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LIMITED LIABILITY LAW PRACTICE

MARTIN C. MCWILLIAMS, JR.*

Almost forty years ago, legislatures began enacting professional corporation statutes¹ that permit professionals to organize as corporations and thereby limit their exposure to personal liability. The professional corporation has proven very popular among lawyers, including South Carolina lawyers.

In recent years, as exposure to liability in law practice has expanded beyond traditional limits² and malpractice judgments have soared,³ legislatures have provided professionals with two additional limited liability formats: limited liability partnerships (LLPs) and limited liability companies (LLCs). This is a national trend⁴ of which South Carolina is a part.⁵

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1. Also known as professional associations, such corporations are designed to be owned by professionals who are also its employees. Generally speaking, the owner/employees are not personally liable for obligations of the corporation unless they render themselves liable by committing malpractice, or negligently hiring or supervising another employee who commits malpractice. *See, e.g.,* S.C. CODE ANN. §§ 33-19-101 to -700 (Law. Co-op. 1990 & Supp. 1997) ("S.C. Professional Corporation Supplement"); *see also* Jennifer J. Johnson, *Limited Liability for Lawyers: General Partners Need Not Apply*, 51 BUS. LAW. 85, 92-98 (1995).

2. For example, lawyers' liability has been extended to subject firms to punitive damages in some cases. *See* Johnson, *supra* note 1, at 85-86 & n.4; Victoria Slind-Flor, *Megafirm Socked on Punitives*, NAT'L L.J., Sept. 12, 1994, at A4 (awarding of \$7.1 million punitive damages against Baker & McKenzie law firm). Lawyers have also been held liable to parties other than clients. *See* Johnson, *supra* note 1, at 86-87 & nn.5-7 ("[L]awyers today face potential liability from a host of new sources that include non-client third parties, government regulators, and court-imposed Rule 11 sanctions." (footnotes omitted)); Mark Rosencrantz, Comment, *You Wanna Do What? Attorneys Organizing as Limited Liability Partnerships and Companies: An Economic Analysis*, 19 SEATTLE U. L. REV. 349, 368-69 (1996) (noting that courts have begun to reject the lack of privity defense in attorney malpractice actions).

3. *See* Johnson, *supra* note 1, at 87-89; Rosencrantz, *supra* note 2, at 350 (finding the partners of Kaye Scholer were personally liable for \$16 million in the Lincoln Savings & Loan matter after the firm's malpractice insurance covered the first \$25 million of liability); *Jury Orders Law Firm to Pay \$4.55 Million*, HOUS. CHRON., Mar. 25, 1993, at 3; Slind-Flor, *supra* note 2, at A4; *Some Law Firms Were Hit by Massive Suits*, NAT'L L.J., Dec. 26, 1994, at C11; Harry J. Haynsworth, *Business Lawyers Under Fire: Liability and Ethical Risks*, Q246 ALI-ABA 23, 25 (1996) ("As of October, 1993, the Resolution Trust Corporation had entered into settlements with 31 law firms for a total of \$202 million.").

4. By 1983, every state had enacted professional corporation legislation. *See* MODEL BUS. CORP. ACT, PROF'L CORP. SUPP. PC-46 to PC-48 (1996) (listing the statutes for all fifty

Again, lawyers, along with other professionals, have taken advantage.⁶

Insofar as they provide non-traditional formats for the practice of law, the professional corporation, LLP, and LLC statutes represent legislative exercises in lawyer regulation. Are such legislative incursions into lawyer regulation acceptable in light of the courts' powers and responsibilities to regulate the practice of law? The few courts around the country that have addressed this question have divided in their results, but are uniform in their assertion of the courts' paramount powers over lawyer regulation and their responsibilities to exercise this power to protect the lawyer-client relationship. Do these new statutes, which purport to insulate lawyers from vicarious malpractice liability,⁷ unduly erode the lawyer-client relationship?

This paper evaluates these questions and the surrounding issues in terms of South Carolina court rules, cases, and constitutional provisions. Part I consists of historical and legislative background, and concludes that, structurally speaking, LLCs and LLPs are no less suitable as formats for the practice of law than the now-familiar professional corporation.⁸ From

states in an Annotation). Many states have LLP Acts, and most have LLC Acts. See Ronald E. Mallen, *Ethics/Malpractice Issues: The Professional and Ethical Issues Facing the Attorney-Employee*, in *THE BEST ENTITY FOR DOING THE DEAL* 1996, at 996 nn.18-21 (PLI Corp. Law & Practice Course Handbook Series No. B4-7143, 1996); Rosencrantz, *supra* note 2, at 356 n.49, 357 n.57; see also Mark A. Cohen, *Law Firms Registering as LLPs in Doves*, MASS. LAW. WKLY., June 10, 1996, at 1 (noting the wave of law firms reorganizing as LLPs).

5. South Carolina's General Assembly enacted a professional corporation statute in 1962, and replaced it with the present statute, the South Carolina Professional Corporation Supplement in 1988. S.C. CODE ANN. §§ 33-19-101 to -700 (Law. Co-op. 1990 & Supp. 1997) ("S.C. Professional Corporation Supplement"). In 1994, the General Assembly added statutes permitting professionals to organize as LLCs, S.C. CODE ANN. §§ 33-43-101 to -1409 (Law. Co-op. Supp. 1997) ("1994 LLC Act"), and LLPs, S.C. CODE ANN. §§ 33-41-20(6), -210, -370, -510, -960, -1010, -1060, -1110 to -1220 (Law. Co-op. Supp. 1997) ("LLP Act"). In 1996, the General Assembly replaced the 1994 LLC Act in its entirety with the South Carolina Uniform Limited Liability Company Act of 1996, which does not expressly contemplate use by professionals. S.C. CODE ANN. §§ 33-44-101 to -1207 (Law. Co-op. Supp. 1997) ("1996 LLC Act").

6. Although neither the South Carolina Bar nor the Secretary of State's office maintains official statistics of this nature, an informal review of firm names listed in Martindale-Hubbell indicates that of the approximately 540 firms listed in South Carolina, 244 were PCs, 4 were LLCs, and 58 were LLPs. The balance consisted of general partnerships and sole practitioners. 14 MARTINDALE-HUBBELL LAW DIRECTORY SC1B-SC299B (1996). This count does not consider members of firms who were themselves PCs.

7. For the sense in which this term is used, see *infra* text accompanying note 107-109.

8. In South Carolina, the firmness of this conclusion is diminished by the failure of the 1996 LLC Act to include provisions contemplating professional service companies, as did the 1994 LLC Act, the LLP Act, and the S. C. Professional Corporation Supplement. Compare S.C. CODE ANN. § 33-41-370(D) (Law. Co-op. Supp. 1997) (professional-services

this conclusion it follows that the next question addressed by this article is to what extent is the practice of law in *any* limited liability format appropriate in South Carolina? Part II considers the basis of the lawyer-client relationship and its function in lawyer regulation. Part III reviews the national case law addressing the issue of limited-liability law practice, and the arguments for and against such practice. This Part concludes that while persuasive practical arguments favor limiting lawyers' liability, courts should consider retaining vicarious malpractice liability in particular cases. Vicarious malpractice liability is principled, and it engages important informing values of the lawyer-client relationship. In addition, abandoning vicarious liability represents a transfer of risk and cost from lawyers to their clients. Part IV reviews South Carolina constitutional and implied court powers, and concludes that South Carolina courts have the discretionary power to regulate lawyers practicing as professional corporations, LLPs, and LLCs, to the extent necessary to preserve the lawyer-client relationship.

I. HISTORICAL AND LEGISLATIVE BACKGROUND

A. *The Advent of Limited-Liability Law Practice*

Traditionally, people in this country practiced law and other professions in general partnerships or as sole practitioners.⁹ These practice formats render all members in the firm personally liable for all obligations of the practice, including one another's professional lapses or misconduct.¹⁰ The corporate practice of law was prohibited.¹¹ In the first half of this century

liability provisions of South Carolina Uniform Partnership Act), and S.C. CODE ANN. § 33-43-304(B) (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2001) (detailing liability provisions for individuals rendering professional services), with S.C. CODE ANN. § 33-44-303 (Law. Co-op. Supp. 1997) (citing liability provisions which fail to mention professional services). However, the 1996 LLC Act does appear to contemplate, by implication, use by professionals. Cf. S.C. CODE ANN. § 33-44-112 cmt. (Law. Co-op. Supp. 1997) ("A limited liability company may be organized for any lawful purpose unless the State has specifically prohibited a company from engaging in a specific activity."). The 1996 LLC Act does not echo the client protections of the other South Carolina limited liability formats, specifically the professional corporation. E.g., S.C. CODE ANN. § 33-19-130 (licensing requirement for rendering professional services); § 33-19-140 (setting forth prohibited activities of professional corporations); § 33-19-320 (explaining confidentiality requirements between clients and professional corporation employees); § 33-19-340 (privileged communications). Presumably, these client protections are left to the professions' governing regulations. E.g., MODEL RULES OF PROFESSIONAL CONDUCT (1992).

9. See, e.g., Johnson, *supra* note 1, at 92; Rosencrantz, *supra* note 2, at 369-70.

10. See Johnson, *supra* note 1, at 85; Michael J. Lawrence, Note, *The Fortified Law Firm: Limited Liability Business and the Propriety of Lawyer Incorporation*, 9 GEO. J. LEGAL ETHICS 207, 212 (1995).

11. One commentator has identified five reasons for the historical ban on the corporate

the prohibition was a matter of common law in South Carolina.¹² Such statutory regulation of the practice of law as existed at the time contemplated practice only by individuals.¹³ The prohibition found expression, along with other aspects of the unlimited-liability model, in the American Bar Association's Canons,¹⁴ which South Carolina and other states adopted¹⁵ as disciplinary rules.¹⁶ In 1946, the Legislature banned the practice of law by corporations in South Carolina.¹⁷ The statutory ban has carried through into the current Code.¹⁸

The development of the professional corporation during the late 1950s foreshadowed the end of the ban on corporate law practice. This development, designed to eliminate some of the differences between professions and commercial businesses,¹⁹ had two principle objectives. The first objective was to make corporate tax and benefit treatment available to professionals.²⁰ Many of the disparities in this area dropped away,

practice of law: (1) the ineligibility of a corporation for a license to practice law; (2) the personal relationship between lawyer and client, unsustainable by a corporation; (3) the prospect of a lawyer's conflicting duties to corporation and client; (4) the lack of professional discipline over the corporation; and (5) the shielding of lawyers from joint and several malpractice liability. Lawrence, *supra* note 10, at 210 (citing ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY: THE LAW AND ETHICS OF PARTNER WITHDRAWAL AND LAW FIRM BREAKUPS § 6.1 (1994)).

12. See, e.g., *State ex rel. Daniel v. Wells*, 191 S.C. 468, 480, 5 S.E.2d 181, 186 (1939) (noting that a corporation cannot practice law, but can only act through natural persons under agency principles).

13. See S.C. CODE ANN. § 312 (Michie 1932) (superseded 1942) (forbidding the practice of law by any person not admitted and sworn as an attorney).

14. ABA CANONS OF PROFESSIONAL ETHICS (1908).

15. S.C. SUP. CT. R. 33 (Michie & Law. Co-op. Supp. 1960) (adopted June 12, 1956) (superseded 1976) (adopting ABA Canons of Professional Ethics as disciplinary rules in South Carolina).

16. "No lawyer shall permit his professional services, or his name to be used in aid of, or to make possible, the unauthorized practice of law by any lay agency, personal or corporate." S.C. SUP. CT. R. 33, Canon 47 (Michie & Law. Co-op. Supp. 1960) (superseded 1976).

17. S.C. CODE ANN. § 333-4 (Supp. 1946) (superseded 1952).

18. S.C. CODE ANN. § 40-5-320 (Law. Co-op. 1986).

19. Cf. Dirk G. Christensen & Scott F. Bertschi, *LLC Statutes: Use by Attorneys*, 29 GA. L. REV. 693, 702 (1995) ("One of the primary purposes of the Georgia LLC Act, like the Professional Corporation Act that preceded it, is to place members of limited liability companies on a par with the shareholders of ordinary business corporations.").

20. Inferentially downplaying limited liability, tax and benefit enhancement were often cited as the primary motivation for permitting law practice in the corporate form. See, e.g., *In re The Florida Bar*, 133 So. 2d 554, 555-56 (Fla. 1961) (allowing the practice of law as a professional corporation because of tax benefits); *In re Bar Ass'n of Haw.*, 516 P.2d 1267, 1268 (Haw. 1973) ("[The Bar Association's] principal motive in seeking permission for its members to incorporate is to enable the attorneys of this State to qualify for the federal tax advantages which would accompany such incorporation. . . . Therefore, we have concluded

however, with amendments to the Internal Revenue Code during the 1980s.²¹ Commentators no longer consider tax consequences to provide a substantial motive for incorporation by professionals.²²

The second objective of the professional corporation was to permit professionals to limit their exposure to personal liability for the obligations of their businesses.²³ To this end, professional corporation statutes

that [incorporated attorneys'] liability shall not be limited."); *Birt v. St. Mary Mercy Hosp. of Gary, Inc.*, 370 N.E.2d 379, 382-83 (Ind. Ct. App. 1977) (in holding that there was no vicarious liability for shareholders of a medical professional corporation for the tort of a physician employee, the court stated that Indiana passed the professional corporation statute "to enable professionals to form tax-favored corporations"); *In re Rhode Island Bar Ass'n*, 263 A.2d 692, 695 (R.I. 1970) (allowing attorneys to practice law in a professional corporation, and thus reap tax benefits if they apply to the supreme court).

Prior to 1982, partnerships were disadvantaged, compared with corporations, in the pension and benefit area. For example, deferral of income through qualified pension plans was available only to "employees." I.R.C. § 401(a)(4) (1954). Partners did not qualify as employees, while corporate principals did. Rev. Rul. 61-157, pt. 2(e)(1), 1961-2 C.B. 67, 71 (declared obsolete by Rev. Rul. 72-488, 1972-2 CB 649). Additionally, prior to 1986, the marginal corporate tax rate was significantly lower than the rates for individuals and partnerships. See Nancy Thoma, Note, *Partnership Interest Abandonment: Loss Characterization*, 18 J. CORP. L. 101, 102 (1992). The above factors combined made corporate tax treatment desirable.

Initially, the Internal Revenue Service resisted taxing professional corporations as corporations. Defeated on this issue in *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954), the I.R.S. reversed its position. S. REP. NO. 91-522, 1969-3 C.B. 423, 594-95 (citing Tech. Info. Rel. 1969-1019 (Aug. 8, 1969)). The Service issued the so-called "Kintner Regulations" to determine whether an unincorporated association would be taxed as a corporation or a partnership. Treas. Reg. § 301.7701-2(a) (1960). Under these regulations, limited liability was one of the factors indicating corporateness. *Id.* § 301.7701-2(d); see Note, *Professional Corporations and Associations*, 75 HARV. L. REV. 776, 778-85 (1962). The Kintner Regulations were rescinded effective January 1, 1997, with the advent of "check the box" regulations, pursuant to which unincorporated associations can choose whether to be taxed as a corporation or partnership, regardless of their characteristics. T.D. 8697, 1997-2 I.R.B.11.

21. The advantageous tax treatment of retirement benefits was extended to partnerships by 1982. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.); Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.). The disparity between corporate and individual tax rates was narrowed in 1986. These reforms effectively eliminated most of the tax reasons to seek incorporation. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2249 (codified as amended in scattered sections of 26 U.S.C.); see David Paas, *Professional Corporations and Attorney-Shareholders: The Decline of Limited Liability*, 11 J. CORP. L. 371, 373 nn.14-17 (1986).

22. Johnson, *supra* note 1, at 138-39; Paas, *supra* note 21, at 372-74.

23. See Paas, *supra* note 21, at 374. In addition to the advantage of limitation of personal liability, limited liability was one of the indicia of corporateness cited in *Kintner*, 216 F.2d at 429.

Creation of the separate person of the corporation resulted in some unforeseen

typically include a version of the corporate veil.²⁴ South Carolina has adopted a version which has been given effect when adopted by other states.²⁵ Limited personal liability—downplayed in the early days as an attribute of the professional corporation format, especially in the field of law practice²⁶—is now said to be the primary motivation for professionals to organize as professional corporations.²⁷

Because the professional corporation concept contradicted traditional notions of law practice, it was greeted with uncertainty in the legal community.²⁸ Generalized early criticisms of law practice in professional

consequences. For example, a general partner is protected from personal tort liability by workers' compensation statutes, but a shareholder of a professional corporation is not so protected and may be personally liable. *See, e.g., Lyon v. Barrett*, 445 A.2d 1153 (N.J. 1982).

24. For example, the Model Professional Corporation Supplement offers adopting legislatures three choices: not limiting liability, limiting liability through a corporate veil, or limiting liability through some evidence of financial responsibility such as insurance or bonds. MODEL BUS. CORP. ACT, PROF'L CORP. SUPP. § 34 (1996). The South Carolina General Assembly chose the corporate veil alternative: "Except as otherwise provided by statute, the personal liability of a shareholder of a . . . professional corporation is no greater in any respect than the liability of a shareholder of a corporation incorporated under the South Carolina Business Corporation Act." S.C. CODE ANN. § 33-19-340(c) (Law. Co-op. 1990). The South Carolina Business Corporation Act provides that "a shareholder . . . is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct." S.C. CODE ANN. § 33-6-220(b) (Law. Co-op 1990); *see also, e.g., N.Y. BUS. CORP. LAW* § 1513 (McKinney 1986) (making the New York Business Corporation Law applicable to professional service corporations).

25. The S. C. Professional Corporation Supplement provides that a professional providing services as a professional corporation employee "is not liable . . . for the conduct of other employees of the corporation unless he is at fault in appointing, supervising; or cooperating with them." S.C. CODE ANN. § 33-19-340(a) (Law. Co-op. 1990). The South Carolina Reporter's Comment to this Code section observes that similarly-worded provisions have been given effect. *Id.* S.C. Rep. cmt. For this proposition the Reporter cites *Grayson v. Jones*, 710 P.2d 76 (Nev. 1985), and *Birt v. St. Mary Mercy Hospital of Gary, Inc.*, 370 N.E.2d 379 (Ind. Ct. App. 1977). *Grayson*, a one-page per curiam opinion, enforces a statutory limitation of liability in a law corporation without discussion of, or even reference to, the rule-making power of the court. *Grayson*, 710 P.2d at 76. *Birt* is a medical malpractice case; thus, its result is inapplicable to law practice. *See also Gershuny v. Martin McFall Messenger Anesthesia Prof'l Ass'n*, 539 So. 2d 1131 (Fla. 1989) (shareholders not liable for negligence of anesthesiologist practicing in a professional corporation); *Sloan v. Metropolitan Health Council of Indianapolis, Inc.*, 516 N.E.2d 1104 (Ind. Ct. App. 1987) (finding HMO liable under doctrine of respondeat superior even though it did not incorporate); *Boyd v. Badenhausen*, 556 S.W.2d 896 (Ky. 1977) (holding the physician-shareholder liable for negligent supervision).

26. *See Robert R. Keatinge & George W. Coleman, The Right Entity May Limit Your Liability*, L. PRAC. MGMT., July/Aug. 1995, at 22, 24; Lawrence, *supra* note 10, at 224.

27. *See Paas, supra* note 21, at 374 ("If there is any reason left to incorporate a professional practice, it cannot be a tax reason. . . . The most significant nontax reason for incorporating a professional practice is to obtain limited liability.").

28. *See Melby v. O'Melia*, 286 N.W.2d 373, 375 (Wis. Ct. App. 1979) ("Attorneys are

corporations centered on the risk to the lawyer-client relationship,²⁹ including the risk that clients' interests might be compromised by the limitation of liability.³⁰ Proponents of the professional corporation addressed these criticisms by incorporating key elements of the lawyer-client relationship into professional corporation statutes.³¹ This was paralleled by the acceptance in 1961 by the ABA of law practice in the corporate form³² within the limits of professional corporation statutes.³³ The protections in the statutes in turn found expression in the ABA Model Code of Professional Responsibility, adopted in 1969,³⁴ and promulgated

in a unique position because their profession is governed by specific ethical standards, and we cannot say that in all situations a service corporation composed of lawyers will be treated like a regular business corporation.”).

29. *In re The Florida Bar*, 133 So. 2d 554, 556 (Fla. 1961) (“Traditionally, prohibition against the practice of a profession through the corporate entity has been grounded on the essentially personal relationship existing between the lawyer and his client.”); *In re Opinion of the Justices*, 194 N.E. 313, 317 (Mass. 1935); *In re Co-operative Law Co.*, 92 N.E. 15, 16 (N.Y. 1910); *Rhode Island Bar Ass’n v. Automobile Serv. Ass’n*, 179 A. 139, 145 (R.I. 1935); *Richmond Ass’n of Credit Men, Inc. v. Bar Ass’n*, 189 S.E. 153, 157-59 (Va. 1937); HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, *THE LAW OF AGENCY AND PARTNERSHIP* § 299, at 502 (2d ed. 1990); Rosencrantz, *supra* note 2, at 352-54.

30. *See generally* Note, *supra* note 20, at 789 (“[T]he enabling of limited liability seems an inroad upon traditionally rigorous notions of legal responsibility. The fund available to compensate a wronged client is diminished.”).

31. The notion that professional corporations would insulate lawyers from their own professional negligence was dispelled by application of the traditional tort rule that every tortfeasor is personally liable for his own torts. *See, e.g.* ABA/BNA, *LAWYERS MANUAL ON PROFESSIONAL CONDUCT* 91:301 (1998) (“[T]he professional corporation does not permit a lawyer to avoid liability arising out of his own professional obligations.”). The S. C. Professional Corporation Supplement, for example, provides that any professional “is liable for a negligent or wrongful act . . . to the same extent as if he [were] a sole practitioner.” S.C. CODE ANN. § 33-19-340(a) (Law. Co-op. 1990). Agency rules were incorporated in provisions rendering a professional liable for the torts of others in the corporation to the extent that the professional “is at fault in appointing, supervising, or cooperating with” the tortfeasor. *Id.* Liability of lawyer/shareholders of professional corporations for their own professional misconduct is well-established. *See, e.g., The Florida Bar*, 133 So. 2d at 556; *American Nat’l Bank & Trust Co. v. Clarke & Van Wagner, Inc.*, 692 P.2d 61, 67 (Okla. Ct. App. 1984) (“The professional corporation was never intended as a shield to protect individual attorneys from liability for their [own] actions.”).

The professional corporation’s liability as an entity for attorney misconduct is also well-established. *See, e.g., The Florida Bar*, 133 So. 2d at 556.

32. ABA Comm. on Professional Ethics, Formal Op. 303 (1961).

33. Formal Opinion 303 provides that attorneys may practice in corporate form if: (1) the lawyer rendering the legal services remains personally liable to the client; (2) restrictions on the liability of other lawyers in the organization are made apparent to the client; (3) none of the stockholders are non-lawyers, and provisions are in place for transfer back to lawyers of any stock that falls into the hands of a layperson; (4) there are no profit-sharing plans including employees who are non-lawyers; and (5) no layperson is permitted to participate in the management of the firm. *Id.*

34. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 3-101(A) (1980) (“A

widely (including in South Carolina)³⁵ as disciplinary rules. They were retained in the ABA Model Rules of Professional Conduct, adopted in 1983, which succeeded the Model Code and provide the basis of the present Rules.³⁶

Since 1961 every state has enacted some statutory form of a professional service corporation, and no state prohibits the use of professional corporations by lawyers.³⁷ South Carolina enacted its Professional Association Act in 1962,³⁸ replacing it with the South Carolina Professional Corporation Supplement³⁹ in 1988.

State legislatures, such as South Carolina's, presumably approve of the use of professional corporations for law practice because they left the professional corporation statutes unamended after their use by lawyers became common. Although statutory prohibitions on the corporate practice

lawyer shall not aid a non-lawyer in the unauthorized practice of law."); DR 3-103(A) (lawyer shall not form a law partnership with a non-lawyer); DR 5-107(B), (C)(3) (lawyer must not let person other than client affect the lawyer's judgment); DR 6-102(A) (lawyer shall not limit his liability to his client).

35. S.C. SUP. CT. R. 32 (Law. Co-op. 1976) (adopted Mar. 1, 1973) (superseded).

36. MODEL RULES OF PROFESSIONAL CONDUCT (1992); see S.C. APP. CT. R. 407, Rules 1.8, 5.4 (Law. Co-op. 1976). Several specific provisions of these Rules are discussed below in the text accompanying note 91-99.

37. See Johnson, *supra* note 1, at 92 ("Today, every state has statutory authorization for the incorporation of professional associations, including law firms."); Keatinge & Coleman, *supra* note 26, at 28 (chart showing which states have legalized LLCs, LLPs, and PCs for use by attorneys); Rosencrantz, *supra* note 2, at 357 ("Currently, attorneys may incorporate as PCs in all fifty states."). A possible exception is Kentucky, whose court rejected a proposed practice rule authorizing law practice in the professional corporation format doubting "that lawyers can so limit their liability." Allan G. Donn, *Limited Liability Entities for Law Firms*, in THE BEST ENTITY FOR DOING THE DEAL 1996, at 237, 240 (PLI Corp. Law & Practice Course Handbook Series No. B4-7143, 1996) (quoting Order Amending Rules of Civil Procedure, Rules of Criminal Procedure, Rules of the Supreme Court, No. 95-1 (Ky. Sept. 22, 1995)).

Some states have adopted statutes directed to particular professions. *E.g.*, COLO. REV. STAT. §§ 12-2-101 to -131 (1997) (accountants); LA. REV. STAT. ANN. §§ 12:801-858 (West 1994) (lawyers); S.D. CODIFIED LAWS §§ 47-11-1 to -13B-18 (Michie 1991) (licensed physicians, chiropractors, dentists, veterinarians, lawyers, and accountants).

38. See S.C. CODE ANN. § 33-19-101 S.C. Rep. cmt. (Law. Co-op. 1990).

39. S.C. CODE ANN. §§ 33-19-101 to -700 (Law. Co-op. 1990 & Supp. 1997). Organization of a professional association under the South Carolina Professional Corporation Supplement requires formation under the South Carolina Business Corporation Act of 1988, S.C. CODE ANN. §§ 33-1-101 to -20-105 (Law. Co-op. 1990 & Supp. 1997), and an election of the South Carolina Statutory Close Corporation Supplement, S.C. CODE ANN. §§ 33-18-101 to -500 (Law. Co-op. 1990 & Supp. 1997). See S.C. CODE ANN. § 33-19-102 (Law. Co-op. 1990). The special provisions of the South Carolina Professional Corporation Supplement and the Close Corporation Supplement control over inconsistent provisions of the Business Corporation Act. S.C. CODE ANN. §§ 33-18-102(a)-(b), 33-19-102 (Law. Co-op. 1990).

of law remain on the books in many states, including South Carolina,⁴⁰ the passage of professional corporation statutes, their recognition by the Rules of Professional Conduct, and their wide use by lawyers can reasonably be viewed as a partial legislative overruling of the general statutory prohibition on the corporate practice of law.

B. LLCs and LLPs: Structurally, No Less Suitable for Lawyers

As a matter of structure, LLCs and LLPs are no less suitable for the practice of law than professional corporations. Acceptance of the LLC and LLP as law practice formats was not immediate; indeed, a Texas prohibition against lawyers organizing as LLCs⁴¹ may have stimulated the invention of the LLP format.⁴² Although not as ubiquitous as the professional corporation, the LLC and LLP formats now enjoy wide acceptance as formats for law practice.⁴³

1. The Limited Liability Partnership

In South Carolina,⁴⁴ as elsewhere,⁴⁵ LLPs are general partnerships that register with a state agency and comply with other requirements,⁴⁶ thus qualifying their general partners for limited tort liability.⁴⁷

40. S. C. CODE ANN. § 40-5-320 (Law. Co-op. 1976 & Supp. 1997).

41. TEX. REV. CIV. STAT. ANN. art. 1528n, §§ 1.01-9.02 (West 1997). Texas lawyers are now permitted to organize as LLCs. TEXAS ETHICS OP. 486 (1994). However, the limited liability entity of choice in Texas remains the LLP, due in large part to a franchise tax imposed on LLCs but not LLPs. See TEX. TAX CODE ANN. § 171.001(a)(2) (West 1992).

42. For an overview of the savings and loan debacle in Texas that started lawyers clamoring for a limited liability entity, see Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065 (1995).

43. Such acceptance is not universal. See *infra* Part III. C.

44. The LLP format was created by amending the South Carolina General Partnership Act. See *supra* note 5.

45. See generally Martin I. Lubaroff, *Registered Limited Liability Partnerships—The Next Wave*, in 8 No.5 INSIGHTS 23 (1994) (chronicling which jurisdictions have enacted LLP legislation and predicting that many other jurisdictions will soon follow).

46. In South Carolina, LLP status is granted to general partnerships upon registration with the Secretary of State and maintenance of professional liability insurance in the amount of \$100,000 in excess of any deductible. S.C. CODE ANN. §§ 33-41-1110(A), (D), -1130(A) (Law. Co-op. Supp. 1997). The LLP must renew its registration annually. § 33-41-1110(E).

47. General partners in South Carolina LLPs are not insulated from liability for any partnership obligation other than as follows:

(A) Except as provided by subsection (B), all partners are liable jointly and severally for everything chargeable to the partnership.

(B) Subject to subsections (C) and (D), a partner in a registered limited liability partnership is not liable directly or indirectly, including by way of indemnification, contribution, or otherwise, for debts, obliga-

As general partnerships, LLPs are subject to the usual laws governing partnerships⁴⁸ and, when used in law practice, to the Rules of Professional Conduct applicable to general partnerships.⁴⁹ Furthermore, many LLP statutes, including the amendments creating LLPs in South Carolina, include professional-use provisions resembling, and presumably patterned after, Model Rule 5.4.⁵⁰ With a view towards lawyer regulation, the only difference between LLPs and the traditional model of law practice is the question of the members' vicarious malpractice liability. Avoiding such liability is the primary, perhaps only, reason for inventing the LLP in the

tions, and liabilities chargeable to the partnership arising from negligence, wrongful acts, or misconduct committed while the partnership is a registered limited liability partnership and in the course of the partnership business by another partner or an employee, agent, or representative of the partnership.

(C) Subsection (B) shall not affect the liability of a partner in a registered limited liability partnership for his own negligence, wrongful acts, or misconduct, or that of a person under his direct supervision and control.

(D) Each individual who renders professional services on behalf of a registered limited liability partnership is liable for a negligent or wrongful act or omission in which he personally participates to the same extent as if he rendered the services as a sole practitioner. A partner of a registered limited liability partnership which renders professional services, as defined in Section 33-19-103(7), is not liable for the negligence, wrongful acts, misconduct, or omissions of other partners, agents, or employees of the registered limited liability partnership unless he is at fault in appointing, supervising, or cooperating with them.

S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997). These provisions purport to insulate partners in an LLP from vicarious malpractice liability to the extent that such liability sounds in tort but *quare* whether they effectively insulate LLP partners from malpractice actions phrased as contract actions or breaches of trust.

48. In South Carolina, the relevant law is the Uniform Partnership Act, S.C. CODE ANN. §§ 33-41-10 to -1220 (Law. Co-op. 1990 & Supp. 1997).

49. For example, a partner is responsible for ensuring that all lawyers in the firm conform to and abide by the Rules of Professional Conduct, and may be held liable for another lawyer's violation thereof. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1 (1992). A partner's responsibilities extend to the acts of nonlawyer employees as well. *Id.* Rule 5.3. In addition, "[a] lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law." *Id.* Rule 5.4(b). A lawyer shall not enter into a partnership which includes a covenant not to compete upon termination of the partnership. *Id.* Rule 5.6.

50. See Lubaroff, *supra* note 45, at 24-25 (discussing this proposition generally and the Delaware LLP statute in particular). For the South Carolina amendments, see *supra* note 5. In South Carolina, such provisions were copied from the S. C. Professional Corporation Supplement. Compare S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997) (discussing the liability of LLP partners), with S.C. CODE ANN. § 33-19-340 (Law. Co-op. 1990) (discussing the liability of employees of professional corporations). In light of the status of LLPs as general partnerships, such provisions may actually be surplusage.

first place.⁵¹

Taken as a whole, then, the LLP more closely resembles traditional law practice formats than does the professional corporation. If professional corporations are appropriate for law practice, LLPs certainly are. Significantly, in a recent Formal Opinion, the American Bar Association Standing Committee on Ethics and Professional Responsibility blessed the practice of law in the LLP format.⁵² The Committee addressed LLPs in the Model Rules of Professional Conduct 1.8(h)⁵³ and 5.4.⁵⁴

2. *The Limited Liability Company*

One can view the LLP as a traditional practice format with a modern wrinkle. By contrast, in this country the LLC is a true innovation. Modeled after the GmbH, the German small-business format widely copied around the world,⁵⁵ the LLC combines a true corporate veil⁵⁶ with the

51. See Lubaroff, *supra* note 45, at 23.

52. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 96-401 (1996).

53. As to Rule 1.8(h), restricting lawyers' prospective limitation of liability to clients, the Committee observed that the LLP format does not limit a lawyer's own liability to clients. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 96-401 (1996). In any event, the Committee observed, the liability limitation of the format derives from state law, not from an agreement between lawyer and client, which is the focus of Rule 1.8(h). *Id.*

54. As to Rule 5.4, the Committee determined that lawyers practicing in LLPs must comply with ABA Formal Opinion No. 303 relating to practice as professional corporations. *Id.* Each lawyer must remain personally responsible to clients. *Id.* Lawyers in LLPs must make the limited liability nature of the enterprise known to clients by, for example, including "LLP" in the firm name. *Id.* The LLP must not include any non-lawyer members. *Id.* Supervisory lawyers remain obligated under Rules 5.1(b) and 5.3(b) to "make reasonable efforts to ensure" that lawyers and nonlawyers under their supervision comply with their ethical responsibilities. *Id.*

55. See, e.g., Ingrid L. Lenhardt, *The Corporate and Tax Advantages of a Limited Liability Company: A German Perspective*, 64 U. CIN. L. REV. 551, 552 (1996); Hugh T. Scogin, Jr., *Withdrawal and Expulsion in Germany: A Comparative Perspective on the "Close Corporation Problem,"* 15 MICH. J. INT'L L. 127, 130-31 (1993).

56. The LLC's limitation of liability may be broader than the version found in the Business Corporation Act. Compare S.C. CODE ANN. § 33-44-303 (Law. Co-op. Supp. 1997) with § 33-6-220 (Law. Co-op. 1990) (the former, applying to LLCs, makes piercing the veil more difficult by explicitly excluding corporate formalities from the piercing analysis).

Differing from the LLP, whose partners are protected from only certain kinds of tort liability, the drafters of the 1996 LLC Act, S.C. CODE ANN. §§ 33-44-101 to -1207 (Law. Co-op. Supp. 1997), intended that the LLC limitation on liability be as comprehensive as the corporate limitation. See S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997). Whether the partnership-like LLC will receive the same treatment as corporations in this respect is an open question. See generally Debra L. Thill, Comment, *The Inherent Powers Doctrine and Regulation of the Practice of Law: Will Minnesota Attorneys Practicing in Professional*

potential for true partnership taxation⁵⁷ to a degree of completeness unthought of in this country prior to 1977.⁵⁸

In addition to limited liability and tax advantages, LLCs offer almost unlimited flexibility in governance. Unlike business corporations, whose governance is mandated in detail by statute, LLCs are governed primarily by the provisions of an agreement among their owners, usually called an "operating agreement."⁵⁹ Members may customize LLC governance to provide a degree of flexibility highly agreeable to investors willing to do without the protections and familiarity of the business corporation act. Finally, there are no limits on the ownership of LLCs, in contrast to the limitations on ownership of Subchapter S corporations.⁶⁰

Many LLC statutes follow the example of the professional corporation statutes and include professional-use provisions paralleling Model Rules of Professional Conduct Rule 5.4 and preserving the common-law relationship characteristics of privilege and confidentiality.⁶¹ Structurally, LLC statutes protect clients just as well as the professional corporation and

Corporations or Limited Liability Companies Be Denied the Benefit of Statutory Liability Shields?, 20 WM. MITCHELL L. REV. 1143, 1172 (1994).

Although little case law exists, "most commentators assume that the [corporate veil] doctrine applies to limited liability companies." *Ditty v. Checkrite, Ltd.*, 973 F. Supp. 1320, 1335 (D. Utah 1997).

57. S-corporation taxation is not true partnership taxation. Susan Kalinka, *Shareholder Guarantees and Subchapter S Basis: Investment in the Corporation*, 64 TEMP. L. REV. 659, 659-60 (1991). In 1988, the IRS ruled that a Wyoming LLC qualified for partnership tax treatment. Rev. Rul. 88-76, 1988-2 C.B. 360. This prompted many states to promulgate LLC legislation even though the IRS continued to evaluate LLC taxation on a case-by-case basis. See Rev. Rul. 93-38, 1993-1 C.B. 233 (allowing partnership taxation of one Delaware LLC but denying it to another); Rev. Rul. 93-6, 1993-1 C.B. 229 (allowing partnership taxation of a Colorado LLC); Rev. Rul. 93-5, 1993-1 C.B. 227 (allowing partnership taxation of Virginia LLC).

58. The Wyoming legislature enacted the first LLC statute in 1977. Wyoming Limited Liability Company Act, WYO. STAT. ANN. §§ 17-15-101 to -144 (Michie 1997). No further statutes were enacted until Florida's in 1983. Florida Limited Liability Company Act, FLA. STAT. ANN. §§ 608.401-.471 (West 1993 & Supp. 1998). At this point, the race was on. See generally Rosencrantz, *supra* note 2, at 355-56 (noting the order in which states enacted LLC statutes).

59. See, e.g., S.C. CODE ANN. § 33-44-103 (Law. Co-op. Supp. 1997).

60. See I.R.C. § 1361(b)(1) (Supp. 1997) (generally limiting ownership to 75 natural persons who are citizens of the United States).

61. E.g., IND. CODE ANN. § 23-18-3-4 (Michie 1995); MICH. COMP. LAWS ANN. § 450.4905 (West Supp. 1997); MISS. CODE ANN. § 79-29-920 (1996). South Carolina included provisions preserving privilege and confidentiality in the 1994 Act but, inexplicably, did not include such provisions in the 1996 Act. Compare S.C. CODE ANN. § 33-43-304(B)-(C) (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2001), (contemplates liability for rendering professional services) with § 33-44-303 (omits mention of professional services and concomitant liability therefor).

LLP statutes, even though LLCs are arguably not contemplated directly by Rule 5.4.⁶²

The LLC and LLP formats are not inherently less appropriate for use by lawyers than professional corporations, especially when provisions are included that parallel Rule 5.4 and preserve common-law client protections of privilege and confidentiality. Accordingly, the issues addressed in the balance of this paper will apply to all three limited-liability formats.

C. *Limitation of Liability*

As noted above, professional corporations are widely accepted; LLCs and LLPs less so, but their acceptance is increasing. The overall popularity of limited liability formats for professionals⁶³ should not, however, be confused with a uniform endorsement of the legislative limitation of vicarious malpractice liability. Many states, using a variety of approaches, avoid giving effect, or full effect, to such limitations.⁶⁴ Rhode Island, for example, bars the use of LLCs by professionals,⁶⁵ appearing to be the only state to do so.⁶⁶ A number of states which do permit lawyers to organize in limited liability formats do not give effect, or full effect, to the

62. The Model Rules of Professional Conduct Rule 5.4 (1992) refers to "a professional corporation or association," and does not refer to LLCs. However, LLCs are a species of unincorporated association. On the other hand, when Rule 5.4 was adopted, unincorporated associations with limited liability did not exist, so that LLC-type associations could not have been contemplated even by use of the term "association."

63. By a recent count, 22 states expressly permitted lawyers to practice as LLCs, while, in many other states (including the 1994 South Carolina LLC Act, S.C. CODE ANN. § 33-43-102(N) (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2001)), lawyers implicitly fall within the statutory definition of "professionals." Christensen and Bertschi, *supra* note 19, at 696-97. The number is undoubtedly greater today. *See generally* Keatinge & Coleman, *supra* note 26, at 28 (noting that California, Delaware, Hawaii, Illinois, Oregon, Rhode Island, and Vermont prohibit law practice in the LLC format; Nevada, West Virginia, and Wisconsin may not; Arkansas, Arizona, Delaware, Illinois, North Dakota, Nevada, Vermont, West Virginia, and Wyoming do not allow law practice in the LLP format). South Carolina's 1996 LLC Act does not expressly contemplate use by professionals. S.C. CODE ANN. §§ 33-44-101 to -1207 (Law. Co-op. Supp. 1997).

64. The Official Comment to S.C. CODE ANN. § 33-44-112 observes that although an LLC can be organized for any lawful purpose, "many states impose restrictions on activities in which a limited liability company may engage. For example, the practice of certain professionals is often subject to special conditions." S.C. CODE ANN. § 33-44-112 cmt. (Law. Co-op. Supp. 1997). Allan G. Donn's article in the April-May 1996 PLI Corporate Law and Practice Course Handbook breaks down acceptance of professional corporations, LLCs, and LLPs by state. Donn, *supra* note 37, at 240.

65. R.I. GEN. LAWS § 7-16-3 (1992 & Supp. 1994) ("Every limited liability company organized under this chapter has the purpose of engaging in any business which a limited partnership may carry on, except the provision of professional services . . .").

66. *See* Donn, *supra* note 37, at 246.

formats' nominal insulation from liability. Delaware,⁶⁷ Wisconsin,⁶⁸ Illinois,⁶⁹ Oregon,⁷⁰ Kentucky,⁷¹ Nebraska,⁷² and Indiana,⁷³ for example, block limitation of vicarious malpractice liability by statute or court rule. Colorado Rule of Civil Procedure 265 permits incorporated law firms to limit lawyer liability by a provision in their articles of incorporation, on condition that the corporation is insured up to minimum standards.⁷⁴ California state bar rules subject professional corporation shareholder malpractice liability to amount minimums and insurance setoff, but, up to such minimums, liability among shareholders is joint and several.⁷⁵ A Nebraska state bar ethics opinion prohibits lawyers from organizing as LLCs, although Nebraska's LLC statute contemplates use by professionals.⁷⁶ The Texas⁷⁷ and District of Columbia⁷⁸ LLP statutes extend or

67. DEL. SUP. CT. R. 67(h)(ii).

68. Wisconsin law previously provided that liability arising out of the provision of professional services is joint and several among shareholders in professional corporations. See *Melby v. O'Melia*, 286 N.W.2d 373, 374 (Wis. Ct. App. 1979). The statute has been amended to limit shareholders' personal liability to their own misconduct and the misconduct of persons under their actual supervision and control. WIS. STAT. ANN. § 180.1915 (West Supp. 1997).

69. ILL. SUP. CT. R. 721(d); see John Richards, Note, *Illinois Professional Service Firms and the Limited Liability Partnership: Extending the Privilege to Illinois Law Firms*, 8 DEPAUL BUS. L.J. 281, 303-04 (1996).

70. Oregon recently lifted its ban on law practice in the LLC format, but mandates joint and several liability for the torts of all members of limited liability law practices. OR. REV. STAT. § 58.185(2)(c) (1988 & Supp. 1996) (professional corporations); § 63.074(2) (Supp. 1996) (LLCs); § 68.270(6) (1988 & Supp. 1996) (LLPs).

71. The Kentucky LLC Act expressly includes attorneys as a profession for which the LLC format is available, but the Kentucky Supreme Court recently rejected a proposed rule which would have given the court's blessing to the legislative enactment. See John T. Ballantine & Thomas E. Rutledge, *Kentucky Supreme Court Rejects Use of LLCs, LLPs and PCs by Attorneys*, KY. BENCH & BAR J., Winter 1996, at 21, 29 (citing Order Amending Rules of Civil Procedure, Rules of Criminal Procedure, Rules of the Supreme Court, No. 95-1 (Ky. Sept. 22, 1995)).

72. NEB. SUP. CT. R. PROF'L SERV. CORP. RULE I.F.

73. IND. R. ADMISSION & DISCIPLINE OF ATTYS. RULE 27.

74. COLO. R. CIV. P. 265 I.A.4. Rule 265 and Colorado Professional Conduct Rule 5.4, which expressly forbids lawyers from organizing as LLCs or PAs unless they are in compliance with Rule 265, are intended to be complementary in regulating attorneys' eligibility to organize as LLCs, LLPs, and PAs. COLO. RULES OF PROFESSIONAL CONDUCT Rule 5.4(d); COLO. R. CIV. P. 265 I.A.4.

75. CAL. STATE BAR LAW CORP. R. IV.B(1); see *Beane v. Paulsen*, 26 Cal. Rptr. 2d 486, 490 (Ct. App. 1993).

76. Neb. State Bar Ass'n Advisory Comm., Ethics Op. 94-1 (1994).

77. TEX. REV. CIV. STAT. ANN. art. 6132b-3.08(a)(2)(B) (West Supp. 1998) (noting that "reasonable steps to prevent or cure" the negligence of another partner is an affirmative defense).

78. D.C. CODE ANN. § 41-146(a)(2) (Supp. 1997) (repealed effective Jan. 1, 1998)

extended liability to partners who had notice or knowledge of a partner's malpractice.⁷⁹

A number of states, including South Carolina, subject professional practice in limited liability formats to rules of the respective professions' governing bodies.⁸⁰ While some states, such as Ohio, render all shareholders in law corporations liable for all obligations as if they were partners,⁸¹ others respect the statutory grant of limited liability for contract obligations,⁸² but deal separately with limitations on vicarious malpractice liability. Cases addressing limiting malpractice liability are discussed in Part III.

II. PRESERVING THE LAWYER-CLIENT RELATIONSHIP

Part I described a transformation of the practice of law from the traditional, unlimited liability model prohibiting law practice in the corporate form, to one in which three limited-liability formats are available to lawyers. The gradual acceptance of this transformation hinged upon institutional confidence in mechanisms designed to protect the lawyer-client relationship,⁸³ and the public perception of the legal profession—if you will, the lawyer-public relationship.⁸⁴ This Part addresses those two

(indicating that “written notice or knowledge” of errors or negligence of one partner makes another partner in an LLP liable).

79. For the most comprehensive breakdown of which the author is aware of as of this writing, see Donn, *supra* note 37.

80. See S.C. CODE ANN. §§ 33-19-103(5)-(6), -110 (Law. Co-op. 1990); S.C. CODE ANN. § 33-41-1130(A)(2) (Law. Co-op. Supp. 1997); S.C. CODE ANN. § 33-43-1104 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2001); Johnson, *supra* note 1, at 98. The South Carolina 1996 LLC Act does not explicitly provide for use by professionals, although an Official Comment refers to such use. S.C. CODE ANN. § 33-44-112 cmt. (Law. Co-op. 1997).

81. See discussion of *South High Development, Ltd. v. Weiner, Lippe & Cromley Co.*, 445 N.E.2d 1106 (Ohio 1983), *infra* note 130-147.

82. E.g., *We're Assocs. Co. v. Cohen, Stracher & Bloom, P.C.*, 480 N.E.2d 357, 360 (N.Y. 1985) (“[T]he shareholders of a [legal] professional corporation cannot be held personally liable for an ordinary business debt of the corporation.”)

83. Cf. ABA Comm. on Professional Ethics, Formal Op. 303 (1961) (allowing attorneys to practice in the PC form); ABA Comm. on Ethics and Professional Responsibility, Formal Op. 96-401 (1996) (allowing attorneys to practice in the LLP form); Rosencrantz, *supra* note 2, at 354 (“The noncorporate status of the professional was considered necessary to preserve for clients ‘the benefits of a highly confidential relationship based upon personal confidence, ability, and integrity.’” (quoting *In re The Florida Bar*, 133 So. 2d 554 (Fla. 1961))).

84. See *Hamaas v. State*, 279 S.C. 592, 596, 310 S.E.2d 440, 443 (Ct. App. 1983) (“[T]he practice of law is a profession—not a business or skilled trade. . . . [T]he chief end of a profession is public service.” (quoting *In re Jacobson*, 240 S.C. 436, 448, 126 S.E.2d 346, 353 (1962))); Rosencrantz, *supra* note 2, at 354 (“Some states feared that professionals, if allowed to incorporate, would emphasize the business aspect of their professions rather

relationships and their function in lawyer regulation, concluding that the limitation of vicarious malpractice liability by statute omits a significant component of lawyer regulation.

The lawyer-client relationship and its traditional incidents are based on agency.⁸⁵ In particular, the relationship relies upon the agent's duty of loyalty and that duty's subset, the duty of exclusivity with respect to the subject matter of the agency.⁸⁶ The values served by these duties render anathema the intervention in the relationship of any "lay intermediary."⁸⁷ Indeed, the traditional prohibition on the corporate practice of law has been described in these terms.⁸⁸

Thus, the preservation of the lawyer-client relationship depends upon mechanisms tending to eliminate lawyer responsiveness to any goal or master other than the advancement of client interests.⁸⁹ This objective can be described as an attempt to minimize the inevitable divergence between the interests of principal and agent.⁹⁰ Such divergence is particularly pernicious in law, where the agent is so substantially the advantaged party.

The Model Rules of Professional Conduct are designed in large part to preserve the lawyer-client relationship⁹¹ and to discourage any motivation for action by the lawyer other than in furtherance of the client's best interest.⁹² The reformation of the Rules to contemplate corporate law practice required that these two objectives be dealt with principally in Rules 5.4 and 1.8.

By its terms, Rule 5.4 is directed toward preservation of the lawyer's

than the service aspect, and clients would suffer as a result.").

85. See, e.g., *Millbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537, 543 (2d Cir. 1994) (stating that attorneys have a "unique position of trust and confidence"); *In re Cooperman*, 633 N.E.2d 1069, 1071 (N.Y. 1994) (stating that a client's hiring of an attorney creates a "unique fiduciary reliance . . . imbued with ultimate trust and confidence").

86. See RESTATEMENT (SECOND) OF AGENCY §§ 387, 394 (1958) (explaining that an agent must only act to benefit a principal).

87. See, e.g., *State ex rel. Daniel v. Wells*, 191 S.C. 468, 480, 5 S.E. 2d 181, 186 (1939) (explaining that a layman cannot appear in court to represent a corporation).

88. See *Richards*, *supra* note 69, at 303 (citing *In re Co-operative Law Co.*, 92 N.E. 15, 16 (N.Y. 1910) (creating profits for shareholders would interfere with the lawyer-client relationship)).

89. See, e.g., *In re Education Law Ctr., Inc.*, 429 A.2d 1051, 1055 (N.J. 1981) (explaining that an attorney must be completely loyal to the client).

90. Cf. Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 700-03 (1982) (explaining the function of a fiduciary's duties).

91. See *In re Wallace*, 574 So. 2d 348, 351 (La. 1991) ("These rules are designed to give the client the right to control and direct the assertion and protection of his legal rights as fully as practicable, and to encourage and require an attorney to act with loyalty and in the best interest of his client.").

92. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4 cmt. (1992).

“professional independence of judgment.”⁹³ Rule 5.4 is an expression of the lawyer’s duty of loyalty with the emphasis falling strongly upon the exclusivity aspect of this duty. To this end, lawyers may not enter into partnerships with nonlawyers,⁹⁴ share legal fees with non-lawyers, except under prescribed conditions,⁹⁵ or practice in the corporate form if any non-lawyer is an owner, director, or officer or has “the right to direct or control the [lawyer’s] professional judgment.”⁹⁶ These rules promote the agency value of exclusivity and encourage congruence of the interests of lawyer and client. Other than the client, the only persons permitted to influence the representation are other lawyers presumably subject to the same rules, professional discipline, and other incidents of lawyer regulation.

Rule 1.8(h) addresses the liability side of the agency relationship⁹⁷ with its deterrent, punitive, and compensatory functions.⁹⁸ The Rule is hardly comprehensive; it constrains only agreements limiting the lawyer’s malpractice liability to clients.⁹⁹ Otherwise, the Rules leave open the issue of liability, presumably leaving it to be dealt with in terms of malpractice. As suggested below, the resulting ambiguity—or perhaps

93. *Id.*

94. *Id.* Rule 5.4(b).

95. *Id.* Rule 5.4(a). The rule lists the conditions as follows:

(1) [A]n agreement by a lawyer with the lawyer’s firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer’s death, to the lawyer’s estate or to one or more specified persons;

(2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may . . . pay to the estate or other representative of that lawyer the agreed-upon purchase price; and

(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement.

Id.

96. *Id.* Rule 5.4(d).

97. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.8(h) (1992); *cf.* MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 6-6 (1980) (“A lawyer who handles the affairs of his client properly has no need to attempt to limit his liability for his professional activities and one who does not handle the affairs of his client properly should not be permitted to do so.”).

98. In the view of some authorities, the spirit of Rule 1.8 is violated by limiting lawyers’ liability. *See, e.g.,* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 96-401 (1996) (concluding that organizing in a manner limiting vicarious malpractice liability does engage Rule 1.8(h) but does not violate it, because the Rule prohibits lawyers from prospectively limiting malpractice liability, but not legislatures); Richards, *supra* note 69, at 305-06 (concluding that allowing attorneys to organize as LLPs and PCs will not violate Rule 1.8 because at most it would limit vicarious liability, not the attorneys’ direct liability to their clients).

99. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.8(h).

even ambivalence—is significant.

The new limited-liability statutes self-consciously follow the Rules by incorporating traditional elements of the lawyer-client relationship, using language similar to that of the Rules.¹⁰⁰ For example, the S. C. Professional Corporation Supplement limits a professional corporation's business purpose to the practice of a single profession,¹⁰¹ requires the corporation to render professional services only through individuals appropriately professionally licensed and in good standing,¹⁰² limits the number of non-professionals serving as officers or directors,¹⁰³ and preserves client privilege and confidentiality.¹⁰⁴

Modern limited-liability statutes also directly address the potential personal liability of shareholder-employees, going well beyond the Rules in this respect. For example, the S. C. Professional Corporation Supplement provides that shareholder-employees of professional corporations are personally liable for their own professional liabilities, in the usual way.¹⁰⁵ Being a jural person, the limited liability enterprise itself is subject vicariously to all liabilities of the business, including the professional liabilities of its owners.¹⁰⁶

Like the exclusivity rules already discussed, these liability provisions are informed by familiar rules of agency. However, they do not extend to the partnership characteristic of joint and several liability of all principals of the enterprise.¹⁰⁷ Thus, the corporate veil provision of the S. C.

100. Compare, e.g., S.C. CODE ANN. §§ 33-19-110 to -140 (Law. Co-op. 1990) (structural limitations on professional corporations), and §§ 33-19-320 to -340 (confidentiality, privilege, and liability in professional corporations), with Rule 5.4 (conditions to corporate practice of law).

101. S.C. CODE ANN. § 33-19-110(a) (Law Co-op. 1990).

102. S. C. CODE ANN. § 33-19-130(a) (Law Co-op. 1990).

103. S.C. CODE ANN. § 33-19-300 (Law. Co-op. 1990) (providing that not less than half the directors of a professional corporation and all the officers except the secretary and treasurer, if any, must be licensed professionals).

104. See S.C. CODE ANN. §§ 33-19-320 to -330 (Law. Co-op. 1990) (providing that the duties of privilege and confidentiality run to the corporation, as well as to the individual practitioner-employee).

105. S.C. CODE ANN. § 33-19-340(a) (Law. Co-op. 1990) ("Each individual who renders professional services as an employee of a . . . professional corporation is liable for a negligent or wrongful act or omission in which he personally participates to the same extent as if he rendered the services as a sole practitioner."). The Official Comment to this code section observes that courts have given effect to similarly-worded provisions. See *id.* S.C. Rpt. cmt. (citing *Grayson v. Jones*, 710 P.2d 76 (Nev. 1985) (per curiam) and *Birt v. Saint Mary Mercy Hosp. of Gary, Inc.*, 370 N.E.2d 379 (Ind. Ct. App. 1977)). Without discussion, *Grayson* enforces the statutory limitation of liability in favor of shareholders in a law corporation. *Grayson*, 710 P.2d at 77. *Birt*, a medical malpractice case, explicitly provides that its reasoning and holding do not apply to legal malpractice. *Birt*, 370 N.E.2d at 384-85.

106. S.C. CODE ANN. § 33-19-340(b)-(c) (Law. Co-op. 1990).

107. § 33-19-340. Indeed, one effect of the amendments to the South Carolina Uniform

Professional Corporation Supplement purports to protect shareholder-employees from personal liability for the malpractice of colleagues except those whom they appoint or supervise or with whom they cooperate.¹⁰⁸ All shareholder-employees are purportedly shielded from contract liabilities of the business unless they expose themselves to liability in some way.¹⁰⁹

In short, the Rules and statutes incorporate agency-based mechanisms for preservation of almost all of the traditional incidents of the lawyer-client relationship. The one traditional incident which is omitted is personal vicarious malpractice liability. Therefore, the essential question posed is whether vicarious malpractice liability is important to the lawyer-client relationship, or whether one can preserve the relationship satisfactorily without it.

The absence of vicarious malpractice liability from the Rules of Professional Conduct is not conclusive of its marginality in terms of lawyer regulation. The contrary is true for two reasons. One reason relates to the function of malpractice in lawyer regulation, and the other lies within the Rules themselves. First, malpractice liability, including vicarious malpractice liability, is a distinct sector of lawyer regulation.¹¹⁰ With its distinctive remedial aspect, vicarious malpractice liability lies perhaps closer to the heart of the lawyer-client relationship than the disciplinary sector based on the Rules. Legislative limitation of lawyers' malpractice liability is a direct exercise in regulation of the practice of law. Malpractice as a sector of lawyer regulation does not rely for potency on statutes or court rules; it is an aspect of lawyer regulation maintained by the courts pursuant to their powers and responsibilities to regulate law practice.¹¹¹

The Rules of Professional Conduct themselves address one distinct

Partnership Act creating the LLP format is to eliminate such liability—at least for torts. See S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997).

108. S.C. CODE ANN. § 33-19-340(a) (Law. Co-op. 1990).

109. See § 33-19-340(b) (“[T]he personal liability of a shareholder of a domestic or foreign professional corporation is no greater in any respect than the liability of a shareholder of a corporation incorporated under the South Carolina Business Corporation Act.”). The Business Corporation Act provides that shareholders are not liable for corporate obligations by virtue of being shareholders, but may become liable for corporate obligations “by reason of his own acts or conduct.” S.C. CODE ANN. § 33-6-220(b) (Law. Co-op. 1990).

110. See *Birt v. St. Mary Mercy Hosp. of Gary, Inc.*, 370 N.E.2d 379, 385 (Ind. Ct. App. 1977) (characterizing the Indiana Supreme Court’s order rendering shareholders in law firms organized as professional corporations jointly and severally liable for one another’s malpractice as an exercise of “constitutional authority to promulgate administrative regulation of the practice of law”). See generally David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799 (1992) (discussing various enforcement systems in the regulation of lawyer conduct).

111. See discussion *infra* Part III.

sector of lawyer regulation, the disciplinary sector. Malpractice is not within their ambit. Their parameters do not therefore define the applicability of malpractice. The absence of malpractice from the Rules does not mean that it has disappeared from lawyer regulation. The Rules are not comprehensive in their account of lawyer regulation, and neither are statutes imitating the Rules.

Moreover, the Rules themselves emphasize the duty of loyalty and exclusivity, avoidance of the intervention of the lay intermediary, and minimization of the divergence of interests between lawyer and client. However, elimination of vicarious liability in a corporate setting decreases the interest of lawyers in those cases in which they are not involved. Such lawyers' interest in profits from such cases will not decrease but will become concomitantly more important. Internal monitoring of the client's interest will diminish—indeed, is discouraged by statutes such as South Carolina's—but monitoring of the active lawyer's fee collections will not.¹¹² The result is a class of passive lawyers within the firm, interested in fee collections but purposefully disinterested in the client's interests. These lawyers will closely resemble passive investors or lay intermediaries.¹¹³ The interests of such lawyers having diverged from those of the active lawyer, the active lawyer, the active lawyer's duties to the passive lawyers will encourage the active lawyer's interests to diverge from those of the client. In short, deleting vicarious malpractice liability creates a mechanism encouraging divergence of the lawyer's interest from that of the client.

As early as 1962, commentators recognized that statutes permitting limited liability law practice “perhaps unwittingly, purport to alter the preexisting manner of professional operations” and require that “professionals modify their traditional scope of responsibility and liability at least to some degree,” leading to “uncertainty and potential demoralization so

112. The following statutes purport to eliminate vicarious malpractice liability except with respect to those lawyers who appoint, supervise or cooperate with the misfeasant lawyer: S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997) (LLPs); S.C. CODE ANN. §§ 33-44-302 to -303 (Law. Co-op. Supp. 1997) (LLCs); S.C. CODE ANN. § 33-19-340 (Law. Co-op. 1990) (PAs).

113. See Note, *supra* note 20.

If a range of professional decisions is reserved to a board of directors, in derogation of the individual lawyer's traditional responsibility, the expectations of clients may be defeated and the profession's tradition of individual self-reliance and integrity impaired. . . . [This] is unlikely to improve the public image of the profession, especially since those operating under the new forms obtain . . . the further and quite gratuitous benefit of curtailing their traditionally stringent liability toward clients.

Id. at 789-90.

entailed for layman and professional alike.”¹¹⁴ The practical effects of this departure from traditional practice values are discussed in the next Part. For present purposes, it is sufficient to conclude that releasing members of a law practice from all direct, personal connection with a client encourages a divergence of interests between the active lawyer and that lawyer’s uninvolved, and unexposed, co-owners. This divergence in turn tends to increase, rather than decrease, the divergence of interests of the active lawyer and the client. This divergence of the active lawyer’s interests from the interests of the client contradicts the objectives of the malpractice and disciplinary sectors of lawyer regulation—the latter in contradiction of the Rules’ own orientation.

By contrast, retaining vicarious malpractice liability connects all lawyers in the practice directly to each client and ensures that the uninvolved lawyers’ interests are the same as those of the active lawyer, minimizing the divergence of interest between them, and therefore between the active lawyer and the client. As discussed in the next Part, despite statutes purporting to eliminate it, vicarious malpractice liability can be retained through the exercise of judicial powers over lawyer regulation.

III. EXPERIENCE IN THE COURTS

Law practices are exposed to a full range of liabilities including contract obligations, torts, breaches of trust, and malpractice (direct and vicarious). In the face of statutes purporting to limit lawyers’ personal liability for obligations of their practices, courts have reached a wide variety of results. This Part takes the position that the varying results are justified by the extent to which obligations implicate the lawyer-client relationship. To the extent that client interests are implicated by practice obligations, the firm and its members, not the client, should bear the threat and the cost. In addition to financial interests, the interests referred to include the fact of, and the client’s perception of, the congruence of interest between the practice and the client.

The cases reflect some generally discernable patterns. First, the overwhelming majority of courts to consider the issue of lawyer liability has determined that the issue falls within its inherent powers. Legislative limitation of liability is accordingly treated as an incursion into judicial power. Having identified an incursion, some courts treat it as *ultra vires*, and therefore void. Other courts treat incursions as merely voidable at their discretion. As is discussed below, the voidable approach makes better sense. Many states, including South Carolina, have arguably taken the voidable approach with respect to past legislative incursions.

114. Note, *supra* note 20, at 793.

A court adopting the voidable approach, and thereby asserting discretionary power to invalidate the legislative limitation of liability, must decide what circumstances justify exercise of this power. The courts addressing this issue have treated it as turning on the preservation of the lawyer-client relationship, but the cases do not clearly express what aspects of the relationship are implicated. This Part concludes that the most urgent case for court intervention is the divergence of the interests of lawyer and client—a divergence which is minimized most efficiently by retaining the threat of vicarious liability for malpractice.

A. Sources and Extent of Court Power

Most state courts addressing the issue of legislative limitation of lawyer liability recognize the issue as implicating lawyer regulation.¹¹⁵ State courts claim paramount powers in this area, finding these powers, most often, in constitutional provisions.¹¹⁶ Such constitutional provisions may be express grants of power over lawyer regulation,¹¹⁷ or lawyer discipline¹¹⁸ which is a subset of lawyer regulation,¹¹⁹ or they may be characterized as “implied” or “inherent”¹²⁰ powers accompanying constitutional designations of court systems. Even a court asserting what might be thought of as a purely inherent power—a power relating to no express

115. See, e.g., *In re The Florida Bar*, 133 So. 2d 554, 555 (Fla. 1961); *First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674, 675 (Ga. 1983), *overruled in part by Henderson v. HSI Fin. Servs., Inc.*, 471 S.E.2d 885 (Ga. 1996); *In re Bar Ass’n of Haw.*, 516 P.2d 1267, 1268 (Haw. 1973); *South High Dev., Ltd. v. Weiner, Lippe & Cromley Co.*, 445 N.E.2d 1106, 1109 (Ohio 1983); *American Nat’l Bank & Trust Co. v. Clarke & Van Wagner, Inc.*, 692 P.2d 61, 66-68 (Okla. Ct. App. 1984); *In re Rhode Island Bar Ass’n*, 263 A.2d 692, 695 (R.I. 1970).

116. Courts often characterize such powers as “exclusive.” See, e.g., *Colorado Supreme Court Grievance Comm. v. District Court*, 850 P.2d 150, 152 (Colo. 1993); *Eckles v. Atlanta Tech. Group, Inc.*, 485 S.E.2d 22, 25 (Ga. 1997); *Washington County Dep’t of Human Servs. v. Rutter*, 651 N.E.2d 1360, 1362-63 (Ohio Ct. App. 1995); *Lloyd v. Fishingier*, 605 A.2d 1193, 1195 (Pa. 1992); see also cases discussed *infra* Part III.B.

117. E.g., OHIO CONST. art. IV, § 5(B); S.C. CONST. art. V, § 4; UTAH CONST. art. VIII, § 4.

118. E.g., FLA. CONST. art. V, § 15; OHIO CONST. art. IV, § 2(B)(1)(g); S.C. CONST. art. V, § 4; UTAH CONST. art. VIII, § 4.

119. See *supra* note 110 and accompanying text.

120. Some authorities draw a distinction between “implied” powers, those unmentioned powers necessary to carry out express powers, and “inherent” powers, powers naturally inhering in courts but deriving from no express grant. See FELIX F. STUMPF, *INHERENT POWERS OF THE COURTS: SWORD AND SHIELD OF THE JUDICIARY* 5 (1994). Rather than enter the dispute, this paper will use the term “inherent” as defined by the South Carolina courts; that is, any power not expressly granted in the constitution is “inherent.” See, e.g., *In re Ferguson*, 304 S.C. 216, 218, 403 S.E.2d 628, 630 (1991); *State ex rel. McLeod v. Hite*, 272 S.C. 303, 305, 251 S.E.2d 746, 747 (1979).

constitutional grant, but inhering purely from the court's status as a court—would probably ultimately find a source for its power in some constitutional provision.¹²¹ In some states, including South Carolina, statutes also support court powers over lawyer regulation.¹²²

B. Applications of Court Power

One can sort the decided cases roughly into two categories. The first category characterizes any incursion by another branch of government as *ultra vires*, and therefore void. The second category characterizes incursions as voidable at the court's discretion.¹²³ In the jurisprudence of lawyer regulation, the void/voidable question is not new.¹²⁴ Nor is the question an easy one because constitutional language in many states, taken literally, could lead to a conclusion that incursions across constitutional lines are *ultra vires*, notwithstanding that legislation regulating lawyers is enforced by the courts of those very states.¹²⁵ The conclusion that legislative incursions are *ultra vires* and therefore void leads, of course, to

121. See, e.g., *Singer Hutner Levine Seeman & Stuart v. Louisiana State Bar Ass'n*, 378 So. 2d 423, 426 (La. 1979) (citing constitutional separation of powers clause and then observing, "[t]his division creates in the judicial branch an inherent power which the executive and legislative branches cannot abridge"); *In re Integration of Bar of Minn.*, 12 N.W.2d 515, 518 (Minn. 1943) (asserting inherent power flowing from its existence as a court to unify the state bar, but the court also relied on constitutional provisions); *In re Unification of N.H. Bar*, 248 A.2d 709, 711-12 (N.H. 1968) (same).

122. E.g., DEL. CODE ANN. tit. 10, § 1906 (Supp. 1996); D.C. CODE ANN. § 11-2501 (1995); IND. CODE ANN. § 33-2-3-1 (Michie 1992); R.I. GEN. LAWS § 8-1-2 (1997); S.C. CODE ANN. § 40-5-10 (Law. Co-op. 1986); UTAH CODE ANN. § 78-51-19 (1996).

123. See, e.g., *Singer Hutner*, 378 So. 2d at 426 ("This court will uphold legislative acts passed in aid of its inherent power, but will strike down statutes which tend to impede or frustrate its authority.").

124. For example, see the exhaustive exploration in *Clark v. Austin*, 101 S.W.2d 977 (Mo. 1937) (en banc). Judge Frank's principal opinion, attracting seven justices, took the view that "any encroachment on judicial power, whether reasonable or unreasonable, violates the Constitution which provides, in express terms, there shall be no encroachment at all." *Id.* at 980-81. Chief Judge Ellison's concurring opinion, on behalf of five justices, argued at length that "the legislative department may enact laws [regulating aspects of law practice] if and in so far as such statutes do not destroy the inherent power of the courts." *Id.* at 986.

125. E.g., *Opinion of the Justices to the Senate*, 376 N.E.2d 810, 822 (Mass. 1978) (noting that the legislature may promulgate standards of conduct to aid the judicial department, but rules set down by the Supreme Judicial Court of Massachusetts control); *Clark*, 101 S.W.2d at 995 (noting that whether a statute regulating the practice of law is constitutional valid is determined by the courts); *Calhoun v. Supreme Court*, 399 N.E.2d 559, 565 (Ohio Ct. App. 1978) ("The General Assembly may enact statutes concerning [the practice of law], but they have been interpreted as aids or guides to the judiciary. Such statutes are subservient to any rule adopted by the Supreme Court."); see also Paas, *supra* note 21, at 383-86.

only one result, and one which requires no analysis beyond the *ultra vires* conclusion.

Despite its facial attractiveness and relative ease of application, the *ultra vires* position has weaknesses discussed below. In any event, the South Carolina courts,¹²⁶ and probably most others, have already taken a voidable position in other cases.¹²⁷

Three significant decisions addressing limitation of lawyer liability have taken the *ultra vires* view: *In re Bar Ass'n of Hawaii*,¹²⁸ decided in 1973; *First Bank & Trust Co. v. Zagoria*,¹²⁹ a Georgia case decided in 1983; and the Ohio Supreme Court's decision in *South High Development, Ltd. v. Weiner, Lippe & Cromley Co.*,¹³⁰ also decided in 1983. Each opinion characterizes the issue as one of lawyer regulation, then asserts the courts' paramount powers, and finally, having identified a legislative incursion, declares the legislative incursion void.

In *Bar Ass'n of Hawaii* the Hawaii Supreme Court addressed a state Bar petition requesting permission for lawyers to organize and practice as professional corporations.¹³¹ Determining that the court and not the legislature possessed the power to determine the limits of lawyers' liability arising from the practice of law, the court concluded that "the promulgation of any rule allowing incorporation shall not be in derogation of the attorney-client relationship to the detriment of the client . . . [and] we reject . . . an alteration [of liability rules] because we believe that its adoption would not provide adequate protection to a client's claims against a law corporation."¹³² The court did not cite any authority, concerning the source of its power, or expand upon the danger posed to clients' claims.

The Ohio Supreme Court extended the *ultra vires* view to its logical conclusion in *South High*, decided in 1983, the same year as *Zagoria*.¹³³

126. See *infra* text accompanying note 245.

127. Cf. *Degan v. United States*, ___ U.S. ___, 116 S. Ct. 1777, 1780 (1996) ("In many instances the inherent powers of the courts may be controlled or overridden by statute or rule.").

128. 516 P.2d 1267 (Haw. 1973).

129. 302 S.E.2d 674 (Ga. 1983), *overruled in part by* *Henderson v. HSI Fin. Servs., Inc.*, 471 S.E.2d 885 (Ga. 1996).

130. 445 N.E.2d 1106, 1107 (Ohio 1983).

131. *Bar Ass'n of Haw.*, 516 P.2d at 1268.

132. *Id.* at 1268.

133. The *South High* court faced a bigger obstacle than the *Zagoria* court did: The Ohio Constitution provided shareholders of corporations with the protection of the corporate veil. OHIO CONST. art. XIII, § 3. Despite this protection, the Ohio Court promulgated the following bar governance rule making lawyer/shareholders of professional corporations generally liable for all obligations of the corporation: "The participation by an individual as a shareholder of a legal professional association shall be on the condition that such individual shall, and by such participation does, guarantee the financial responsibility of the

South High involved a contract claim rather than malpractice liability.¹³⁴ The court held that all lawyer-shareholders are jointly and severally liable for all of the practice's obligations as if they were general partners.¹³⁵ In reaching its conclusion the *South High* court relied on constitutional grants of disciplinary and rule-making powers over the practice of law.¹³⁶ *South High* takes the *ultra vires* view to its farthest extent, rendering every part of the legislative incursion void, including the purported protection from individual liability for corporate contractual obligations.

The California Court of Appeal adopted the essential positions of the *ultra vires* cases and reached an analogous result in *Beane v. Paulsen*.¹³⁷ California state bar rules subject professional corporation shareholder malpractice liability to recovery minimums and insurance setoff.¹³⁸ Up to those minimums, however, all shareholder/lawyers are jointly and severally liable for malpractice claims against their corporation, and, with respect to such liability, have been treated as general partners.¹³⁹ In *Beane*, the California Court of Appeal held two former shareholders of a professional corporation vicariously liable for their co-shareholder's

association for its breach of any duty, whether or not arising from the attorney-client relationship." *South High*, 445 N.E.2d at 1107 (quoting the 1983 version of the Supreme Court's rules governing the Ohio Bar). This dilemma required the court to distinguish "private" corporations, organized for profit and owned by passive shareholders, from professional corporations, owned by shareholders active in the business. The court concluded that "limited liability is not necessary for [professional corporations]." *Id.* at 1108. The court did not cite any authority for this proposition. However, the limitation of the *South High* holding to legal professional corporations was emphasized in *KMS Energy, Inc. v. Titmas*, 610 N.E.2d 1080 (Ohio Ct. App. 1992), in which a shareholder in a nonlegal professional corporation was held insulated from personal liability by the professional corporation statute. *Id.* at 1081.

134. *South High*, 445 N.E.2d at 1107.

135. *Id.*; accord *Columbia Real Estate Title Ins. Co. v. Columbia Title Agency, Inc.*, 465 N.E.2d 468, 470 (Ohio Ct. App. 1983) (citing *South High*, 445 N.E.2d 1106); *Reiner v. Kelley*, 457 N.E.2d 946, 952 (Ohio Ct. App. 1983) (citing *South High*, 445 N.E.2d 1106); *Nelson v. Patrick*, 326 S.E.2d 45, 50 (N.C. Ct. App. 1985) ("A professional corporation is liable to the same extent as if it were a partnership."). But see *We're Assocs. Co. v. Cohen, Stracher & Bloom, P.C.*, 480 N.E.2d 357, 359 (N.Y. 1985) (protecting individual shareholders in a professional service corporation from personal liability); *Lyon v. Barrett*, 445 A.2d 1153, 1158 (N.J. 1982) (holding professional corporation but not individual attorney shielded from tort liability by Workers' Compensation law.); *Schnapp, Hochberg & Sommers v. Nislow*, 431 N.Y.S.2d 324, 326 (N.Y. Sup. Ct. 1980) (holding dentist/shareholders in professional corporations to be insulated from contract liability).

136. "The supreme court . . . shall make rules governing the admission to the practice of law and discipline of persons so admitted." OHIO CONST. art. IV, § 5(B).

137. 26 Cal. Rptr. 2d 486 (Ct. App. 1993).

138. See CAL. STATE BAR LAW CORP. Rule IV.B(1)(c), B(3).

139. *Beane*, 26 Cal. Rptr. 2d at 490.

malpractice.¹⁴⁰ Noting that the plaintiff “was not represented by a partnership but by a professional corporation,” the court observed, “[i]t is not a distinction, however, that affects our analysis of the question of liability” of the shareholders.¹⁴¹ The court analyzed shareholder liability under general partnership principles, even referring to the corporation as a partnership.¹⁴² The *Beane* court refers approvingly to *First Bank & Trust Co. v. Zagoria*,¹⁴³ *Reiner v. Kelley*,¹⁴⁴ and *Bar Ass’n of Hawaii*,¹⁴⁵ all opinions in which the “traditional liability for malpractice to clients” was determined to be an essential element of the lawyer-client relationship.¹⁴⁶

The policy underlying the California rules and *Beane* is evident: Shared liability by all members of a law practice is a significant means of lawyer regulation that justifies curtailing legislative limitations of liability. *Beane* echoes the essential positions taken by *South High* and *Bar Ass’n of Hawaii*: First, the personal liability of lawyers, especially malpractice liability, is recognized as a type of lawyer regulation, and therefore falls within the court’s powers. Further, the opinions imply court powers extending beyond the express scope of the Rules—powers not limited to disciplinary enforcement of published ethics rules. Most significantly, these decisions focus upon preservation of the lawyer-client relationship in order to protect the client. In other words, these opinions take the view that the limited liability statutes in question, with their mechanisms paralleling those of the disciplinary rules, do not fully protect clients or preserve the lawyer-client relationship. These cases extend beyond agency rules to the partnership characteristic of general vicarious liability, the last line of defense against the intrusion of a lay intermediary.

South High is of particular interest in that this case involved contract liability and not malpractice, but nevertheless, the court rested its decision on constitutional grants of lawyer-regulation powers. This is a clear indication that the court views lawyer liability, even outside the context of malpractice, as implicating lawyer regulation.

The Georgia Supreme Court echoed the positions taken by the *ultra vires* cases in *Zagoria*.¹⁴⁷ A lawyer/shareholder in a professional corporation, sued for a fellow-shareholder’s professional negligence, asserted statutory protection from personal liability under the Georgia professional

140. *Id.* at 491.

141. *Id.* at 490.

142. *Id.* at 492 (describing “past tortious acts of their partnership”).

143. 302 S.E.2d 674 (Ga. 1983).

144. 457 N.E.2d 946, 951 (Ohio Ct. App. 1983) (following the reasoning of *South High*).

145. 516 P.2d 1267 (Haw. 1973).

146. *Beane*, 26 Cal. Rptr. 2d at 491 n.7.

147. *Zagoria*, 302 S.E.2d at 674.

corporation act.¹⁴⁸ Characterizing the case “as one which calls for the exercise of this court’s authority to regulate the practice of law,”¹⁴⁹ the Georgia Supreme Court concluded that the legislature “cannot constitutionally cross the gulf separating the branches of government by imposing regulations upon the practice of law.”¹⁵⁰ These assertions represent a conclusion that vicarious malpractice liability is a matter of lawyer regulation based on the paramount power of the constitution. They also express the *ultra vires* view that legislative limitation of liability is void.

While the rhetoric of *Zagoria* echoes the *ultra vires* view, the result in the case was limited. The holding extended only to the malpractice issue: “[W]hen a lawyer holds himself out as a member of a law firm the lawyer will be liable not only for his own professional misdeeds but also for those of the other members of his firm” as if the firm were a general partnership.¹⁵¹ The court left the balance of the statute, and indeed of the corporate veil provision, undisturbed.

The *Zagoria* court explained this result in terms of the lawyer-client relationship, indicating that the relationship extended to all lawyers in a practice:

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.¹⁵²

The opinion falls short by not making clear exactly what it is about vicarious malpractice liability that implicates the lawyer-client relationship in a fatal way. Of course, under the *ultra vires* view, once the court finds lawyer regulation present, no further explanation is necessary. One can read the above-quoted sentences as no more than an explanation of why the issue is one of lawyer regulation.

However, *Zagoria* stands for more. Clear it is not, but the reference to the “fidelity of the other members of the firm” must go directly to the prohibition on intervention of lay intermediaries. All members of the practice must put the interest of the client ahead of their own. *Zagoria* correctly characterizes this as an issue of lawyer regulation and, inarticulately perhaps, validates clients’ right to be confident in the absence of

148. *Id.* at 675.

149. *Id.*

150. *Id.*

151. *Id.* at 676.

152. *Id.* at 675.

influences not fully responsive to their interests. Because malpractice is an element of lawyer regulation, the legislature has no power to take it away.

The weakness of the *ultra vires* position lies in its fundamental postulate that constitutional or other grants of power over lawyer regulation are exclusive, rendering legislatures incapable of enforceable lawmaking in the area. Such a position is difficult to justify in the face of the judicial acceptance of lawyers' use of professional corporations, which is nothing less than a comprehensive legislative prescription for law practice. The *ultra vires* position overlooks the substantial crossover between legislative and judicial powers in regulating lawyers.¹⁵³ The traditional statutory ban on the corporate practice of law is only the most obvious example. In South Carolina the Constitution mandates that the General Assembly and the courts share the power to make court rules.¹⁵⁴

This weakness of the *ultra vires* position may underlie the Georgia Supreme Court's brief opinion in *Henderson v. HSI Financial Services, Inc.*¹⁵⁵ *Henderson* overrules *Zagoria* "to the extent [*Zagoria*] states that this court, rather than the legislative enabling act, determines the ability of lawyers to insulate themselves" from vicarious malpractice liability.¹⁵⁶ Exercising its "regulatory power" to permit lawyers to organize as professional corporations, the *Henderson* court gave effect to the statutory limitation of personal vicarious malpractice liability in favor of two uninvolved lawyer/shareholders.¹⁵⁷ Permitting such limitation of liability, according to the court, would not "leave the public unprotected" because the professionally negligent lawyer and the professional corporation as an entity would remain liable to the client.¹⁵⁸ The court took further comfort from approval of the professional corporation format by the American Bar Association and the incorporation of such approval into the Model Code of Professional Responsibility, adopted as part of Georgia's

153. See *supra* text accompanying note 125; see also Wilkins, *supra* note 110, at 805-08 (for example, the legislative creation of the Securities and Exchange Commission and the Internal Revenue Service, which establishes their own practice rules for lawyers appearing before them).

154. S.C. CONST. art. V, § 4 ("Subject to the statutory law, the Supreme Court shall make rules governing the practice and procedure" in state courts). But see *Rutherford v. Rutherford*, 307 S.C. 199, 204, 414 S.E.2d 157, 160 (1992) ("The legislative authority to enact legislation governing the practice and procedure in the state courts simply cannot be read as an unlimited power contrary to other constitutional limitations on that power.").

155. 471 S.E.2d 885 (Ga. 1996).

156. *Id.* at 886.

157. *Id.* at 886-87. The opinion reserves judgment on propriety of lawyers practicing in other limited liability formats. *Id.* at 887 n.10.

158. *Id.* at 886.

bar rules.¹⁵⁹

Henderson contains no analysis beyond the foregoing conclusory statements. The case is perhaps best understood for the proposition that once the court uses its powers of lawyer regulation to recognize a legislated format for law practice, the format's limitation of vicarious malpractice liability must be accepted.¹⁶⁰ *Henderson* is disappointing in at least three respects. The first is the *non sequitur* implicit in the preceding paragraph. It is not obvious that courts abandon their powers of lawyer regulation by accepting a legislated practice format.¹⁶¹ Even more disappointing is the opinion's failure to recognize or even address any role for malpractice in lawyer regulation. The court deletes the client's right of redress with its concomitant regulatory effects, without even acknowledging that it is doing so. Finally, in the process of displacing *Zagoria*, a decision which served as a national benchmark, surely the *Henderson* court could have indulged in more analysis. Perhaps no opinion goes as far as *Henderson* in illustrating the absence of judicial analysis of the fundamental and critical issues involved in legislative limitation of lawyer liability. *Henderson* illustrates the inherent weakness of the all-or-nothing *ultra vires* approach. Constitutional categories subsume the principles in issue; analysis is foregone. The result in *Henderson* is abandonment of an aspect of the lawyer-client relationship, without discussion.

In addition to its functional weakness, the exclusivity inherent in the *ultra vires* approach is unnecessary to the courts' protection of their paramount powers, so long as the courts are alert to the exercise of their powers when necessary. The heart of the matter is, of course, to determine when exercise of the power is necessary. While the opinions are inarticulate on this question, as the cases discussed in the following material illustrate they are uniform in exercising the power when legislation threatens the attorney-client relationship.

Like the *ultra vires* cases, the cases taking the voidable approach focus on the threat to the lawyer-client relationship. The Rhode Island Supreme

159. *Id.* at 887.

160. *Id.* at 886 ("Although this court defines whether lawyers may practice their profession in a partnership, professional corporation, or other group structure, the relevant statutes govern whether a particular structural form provides its members with exemptions from personal liability.").

161. *Cf.* *Birt v. St. Mary Mercy Hosp. of Gary, Inc.*, 370 N.E.2d 379, 385 (Ind. Ct. App. 1977) (discussing the Indiana Supreme Court's order rendering shareholders in law firms organized as professional corporations jointly and severally liable for one another's malpractice despite the statutory grant of limited liability, and observing that the Supreme Court, in exercising its powers of lawyer regulation, "was not bound . . . to the specific terms of the statute"); *State v. Whitener*, 225 S.C. 244, 248, 81 S.E.2d 784, 785-86 (1954) ("[T]he legislature has no power to take away [by enacting a statutory scheme] powers specifically granted to this Court by the Constitution.").

Court's 1970 decision, *In re Rhode Island Bar Ass'n*,¹⁶² is the earliest statement of the voidable view.¹⁶³ Petitioned by the Rhode Island Bar to permit lawyers to organize under the state's professional corporation statute,¹⁶⁴ the court observed that the statute would limit lawyers' personal, vicarious malpractice liability.¹⁶⁵ However, the court concluded that the legislature's act in establishing a corporate form for law practice did not violate constitutional separation of powers or interfere *per se* with the court's inherent powers to regulate law practice.¹⁶⁶ The court noted that mandatory malpractice insurance and the assets the professional corporation were still available to answer malpractice judgments, postulating that "clients . . . and the members of the public . . . will not suffer by reason of such limited liability."¹⁶⁷ The court also noted its continuing disciplinary powers over lawyers and over the corporations they form.¹⁶⁸ On this basis, the court concluded that "insofar as the relationship of attorney and client and of attorney and the general public is concerned, practice in corporate form will be . . . substantially similar to the practice of law as it presently exists in . . . partnerships."¹⁶⁹

The threat to the lawyer-client relationship triggered the *ultra vires* courts' exclusive powers of lawyer regulation. *Rhode Island Bar* also identifies the lawyer-client relationship as the trigger of its discretionary powers. In an exercise of its discretion, the court in *Rhode Island Bar* did not perceive this detriment to the lawyer-client relationship as fatal to the pertinent legislation. Insurance will protect the financial interest of the client, and any ethical issues will fall within the disciplinary powers of the courts.

Rhode Island Bar is flawed when the court implies that one sector of lawyer regulation, court discipline, subsumes the field and justifies the legislative curtailment of the malpractice sector.¹⁷⁰

The Minnesota Court of Appeals took a voidable approach more congruent with a comprehensive view of lawyer regulation in *London, Anderson & Hoeft, Ltd. v. Minnesota Lawyers Mutual Insurance Co.*¹⁷¹

162. 263 A.2d 692 (R.I. 1970); accord *In re New Hampshire Bar Ass'n*, 266 A.2d 853, 854 (N.H. 1970) (positing jurisdiction over the practice of law based on "custom, practice, judicial decision and statute").

163. *Rhode Island Bar*, 263 A.2d at 697.

164. *Id.*

165. *Id.* at 697.

166. *Id.*

167. *Id.*

168. *Id.* at 696.

169. *Rhode Island Bar*, 263 A.2d at 698.

170. *Cf. Wilkins, supra* note 110, at 803 (discussing who should be responsible for regulating lawyer misconduct).

171. 530 N.W.2d 576 (Minn. Ct. App. 1995).

A law firm's malpractice insurer paid a claim and sought to recover the deductible from a lawyer/shareholder not involved in the activity giving rise to the claim.¹⁷² The Minnesota Court of Appeals declined to hold the uninvolved lawyer/shareholder liable, based on the state's professional corporation statute.¹⁷³ The court explained its exercise of discretion in a footnote: "Because this contract does not implicate the attorney-client relationship, we do not find that [the statute limiting liability] . . . infringes upon the constitutional powers reserved for the Minnesota Supreme Court."¹⁷⁴ The opinion stresses that "the issue before this court is strictly contractual in nature,"¹⁷⁵ and cites *Zagoria, Hawaii Bar* and, "but see," *Rhode Island Bar*. The Minnesota court draws its line short of that in *South High*, where every practice liability implicated lawyer regulation, and instead focuses on malpractice as the bulwark of the lawyer-client relationship. The opinion leaves open exactly what interference with the lawyer-client relationship would trigger the court's discretion, or why. Generally speaking, then, in the "voidable" cases, like the *ultra vires* ones, the lawyer-client relationship triggers the exercise of court discretion. None of the opinions, however, offer much useful guidance as to the nature of the relationship or when an incursion will trigger court action.

For the most painstaking approach to this issue, we must turn to *Birt v. St. Mary Mercy Hospital of Gary, Inc.*,¹⁷⁶ a medical malpractice opinion decided by the Indiana Court of Appeals. Although *Birt* provides that its reasoning and holding do not apply to legal malpractice,¹⁷⁷ the case is of interest because, before giving effect to a statutory limitation of professional liability, it addresses in detail the effect of limited liability on the professional-client relationship.¹⁷⁸ The case is of further interest

172. *Id.* at 577.

173. *Id.*

174. *Id.* at 578 n.2; see also *Porlick, Poliquin, Samara, Inc. v. Compton*, 683 So. 2d 545 (Fla. Dist. Ct. App. 1996), review denied, 695 So. 2d 701 (Fla. 1997) (holding President of legal corporation not personally liable for corporations debt); *Lyon v. Barrett*, 445 A.2d 1153, 1158 (N.J. 1982) (holding shareholder of legal corporation not liable as a shareholder for workers' compensation claim); *We're Assocs. Co. v. Cohen, Stracher & Bloom, P.C.*, 480 N.E.2d 357 (N.Y. 1985) (holding shareholders of professional service corporation not personally liable for ordinary business debt of corporation); *KMS Energy, Inc. v. Titmas*, 610 N.E.2d 1080 (Ohio Ct. App. 1992) (holding shareholder of professional corporation not personally liable for rent owed by corporation).

Presumably the court's constitutional reference was to MINN. CONST. art. III, § 1, the separation of powers clause, and art. VI, § 1, which vests the judicial power of the state in a supreme court.

175. *London, Anderson & Hoeft*, 530 N.W.2d at 578 n.2.

176. 370 N.E.2d 379 (Ind. Ct. App. 1977).

177. *Id.* at 384-85.

178. *Id.*

because the Indiana Supreme Court foreclosed a similar outcome in the context of the legal profession.¹⁷⁹

According to *Birt*, the Indiana legislature, in enacting a professional-service corporation statute, "intended that [the corporation statute] should not destroy the traditional relationship between a professional and his patient through the creation of a corporate shield."¹⁸⁰ *Birt* considers whether the loss of vicarious malpractice liability threatens that relationship.¹⁸¹ Without citing authority, the opinion recognizes the existence of the argument that liability of the negligent physician alone is insufficient to preserve this relationship.¹⁸² Presumably, this argument is a reference to *respondeat superior* liability of the corporation itself, based on agency principles. The opinion posits, however, that "it does not necessarily follow that the statute imports the vicarious liability of the Uniform Partnership Act to apply to associating physicians."¹⁸³ Thus, inferentially, the court would have imported vicarious liability, by the statutory language, had the limitation of such liability interfered with the traditional doctor-client relationship.

Birt identifies and considers four aspects of the traditional relationship: the patients' expectations that the entire enterprise is engaged on the patient's behalf; the related expectation that the enterprise, including all of its principals (rather than the treating physician alone), will be amenable to satisfaction of a malpractice judgment; the benefits of co-supervision by professionals having a personal stake in their associates' professional behavior; and the exclusion of "lay intermediaries" from interference in the professional-patient relationship.¹⁸⁴ Again without citation of authority, *Birt* dismisses as overstated the "patient[s] expectations that an entire firm will be engaged in [the patient's] behalf."¹⁸⁵ "[E]xperience dictates," according to the opinion, "that the physician-patient relationship is generally intensely personal, rather than collective."¹⁸⁶ Concern over collection of damage awards, too, is deemed "overstated," in light of the treating physician's personal liability, corporate liability, and the availabili-

179. *Id.*

180. *Id.* at 383.

181. *Id.*

182. *Birt*, 370 N.E.2d at 383 ("It has been argued that [the statute] must be construed to preserve more than the personal liability of a corporate employee for his own negligent tort existing under general corporations law.").

183. *Id.*

184. *Id.* at 383-84; cf. Lawrence, *supra* note 10, at 210 (to similar effect, especially the conflicting duties of lawyers in corporate settings). Similar arguments are made in favor of retaining vicarious malpractice liability in the practice of law.

185. *Birt*, 370 N.E.2d at 383.

186. *Id.*

ty of insurance.¹⁸⁷ As to co-supervision by colleagues, *Birt* asserts that professional and ethical administrative supervision is adequate.¹⁸⁸

Of the four characteristics of the doctor-client relationship, *Birt* considers only the fourth seriously: the possibility of intervention of a "lay intermediary."¹⁸⁹ This possibility was the reason, according to *Birt*, that "physicians and other professionals" traditionally were limited to practice in partnerships.¹⁹⁰ Vicarious liability accompanied the partnership format as an expression of the aggregate theory of partnership and its resulting special application of agency rules.¹⁹¹ The opinion infers, however, that vicarious liability was an effect, rather than a cause, of the partnership requirement; after all, non-professional partnerships were also subject to general vicarious liability.¹⁹² *Birt* concludes that vicarious liability among partners was not a special rule designed to control professional client relationships.¹⁹³ On the facts before it, the *Birt* court decided that the statute in question did not sufficiently threaten the interposition of a lay intermediary in the physician-patient relationship to warrant setting aside the statutory grant of limited liability.¹⁹⁴

Birt is limited to the physician-client relationship.¹⁹⁵ As to lawyers, the opinion discusses an order of the Indiana Supreme Court, providing in relevant part, "Incorporation by two or more lawyers . . . shall not modify . . . the liability of each for all . . . as existed in a partnership for the practice of law."¹⁹⁶ According to *Birt*, the Indiana Supreme Court promulgated this rule under its constitutional authority to administer the practice of law, and was informed by "the legal profession's unwavering commitment to the interests of the client in regulating the practice of law."¹⁹⁷ *Birt* clearly distinguishes the legal profession from not only commercial enterprises, but also other professions. As far as the practice of law is concerned, *Birt* undercuts the conclusion that joint and several liability in a partnership was an historical coincidence rather than a

187. *Id.*

188. *Id.* at 384.

189. *Id.*

190. *Id.*

191. *Birt*, 370 N.E.2d at 384.

192. *Id.*

193. *Id.* at 385.

194. *Id.*

195. *Id.*

196. *Id.* at 384 (quoting the appendix to the GENERAL PROF'L CORP. ACT, IND. CODE § 23-1-13-1 to -12 (1971) (repealed by P.L. 239-1983, § 3, currently codified at 23-1.5-1-1 to -5-2)). "The [quoted] order was superseded by Admission and Discipline Rule 27 effective January 1, 1976, amended August 31, 1976. The rule very closely parallels the original order." *Id.* at n.9.

197. *Birt*, 370 N.E.2d at 385.

purposeful device for protection of client interests.¹⁹⁸ *Birt*'s discussion of the Indiana Supreme Court order also makes clear that malpractice is a matter of lawyer regulation and as such, is appropriately superimposed upon statutes purporting to limit malpractice liability.¹⁹⁹

Birt, like some of the lawyer-client cases discussed in this Part, can be read for the proposition that the prohibition on the intervention of lay intermediaries is adequately enforced by ethical training and disciplinary rules. This view ignores the role of malpractice liability in policing the divergence between the interests of the principal and the agent, especially *ex ante*. Such policing is critical in the professional sphere where the principal has so little ability for self protection. Among the client's few tools for self protection is avoidance of structures which make the professional responsive to the interests of colleagues who have no personal stake in the appropriate treatment of the client. Taken as a whole, the cases discussed in this Part support the conclusion that the courts' concern in lawyer-liability issues is the lawyer-client relationship. Courts' discretion in exercising their powers of lawyer regulation should accordingly be informed by threats to this relationship. The material which follows applies this conclusion to various kinds of liability.

Contract liability. A law practice's commercial contract liabilities (rent, lights, staff salaries) seldom impact client interests in any direct or significant way. Accordingly, courts routinely enforce limited personal liability in connection with such commercial contracts.²⁰⁰ Exceptions to the general rule arise where the contract liability is directly related to client interests, such as payments of malpractice liability insurance. *South High Development, Ltd. v. Weiner, Lippe & Cromley Co.*,²⁰¹ is an example of a further exception where the court held that regardless of the practice format, all the professional association's liabilities were joint and several regardless of their nature.²⁰² The *South High* result can be attributed to the Ohio Supreme Court's view of its powers over lawyer regulation as

198. The result in *Birt*—enforcing limitation of liability for physicians organized under a professional corporation statute—was substantially based upon this conclusion. See *id.* at 384. As described in the foregoing text, however, such a result is explicitly foreclosed in the context of law practice.

North Carolina has clarified this issue by explicitly incorporating the liability provisions of the UPA into its professional corporation statute, foreclosing the argument and rendering professional corporation shareholders jointly and severally liable with associating professionals. See *Nelson v. Patrick*, 326 S.E.2d 45 (N.C. Ct. App. 1985).

199. *Birt*, 370 N.E.2d at 384-85.

200. See, e.g., *We're Assocs. Co. v. Cohen, Stracher & Bloom, P.C.*, 480 N.E.2d 357 (N.Y. 1985) (lease); *KMS Energy, Inc. v. Titmas*, 610 N.E.2d 1080 (Ohio Ct. App. 1992) (rent).

201. 445 N.E.2d 1106 (Ohio 1983).

202. *Id.* at 1109.

exclusive as well as paramount; more interesting, however, is the court's belief that all practice liabilities impact on lawyer regulation.²⁰³ Notably in this respect, the South Carolina LLP Act does not exempt general partners of limited liability partnerships from contract liabilities; they remain liable as general partners.²⁰⁴

Tort liability. The limited liability statutes echo the common law rule that renders tortfeasors liable for their own torts regardless of the form of organization.²⁰⁵ So far as non-malpractice torts are concerned, vicarious liability in tort would engage a court's discretion only where a client's interests, as a client, were threatened by the tort. Such cases are difficult to imagine outside of malpractice and, as has been seen, the statutes establish a malpractice exception to the usual tort rules.

Breaches of trust. Partners in general partnerships and LLPs are jointly and severally liable for the firm's breaches of trust.²⁰⁶ Because such misdeeds normally constitute malpractice, they will not be treated separately for present purposes.

Malpractice. Like most professional limited liability statutes,²⁰⁷ the South Carolina Supplement and LLP Act purport to protect professional owner/employees from vicarious professional liability.²⁰⁸ Only a handful of courts have addressed whether such provisions are enforceable in favor of lawyers.²⁰⁹

Instances of malpractice present the clearest opportunity for the court to exercise its discretionary power to avoid liability-limiting legislation. Both the client's interest and the attorney-client relationship are directly threatened by a manifest divergence between the interests of principal and agent. A court's willingness to void the legislative limitation of vicarious malpractice liability invokes the *ex ante* protections provided by such potential liability provides to the attorney-client relationship, and preserves for the client the remedial effects of such liability. Perhaps most impor-

203. *But see* We're Assocs. Co. v. Cohen, Stracher, & Bloom, P.C., 478 N.Y.S.2d 670, 675 (N.Y. App. Div. 1984) ("There is . . . no basis for concluding that attorneys who practice in a professional corporation have some exceptional legal obligation over and above that of other professionals simply by virtue of their particular profession.").

204. *See* S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997).

205. *See, e.g.,* S.C. CODE ANN. § 33-41-370(C) (Law. Co-op. Supp. 1997) (LLP members remain liable in tort); S.C. CODE ANN. § 33-44-303 cmt. (Law. Co-op. Supp. 1997) (LLC members liable for their personal torts); DEL. CODE ANN. tit. 6 § 18-303 (Supp. 1996) (same)); *Ditty v. Checkrite, Ltd.*, 973 F. Supp. 1320, 1337-38 (D. Utah 1997) (noting an officer or director of a corporation who is also a debt collector may be held personally liable under the Fair Debt Collection Practices Act).

206. S.C. CODE ANN. § 33-41-360 (Law. Co-op. 1990).

207. For exceptions, see discussion *supra* Part I.C.

208. S.C. CODE ANN. § 33-19-340 (Law. Co-op. 1990 & Supp. 1997) (LLP).

209. *See supra* note 115.

tantly, such willingness would validate, as a matter of principle, the preservation of structures lying at the heart of the attorney-client relationship.

Why would courts foreclose the exercise of their discretionary powers in such cases? Many persuasive arguments, illustrated by the revision of *Zagoria*²¹⁰ in *Henderson*,²¹¹ have been put forward in favor of limiting vicarious malpractice liability. These arguments fall into patterns: First, vicarious malpractice liability provides more protection than is necessary in light of malpractice insurance, personal liability of the misbehaving lawyer, and enterprise liability. Second, disciplinary rules are adequate to protect clients. Third, lawyers should be able to take advantage of the corporate veil like other business owners. Fourth, the legislature, not the courts, has jurisdiction over civil causes of action, and thus malpractice liability falls outside the courts' supervision of lawyers. Fifth, clients' reasonable expectations are limited to a personal relationship with individual lawyers, not entire firms. Sixth, shareholder liability without fault is not fair. Seventh, vicarious malpractice liability requires monitoring, and monitoring is not practical in the modern law firm. The material that follows addresses these arguments.

1. More Protection Than is Necessary

This argument overlooks two issues: one of principle and one of practice. The issue of principle relates to a client's right to call upon the undivided loyalty of a law practice,²¹² a loyalty undercut by the presence of supervisory interests not directly connected to client interests. As an early commentator expressed it, "the enabling of limited liability seems an inroad upon traditionally rigorous notions of legal responsibility."²¹³ In this respect, courts should consider the great weight traditionally given to the appearance of propriety and to client confidence in a justice system oriented to serve the client's best interests.

The practical issue relates to the compensatory function of vicarious malpractice liability. Perhaps in most cases, victims of malpractice can be adequately compensated without resort to vicarious liability, and a court would be justified in staying its hand. What is not clear is why a court

210. 302 S.E.2d 674 (Ga. 1983).

211. 471 S.E.2d 885 (Ga. 1996).

212. See *supra* note 86.

213. Note, *supra* note 20, at 789 (noting, with respect of active lawyers supervised by colleagues shielded from personal liability, that "[i]f a range of professional decisions is reserved to a board of directors, in derogation of the individual lawyer's traditional responsibility, the expectations of clients may be defeated and the profession's tradition of individual self-reliance and integrity impaired").

should foreclose its ability to deal with the few remaining cases.

The argument that mandatory insurance adequately protects clients, is not dispositive. First, and most importantly, it does not deal with the divisiveness fostered within law firms by the new liability rules, discussed below. Further, as a practical matter, malpractice insurance policies require large deductibles. Who is going to pay these?²¹⁴ Not every lawyer has a quarter of a million dollars in personal assets, and probably few firms do. Eliminating vicarious malpractice liability transfers from a firm's lawyers to its clients the risk that the misfeasant cannot pay the malpractice insurance deductible amount.

Finally, law firms, as a general rule, have obtained most-likely-case malpractice insurance and have self-insured with respect to the possibility of a judgment in excess of policy limits. "Self insuring" in this sense relies, of course, on the personal assets of the members of the practice. When limited-liability statutes render those members inaccessible to a malpractice creditor, risk of a judgment in excess of policy limits shifts from the members of the practice to the creditor—the victim. This result can be avoided by the purchase of larger insurance policies. Absent regulation, however, a law practice may not bother with larger insurance policies; indeed, risk having successfully been shifted, the incentive to insure at all would diminish. Even if larger policies are purchased, the incremental premium cost would be externalized to clients through fees.

In short, the risk and cost of eliminating vicarious malpractice liability are passed on to the client. Between a victim of malpractice and a lawyer whose firm has committed malpractice, who has the greater claim on the profits of the firm? The answer to this question has traditionally been clear, and courts must consider as a matter of principle or practicality, whether something has happened to justify changing that answer.

2. *Disciplinary Rules are Adequate to Protect Client Interests*

The thesis of the adequacy argument is that nothing in the Rules of Professional Conduct contraindicates limiting liability, including vicarious malpractice liability.²¹⁵ Rules 1.8, 5.4,²¹⁶ and 5.1, making lawyers liable for their colleagues' known but uncured disciplinary violations,²¹⁷

214. See *supra* text accompanying notes 171-74 (discussing the *London* case).

215. Lawrence, *supra* note 10, at 228 ("The use of limited liability business organizations, like the LLC and LLP, by lawyers is permissible under the *Model Rules*. The concept of vicarious liability is not dictated by the *Rules*, but is a by-product of general partnership law.").

216. See discussion *supra* Part II.

217. S.C. APP. CT. R. 407, Rule 5.1. (Law. Co-op. 1976).

are cited for this proposition.²¹⁸ Read in the obverse, Rule 5.1 requires knowledge before a violation will be imputed; thus vicarious liability appears inappropriate. This may be true for discipline, but applying the argument to malpractice liability wrongly assumes that discipline states a comprehensive and exclusive account of lawyer regulation.

Commentators Christensen and Bertschi²¹⁹ argue that malpractice liability does not question the courts' inherent power to regulate lawyers.²²⁰ If they mean that malpractice is different than discipline, then certainly they are correct. However, Christensen and Bertschi dramatically overlook the role of malpractice in lawyer regulation, and therefore, the courts' role in its supervision.

As illustrated above, and argued elsewhere,²²¹ the Rules do not provide for comprehensive lawyer regulation; nor are they intended to do so. Their role in malpractice is ambiguous. In one sense they are club rules, and the justification and redress they offer the malpractice victim is attenuated. In South Carolina a violation of the Rules of Professional Conduct does not definitively establish malpractice liability,²²² but it may be introduced as evidence thereof.²²³ Certainly nothing in the Rules forecloses malpractice actions, nor are they so intended.²²⁴

The adequacy argument should not be taken lightly because it is consistently repeated by courts and commentators. Nevertheless, courts should consider carefully whether, and to what extent, disciplinary rules are potent and comprehensive enough to justify deleting an aspect of malpractice, with its *ex ante* and compensatory functions, and its role in fostering public confidence.

3. *Law Practices Should be Treated Like Other Businesses*²²⁵

The least appealing argument favoring limitation of liability is that

218. Lawrence, *supra* note 10, at 213-217.

219. See *supra* note 19.

220. See Christensen & Bertschi, *supra* note 19, at 718.

221. Wilkins, *supra* note 110, at 822.

222. S.C. APP. CT. R. 407, Rule 5.1 cmt. (1976) (stating that "[w]hether a lawyer may be liable civilly or criminally for another lawyer's conduct is a question of law beyond the scope of these Rules"); see also MODEL RULES OF PROFESSIONAL CONDUCT Preamble: A Lawyer's Responsibilities (1992).

223. E.g., Allen v. Lefkoff, Duncan, Grimes & Dermer, P.C., 453 S.E.2d 719, 721 (Ga. 1995) (holding ethics rules "relevant to the standard of care in a legal malpractice action").

224. MODEL RULES OF PROFESSIONAL CONDUCT Scope (1992).

225. Christensen & Bertschi, *supra* note 19, at 702 ("One of the primary purposes of the Georgia LLC Act, like the Professional Corporation Act that preceded it, is to place members of limited liability companies on a par with the shareholders of ordinary business corporations.").

vicarious malpractice liability is inconsistent with the “modernizing” or commercialization of the practice of law.²²⁶ These policy-informed arguments simply fail to account for principle-based client interests. The practice of law is not like other businesses because lawyers have power over clients and control over a monopoly practice in the courts. This writer is not convinced that lawyers have a “right” to commercial-style limitation of liability; and in any event, if such a right exists, it surely should be subordinate both to clients’ rights and to public confidence in the undivided loyalty of lawyers.

4. *The Legislature has Power Over Civil Causes of Action*

There is no question that the legislature has the power to enact limited-liability formats for use by the professions, and the general acceptance of the professional corporation is the most obvious example.²²⁷ Nor is there any question that it lies within the legislative province to create and modify civil causes of action.²²⁸ This issue arises when the legislature and courts share overlapping jurisdiction. Paas, Christensen and Bertschi, and others award legislatures exclusive jurisdiction over lawyer liability.²²⁹ In its opinion in *Henderson* modifying the rule of *Zagoria*, the Georgia Supreme Court accepts this argument at least in part.²³⁰ Other courts have accepted it as well.²³¹ While such commentators do not deny the power of courts over lawyer regulation, they overlook entirely the role of malpractice

226. See Paas, *supra* note 21, at 379-80 (criticizing the result in *South High*, Paas expresses uncertainty whether “in large law firms where day-to-day management is left to a committee a shareholder also should be liable for the actions of his firm. . . . [S]uch passive shareholders may find limited liability to be as necessary as do shareholders in a regular business corporation”). Extending this argument to vicarious malpractice liability proves the case for “lay intermediaries” in law practices enjoying limited vicarious malpractice liability.

227. The legislative enactment of formats limiting professionals’ liability can be seen as the partial removal of the prior statutory impediment on the practice of law. See Christensen & Bertschi, *supra* note 19, at 698.

228. Paas, *supra* note 21, at 383-89.

229. See Christensen & Bertschi, *supra* note 19, at 713; Paas, *supra* note 21, at 388 (arguing that court powers are limited to determining whether individuals have the fitness or capacity to practice law and that the determination of malpractice liability falls outside these powers and therefore is “inappropriate”).

230. *Henderson* overruled *Zagoria* “to the extent it states that this court, rather than the legislative enabling act, determines the ability of lawyers to insulate themselves” from vicarious malpractice liability. *Henderson v. HSI Fin. Servs., Inc.*, 471 S.E.2d 885, 886 (Ga. 1996).

231. E.g., *Stewart v. Coffman*, 748 P.2d 579, 582 (Utah. Ct. App. 1988) (noting that “the Utah Supreme Court is only concerned with potential disciplinary actions and has specifically refrained from addressing questions of civil liability”).

as a form of lawyer regulation.²³²

Under legislative aegis, civil actions come and go on the basis of policy and politics, and this is as it should be. However, with questions of lawyer regulation the fundamental management of the courts and the public's confidence in the legal system are at stake. Legal malpractice involves more than a single lawyer's pocketbook. Rather, the issues involved are many: *ex ante* effects and client redress; the lawyer-client relationship; the absence of the lay intermediary; and, ultimately, public confidence in the profession and the justice system itself. These issues should not be subject to policy and politics and for this reason they have been assigned to the courts. The commentators referred to above oversimplify the issue of limitation of vicarious lawyer malpractice. At best, the issue is one susceptible to mixed jurisdiction, and case-by-case consideration by courts. Surely, however, courts, in determining whether limited liability should be avoided in a particular case, should strongly consider the extent to which court management of lawyer regulation is involved.

This issue may be moot in states such as South Carolina where professional use of limited liability formats is subject by statute to the rules of the respective professions' governing bodies.²³³ For lawyers this constitutes a legislative concession of the last word to the courts.²³⁴

5. *Clients' Expectations*

An early commentator raised the issue of clients' expectations *vis a vis* limited liability law practice,²³⁵ but it seems to have faded from the debate.²³⁶ Nevertheless, client expectations deserve weight with respect

232. Compare Christensen & Bertschi, *supra* note 19, at 718 ("[M]atters 'relating to the practice of law . . . are within the inherent and exclusive power of the Supreme Court' . . .") (quoting *Carpenter v. State*, 297 S.E.2d 16, 17 (Ga. 1982)), with *id.* at 717 ("[T]he General Assembly has plenary power to abolish or limit causes of action and remedies, and . . . such limiting statutes do not infringe upon the powers of the courts in violation of the doctrine of separation of powers.").

233. See *supra* note 100.

234. Cf. S.C. CODE ANN. § 33-44-112 cmt. (Law. Co-op. Supp. 1997) ("[T]he practice of certain professionals is often subject to special conditions.").

235. Note, *supra* note 20, at 789 ("If . . . the client reasonably expects that the entire firm is working for him, his reasonable expectations deserve to be protected and joint liability imposed on all the members.").

236. See Paas, *supra* note 21, at 382-83 (alluding briefly to client expectations, but then brushing them off, on the basis that clients cannot expect fidelity from other lawyers in the firm unless they pay for it). At the most superficial level this argument overlooks fee sharing among members of a practice, and fails to address client expectations as a substantive issue relating to public confidence in the legal system.

to clients' confidence in their lawyers and the public's image of the profession. This is made clear by the cases taking strongly into account putative clients' reasonable expectations concerning whether they are represented and who represents them.²³⁷ However, this provision of the Rules invokes the discipline of the Rules, not malpractice liability, and could operate only as a weak alternative to vicarious malpractice liability. Courts considering whether to give effect to legislative limitation of vicarious malpractice liability should give reasonable client expectations direct weight in the context of malpractice.

6. *Liability Without Fault*

An issue missing from the debate, or at best present only by implication,²³⁸ is that of the justification of liability without fault. By definition vicarious malpractice liability is liability without fault. In our fault-based remedial system, such liability is strong medicine, normally applied only in cases supported by strong public policies. In the context of law practice, the case law indicates that protection of the client's interest through the preservation of the lawyer-client relationship is a fundamental public policy.²³⁹ This author is not convinced that any countervailing public policy of comparable potency is engaged on behalf of limiting the liability of owners of a corporate law practice.

Law practices typically accumulate few assets in the business. Profits are distributed promptly to the owners for tax reasons and to protect the profits from liabilities of the business. As is suggested above, courts should consider who has the greater claim on profits of a law business: the owners, or the victim of the malpractice. The courts have the power to consider this question on a case-by-case basis.

7. *Monitoring is No Longer Practical*

Exposure to personal, vicarious malpractice liability encourages monitoring by colleagues within a law practice. Those who argue against such liability denigrate monitoring as impractical in the modern law firm,

237. See, e.g., STEPHEN GILLERS, REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS 17-18, 296-310 (1995).

238. See Paas, *supra* note 21, at 388 (referring obliquely to this issue characterizing vicarious malpractice liability as "punishing the innocent"). In addition to mischaracterizing the essence of a civil action for damages, Paas overlooks the fact that the issue concerns, not some new form of punishment being inflicted on lawyers by courts, but whether the legislature can properly delete traditional modes of lawyer regulation and client protection at the client's cost.

239. See *supra* Part III.B.

expensive to clients, and unnecessary because of lawyers' enhanced self-monitoring in this era of ever-greater direct malpractice exposure.²⁴⁰ When weighing these arguments, courts should consider practical and principled aspects of monitoring. As a matter of principle, one can view monitoring as crucial to the client's perception of a law practice's undivided loyalty and duty of care. All members of a law firm are involved in avoiding conflicts of interest, docket-minding, pinch-hitting for absent lawyers, and other firm-wide expressions of the duty of care and loyalty.

As a practical matter, the cost of eliminating monitoring is high. If lawyers are insulated from personal liability exposure if they do not cooperate with or supervise other lawyers in the firm, or have knowledge of each others' practices, one of the firm's greatest assets—its collective memory and expertise—will be diminished, even lost. Colleagues will be driven apart avoiding professional connection. Insulation of lawyers from liability tends to exacerbate the problems in communications and collegiality caused by the growing commercialism of law firms.²⁴¹ A significant strength of the good law firm has always been that it was greater than the sum of its parts. The demise of monitoring will tend to fracture the firm

240. See Rosencrantz, *supra* note 2, at 374-75.

241. Recently, three of the nation's most prestigious firms incurred huge liabilities for failures of internal controls. New York's Milbank, Tweed, Hadley & McCloy agreed to repay \$1.9 million in fees in connection with accusations of conflict of interest. Paul M. Barrett, *Inside a White Shoe Law Firm's Conflict Case*, WALL ST. J., Jan 23, 1998, at B1. In a 1994 conflict of interest case, Milbank Tweed similarly was held liable for \$2 million. The Bankruptcy Judge Russell Eisenberg involved in the recent matter asked, "Was somebody asleep on the job? Did somebody in charge not care?" *Id.* Hofstra Professor Monroe Freedman believes that many large firms "don't vigorously police potential conflicts among their many clients." *Id.*

The New York firm Willkie, Farr & Gallagher also failed to disclose a conflict in a bankruptcy matter, and the trustee recommended that the firm forfeit \$4.6 million in fees. Dean Starkman, *Willkie Farr Is Criticized for Role in Case*, WALL ST. J., Jan. 27, 1998, at B8. The *Wall Street Journal* quotes the firm as characterizing the conflict as "an oversight." *Id.*

Three weeks later *The Wall Street Journal* reported that the Pennsylvania Insurance Department had assigned partial responsibility to Morgan, Lewis & Bockius for its client's looting of two insurance companies, and that Morgan Lewis had settled the matter for \$35 million. Dean Starkman, *Morgan Lewis Acts to Settle Looting Case*, Feb. 24, 1998, at B5. At issue was the firm's alleged failure to monitor a lawyer. The article referred to "problems that can develop at law firms that have grown so rapidly it is difficult for them to keep tabs on individual lawyers." *Id.* The firm's malpractice policy will cover most, but not all, of the settlement. *Id.* (citing to Morgan Lewis's managing partner).

These failures of internal monitoring illustrate the costs, both to clients and to the public image of the legal profession, of the commercialization of law practice, and the accompanying degradation of internal collegiality. At the same time, limitation of vicarious malpractice liability, by giving lawyers incentive to avoid involvement with each other's clients, would tend further to decrease internal monitoring.

into its parts.

8. *Summary*

In deciding whether to avoid legislative limitation of vicarious malpractice liability, courts will weigh substantial and oft-repeated arguments against the incremental lawyer-regulatory effect of such liability. From the foregoing it appears that the thread running through the arguments against personal vicarious malpractice liability is the desire to foster the developing commercialism of large law firms.²⁴² Although these arguments often wear the clothes of economic efficiency, courts should weigh carefully these policy-based arguments against their costs to clients, client confidence, inter-firm collegiality, and the public perception of the legal system. The foregoing review, while brief, illustrates the absence of principled argument sufficient to justify even an incremental diminution in the attorney-client relationship, which necessarily follows from a limitation of various malpractice liability.

IV. SOUTH CAROLINA

Part III illustrated that when courts address legislative limitations of lawyer liability they assert powers from several sources: state statutes, express powers granted in state constitutions, and “inherent” powers of courts. South Carolina’s Supreme Court has powers of all three kinds.²⁴³ This Part will show that the supreme court’s powers, taken as a whole, are sufficient to address lawyer regulation, and further are paramount to the General Assembly’s powers in the area of limitation of lawyers’ liability.²⁴⁴ The supreme court has exercised its powers in a discretionary, not

242. See Lawrence, *supra* note 10, at 221-23.

243. Rules of practice and procedure are, of course, a special case in South Carolina. See S.C. CONST. art. V, § 4 (“Subject to the statutory law, the Supreme Court shall make rules governing the practice and procedure” in state courts.); see also Stokes v. Denmark Emergency Med. Servs, 315 S.C. 263, 266, 433 S.E.2d 850, 852 (1993); Rutherford v. Rutherford, 307 S.C. 199, 204, 414 S.E.2d 157, 160 (1992).

244. See S.C. CODE ANN. § 33-19-340 (Law. Co-op. 1990) (S.C. Professional Corporation Supplement), S.C. CODE ANN. § 33-43-304 (repealed 1996) (1994 LLC Act), and S.C. CODE ANN. § 33-41-370 (Law. Co-op. Supp. 1997) (S.C. Uniform Partnership Act), which all explicitly limit the liability of professionals in ways deleting vicarious malpractice liability. The 1996 LLC Act does not expressly delete professional vicarious malpractice liability. See *supra* note 8 and accompanying text. By leaving the issue of liability to professional governing bodies, the 1996 LLC Act appears to present less of a legislative incursion into lawyer regulation than the other limited liability statutes. S.C. CODE ANN. § 33-41-112 cmt. (Law. Co-op. Supp. 1997) (referring to “special conditions” to which professional LLCs are “often subject”).

an *ultra vires*, manner.²⁴⁵

A. Statutory Powers

In South Carolina the statutory picture is facially ambiguous. The South Carolina Code includes a number of provisions²⁴⁶ which are manifestly lawyer-regulatory, suggesting a sharing of lawyer regulation between the court and General Assembly. At the same time, however, the Code acknowledges the supreme court's plenary, inherent powers to regulate law practice and to make rules and regulations governing admission and discipline.²⁴⁷ Any remaining ambiguity is resolved by the court's clear assertion of power over lawyer regulation, both inherent and from constitutional sources, discussed below.

B. Constitutional Powers

Some state constitutions grant supreme courts express powers over lawyer regulation.²⁴⁸ Other constitutions include a hybrid of express and

245. See *infra* text accompanying note 268.

246. See S.C. CODE ANN. § 40-5-60 (Law. Co-op. 1986) ("General Assembly not precluded from prohibiting practice of law by any class."); S.C. CODE ANN. § 40-5-70 (Law. Co-op. 1986) (State Board of Bar Examiners may make rules, consistent with "the provisions of law and subject to the approval of the Supreme Court"); S.C. CODE ANN. § 40-5-80 (Law. Co-op. 1986) ("Citizens not prevented from appearing in person or for others without reward."); S.C. CODE ANN. § 40-5-220 (Law. Co-op. 1986) (license to practice granted only by Supreme Court); S.C. CODE ANN. § 40-5-310 (Law. Co-op. 1986) ("Practicing without being admitted and sworn prohibited" dating from 1721.); S.C. CODE ANN. § 40-5-320 (Law. Co-op. 1986) ("Practice of law by corporations and voluntary associations unlawful."); S.C. CODE ANN. § 40-5-330 (Law. Co-op. 1986) ("Attorneys not allowed to argue longer than two hours" dating from 1868.); S.C. CODE ANN. § 40-5-340 (Law. Co-op. 1986) (making the purchase of claims by lawyers a crime dating from 1868); S.C. CODE ANN. § 40-5-350 (Law. Co-op. 1986) ("Soliciting legal business unlawful."); S.C. CODE ANN. § 40-5-360 (Law. Co-op. 1986) ("Splitting fees with laymen unlawful."); S.C. CODE ANN. § 40-5-370 (Law. Co-op. 1986) (advising debtors in pooling plan deemed practice of law); S.C. CODE ANN. § 40-5-510 (Law. Co-op. 1986) ("Removal, suspension and imprisonment of attorneys for contempt or disorderly conduct."); S.C. CODE ANN. § 40-5-520 (Law. Co-op. 1986) ("Any attorney . . . may be removed or suspended who shall be guilty of any deceit, malpractice or misbehavior" but only after notice and an opportunity to be heard, dating from 1868.).

247. S.C. CODE ANN. §§ 40-5-10 to -20 (Law. Co-op. 1986). These statutes do not purport to create the powers referred to but only to acknowledge them. Accordingly, should the legislature repeal these statutes, the powers would still exist inherently and by constitutional mandate. See *infra* note 254 and accompanying text.

248. The South Carolina Constitution mandates that the "Supreme Court shall have jurisdiction over the admission to the practice of law and the discipline of persons admitted." S.C. CONST. art. V, § 4. Similar provisions in Florida, FLA. CONST. art. V, § 23 (repealed),

implied provisions that interpreted together, vest the state's supreme court with the ultimate authority over lawyer regulation.²⁴⁹ In addition, separation of powers clauses are commonly asserted as bases of court power or jurisdiction.²⁵⁰

The South Carolina Supreme Court is given express "jurisdiction over the admission to the practice of law and the discipline of persons admitted."²⁵¹ The South Carolina Constitution also includes a separation of powers clause, which the supreme court has historically invoked in invalidating legislative incursions into what it perceives as the judicial realm.²⁵² Other state supreme courts make similar use of such clauses, with some relying on this basis as the sole source of court power in the absence of express constitutional grants.²⁵³

C. Inherent Powers

The South Carolina Supreme Court has asserted inherent powers over the practice of law, which are possessed "irrespective of specific grant Such powers can neither be taken away nor abridged by the legislature."²⁵⁴ Such powers are asserted even in cases of overlapping jurisdic-

Ohio, OHIO CONST. art. IV, § 5(b), and Utah, UTAH CONST. art. VIII, § 4, for example have provided the basis for court approaches to legislative incursions into lawyer regulation. See *In re The Florida Bar*, 133 So. 2d 554 (Fla. 1961); *Stewart v. Coffman*, 748 P.2d 579 (Utah Ct. App. 1988).

249. The express constitutional creation of a supreme judicial court is construed to include implied powers to govern the practice of law. See *First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674, 675 (Ga. 1983), *overruled in part* by *Henderson v. HSI Fin. Servs., Inc.*, 471 S.E.2d 885 (Ga. 1996); *In re Bar Ass'n of Haw.*, 516 P.2d 1267, 1268 (Haw. 1973); *In re Unification of the N.H. Bar*, 248 A.2d 709, 711-12 (N.H. 1968); *In re Rhode Island Bar Ass'n*, 263 A.2d 692, 693-94 (R.I. 1970).

250. S.C. CONST. art. I, § 8 states that "the legislative, executive, and judicial powers of the government shall be forever separate and distinct from each other" See also GA. CONST. art. I, § 2 ¶ 4; MINN. CONST. art. III, § 1; R.I. CONST. art. III.

251. S.C. CONST. art. V, § 4. The supreme court stated without citing authority that "the Constitution imposes upon this Court the responsibility of removing from the practice those persons whose conduct has been such that they should no longer be entrusted to represent citizens with legal problems." *In re Rushton*, 286 S.C. 543, 547, 335 S.E.2d 238, 240 (1985).

252. *E.g.*, *Williams v. Bordon's, Inc.*, 274 S.C. 275, 262 S.E.2d 881 (1980) (holding that a statute requiring courts to grant continuances for attorney legislators to attend legislative sessions unconstitutionally violated separation of powers as an attempt by legislature to exercise ultimate authority over an item inherent in the exercise of judicial power).

253. See, *e.g.*, *Singer Hutner Levine Seeman & Stuart v. Louisiana State Bar Assoc.*, 378 So. 2d 423, 426 (La. 1979) (citing separation of powers clause as basis of "inherent power which [other branches] cannot abridge" and concluding, "[t]his court will uphold legislative acts passed in aid of its inherent power, but will strike down statutes which tend to impede or frustrate its authority").

254. *State v. Hite*, 272 S.C. 303, 305, 251 S.E.2d 746, 747 (1979) (quoting 20 AM. JUR.

tion. For example, in *In re Ferguson*²⁵⁵ the South Carolina Supreme Court suspended a circuit judge for misbehavior. The judge argued that his suspension violated the constitutional limitation on the General Assembly's power to reduce a sitting judge's salary, and further that under the constitution he could be removed from office only through impeachment by the General Assembly.²⁵⁶ The court rejected both arguments, stating that:

[T]his Court, as the highest constitutional court, has the responsibility to protect and preserve the judicial system. . . . [W]e have the inherent authority to take whatever action is necessary to effectuate this responsibility.

. . . The fact the Constitution provides the Legislature with the means to remove a circuit judge by impeachment does not preclude this Court from exercising its inherent power to protect itself and the public, and administer justice²⁵⁷

The court's inherent powers can be asserted affirmatively, enabling the judiciary to carry out its constitutional functions without legislative direction, or negatively to exclude legislative action within its exclusive realm.²⁵⁸ The affirmative inherent powers of South Carolina courts arise from the South Carolina Constitution, which provides for a unified judicial system to be administered by the supreme court.²⁵⁹ The courts relied

2D Courts § 78); see also *Eckles v. Atlanta Tech. Group, Inc.*, 485 S.E.2d 22, 25 (Ga. 1997) ("[N]o statute is controlling as to the civil regulation of the practice of law in this state. Only this Court has the inherent power to govern the practice of law in Georgia."); *Fleming v. State*, 270 S.E.2d 185, 188 (Ga. 1980) ("This court has the inherent power to govern the practice of law in this State."); *Reliable Collection Agency, Ltd., v. Cole*, 584 P.2d 107, 113 (Haw. 1978) (The "regulation of the practice of law is inherently a function of this court."); *Board of Overseers of the Bar v. Lee*, 422 A.2d 998, 1002 (Me. 1980) ("The inherent power of the Supreme Judicial Court, therefore, arises from the very fact that it is a court and connotes that which is essential to its existence and functioning as a court."); *Washington County Dep't of Human Servs. v. Rutter*, 651 N.E.2d 1360, 1362-63 (Ohio 1995) ("[T]he Supreme Court has consistently indicated that it alone has the inherent power to regulate, control, and define the practice of law in Ohio."); *Berberian v. Kane*, 425 A.2d 527, 527 (R.I. 1981) ("In the exercise of its inherent power to regulate the practice of law and the conduct of attorneys, this court has from time to time promulgated rules in explication and implementation of professional responsibility.").

255. 304 S.C. 216, 403 S.E.2d 628 (1991).

256. *Id.* at 218-19, 403 S.E.2d at 629-30.

257. *Id.* at 218, 403 S.E.2d at 630 (citations omitted). The court further observed that constitutional provisions intended to protect judges from the General Assembly do not protect judges from the supreme court. *Id.* at 219, 403 S.E.2d at 630.

258. CHARLES W. WOLFRAM, MODERN LEGAL ETHICS §§ 2.2.2 to .3 (1986).

259. S.C. CONST. art. V, § 4.

upon such power to suspend a circuit judge,²⁶⁰ to appoint lawyers to serve without pay in civil cases,²⁶¹ to punish for contempt,²⁶² and to discipline lawyers.²⁶³

The negative inherent powers of South Carolina courts derive from the separation of powers doctrine that requires the legislative, executive, and judicial branches be “forever separate and distinct” and that no branch “assume or discharge the duties of any other.”²⁶⁴ Under the most extreme expression of the separation of powers doctrine, any attempt by one branch to interfere with the duties of another is unconstitutional,²⁶⁵ and therefore, *ultra vires* and void. The South Carolina Supreme Court has not expressly adopted this most extreme view. The court has invoked its negative inherent powers as necessary, however, to protect its powers over the regulation of law practice. For example, the court invalidated a statute mandating that courts grant continuances to lawyer-legislators on days when the General Assembly is in session²⁶⁶ and prevented the South Carolina Probation, Parole and Pardon Board from paroling a person held in contempt of court.²⁶⁷ Ultimately, of course, the court determines what the constitution means,²⁶⁸ and its decisions are unreviewable. Without question then, South Carolina courts have the power to regulate the practice of law and to override legislative acts impinging upon this power.

The supreme court uses a voidable, or discretionary, approach to deal with legislative incursions. For example, the court in *State v. Hite* determined that legislative incursions into court powers are not void but should be weighed to determine whether the incursion deprives the court of “sufficient power to protect itself from indignities and to enable it effectively to administer its judicial functions.”²⁶⁹ The court’s adoption of a discretionary approach will require it, in an appropriate case, to determine under what circumstances the court should employ its powers in

260. See *In re Ferguson*, 304 S.C. 216, 403 S.E.2d 628 (1991).

261. See *Hamaas v. State*, 279 S.C. 592, 310 S.E.2d 440 (Ct. App. 1983).

262. See *State v. Brantley*, 279 S.C. 215, 305 S.E.2d 234 (1983); *State ex rel. McLeod v. Hite*, 272 S.C. 303, 251 S.E.2d 746 (1979).

263. See *Burns v. Clayton*, 237 S.C. 316, 117 S.E.2d 300 (1960).

264. S.C. CONST. art. I, § 8; see also *Williams v. Bordon’s, Inc.*, 274 S.C. 275, 279, 262 S.E.2d 881, 883-84 (1980).

265. WOLFRAM, *supra* note 258, § 2.2.3, at 27.

266. See *Williams*, 274 S.C. at 275, 262 S.E.2d at 881.

267. See *Hite*, 272 S.C. at 303, 251 S.E.2d at 746.

268. *State ex rel. McLeod v. Yonce*, 274 S.C. 81, 85, 261 S.E.2d 303, 305 (1979) (“There is no authority save the court to determine when there is and when there is not a violation of the separation of powers of the constitution.”). *Evatte v. Cass*, 217 S.C. 62, 65, 59 S.E.2d 638, 639 (1950).

269. *Hite*, 272 S.C. at 306, 251 S.E.2d at 748 (quoting M.C. Dransfield, Annotation, *Power to Punish for Contempt*, 121 A.L.R. 215, 239 (1939)).

the context of legislated limited liability for lawyers.

We must wait for such a case to see how the court will employ these powers. A hint, perhaps, is provided in *In re Jacobson*,²⁷⁰ where the court wrote that "the practice of law is a profession—not a business or skilled trade."²⁷¹ Expanding upon *Jacobson* some twenty years later, Chief Judge Sanders of the South Carolina Court of Appeals wrote, "We are also not willing to abandon the historic distinction between occupations and professions, despite recent infusions of commercialism into the latter."²⁷²

V. CONCLUSION

The essence of the lawyer-client relationship and the Rules of Professional Conduct is the minimization of the divergence between the interests of lawyer and client. Vicarious malpractice liability minimizes such divergence by connecting all lawyers in the practice to the client. Elimination of vicarious malpractice liability tends to encourage divergence by creating a class of supervisory lawyers within the practice that have no direct connection to clients. On a practical level, elimination of vicarious malpractice liability shifts to clients a risk and cost traditionally born by lawyers. The result is a commercial advantage principally accruing to a relatively few large firms.

Some have labelled vicarious malpractice liability a historical accident, not a principled aspect of the lawyer-client relationship;²⁷³ however, such characterizations overlook the essential role of malpractice in lawyer regulation. As a tool for lawyer regulation, malpractice does not depend for authority on statutes or disciplinary rules, but instead on the courts' responsibility to regulate law practice. Perhaps the modern practice of law requires limited liability. But at the very least, courts should consider the effect on lawyer regulation of an elimination of vicarious malpractice liability. As the supreme court of Oklahoma expressed the point, "One of the most important public interests of the courts of this state is the integrity of the bar and the regulation of its members."²⁷⁴ Certainly the courts have the power to do what they deem to be in the best interests of the practice and the public.

270. 240 S.C. 436, 126 S.E.2d 346 (1962).

271. *Id.* at 448, 126 S.E.2d at 353.

272. *Hamaas v. State*, 279 S.C. 592, 596, 310 S.E.2d 440, 442-43 (Ct. App. 1983).

273. *See Birt*, 370 N.E.2d 379, 384 (Ind. Ct. App. 1977); Lawrence, *supra* note 10, at 228 ("The concept of vicarious liability is not dictated by the *Rules*, but is a by-product of general partnership law.").

274. *American Nat'l Bank & Trust Co. v. Clarke & Van Wagner, Inc.*, 692 P.2d 61, 68 (Okla. Ct. App. 1984).