A, § 15; see also *supra* note 148 and accompanying text.

<sup>238</sup> See MASS. GEN. LAWS ch. 108A § 15(4).

<sup>239</sup> See *id.*

<sup>240</sup> See *id.*

<sup>241</sup> See *supra* notes 226-40 and accompanying text.

<sup>242</sup> See *supra* notes 216-240 and accompanying text.

<sup>243</sup> See *id.*

<sup>244</sup> See *id.*

<sup>245</sup> See *supra* notes 1-3 and accompanying text.

accelerate.<sup>246</sup> As the various state-specific LLP statutes are currently written, there is no reason why a general partnership law firm would not choose to register as a LLP.<sup>247</sup>

LLPs in their original conception represent an equitable solution to the problem of unlimited attorney liability by providing non-culpable partners with a shield from personal liability for the wrongful acts of fellow partners.<sup>248</sup> The recent trend in LLP statutes which extends this shield to cover all ordinary business obligations of the partnership is an unreasonable extension of the original principle.<sup>249</sup> Commentators have suggested that as time goes on statutes such as the Massachusetts LLP Act will be viewed by the public as "legislation for lawyers."<sup>250</sup> In turn, these statutes will only perpetuate the pejorative stereotypes of attorneys which currently pervade society.

As this becomes the case, it will be the responsibility of both clients and creditors of law firms to educate themselves as to the extent of the law and to closely monitor the affairs of the LLPs with which they conduct business.<sup>251</sup> As time passes, it seems inevitable that many of these businesses will become more sophisticated in their dealings with LLP law firms by contracting for the personal liability of the partners themselves.<sup>252</sup> While the current LLP statute has succeeded in shifting the default rule of personal liability as it previously applied to all partnerships, it is possible that the inequities associated with this situation can be avoided through a higher level of sophistication on the part of both attorneys and their clients.<sup>253</sup>

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<sup>246</sup> See *supra* notes 179-216 and accompanying text.

<sup>247</sup> See *supra* notes 91-221 and accompanying text.

<sup>248</sup> See *supra* notes 43-77 and accompanying text.

<sup>249</sup> See *supra* notes 207-41 and accompanying text.

<sup>250</sup> See, e.g., Hamilton, *supra* note 28, at 1103; Weidlich, *supra* note 26, at 1.

<sup>251</sup> See *supra* notes 207-41 and accompanying text.

<sup>252</sup> See *id.*

<sup>253</sup> See *id.*