State Law & State Taxation Corner

LLPs and Professional Malpractice Insurance: Grading the *Mortgage Grader* Decision

By Thomas E. Rutledge

A limited liability partnership (LLP) is first a general partnership that makes a special election for LLP status, thereby achieving limited liability for the partners.[1] Many states, including New Jersey and Kentucky, require that, in order for a law firm to elect LLP status, it must have in place malpractice insurance or similar protections for clients.[2] The rules as to the maintenance of malpractice insurance are, however, generally silent as to the consequences when that requirement is not satisfied.

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The Dispute and Decisions

The New Jersey Supreme Court, in *Mortgage Grader Inc. v. Ward & Olivo*,[3] addressed the question of what happens when the required malpractice insurance is no longer maintained. As detailed below, it held that, under its rule allowing law firms to organize as LLPs, that insurance need not be maintained during the "winding up" of the firm, and the "conversion" of an LLP into a general partnership for failure to maintain insurance is not an available remedy.

This dispute involved an allegation of malpractice by Mortgage Grader arising out of allegedly deficient advice delivered by Olivo; there is no allegation that Ward had any involvement with the file. After the (allegedly) deficient advice was rendered: (a) Ward withdrew from the firm; (b) the firm proceeded to wind-up its affairs; and (c) the firm allowed its malpractice coverage to lapse. That process commenced in June 2011; the malpractice insurance lapsed in August 2011.[4] It was not until October 2012 that Mortgage Grader filed its complaint.[5]

Ward, in addition to defending on a procedural basis, sought dismissal on the basis that he was a partner in an LLP and thereby shielded from personal exposure on partnership obligations.[6] The trial court rejected that assertion, finding that Ward & Olivo had continued collecting fees even as it allowed its malpractice coverage to lapse. From there, applying Rule 1:21-1C(a)(3), the trial court observed that "'[t]he condition precedent to attorneys operating as an LLP is [maintaining] malpractice insurance.'"[7] The firm having been still operating as it collected fees but allowing its malpractice coverage to lapse, the trial court held

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that Ward & Olivo reverted to a general partnership and that Ward lost the benefit of an LLP election.

The Appellate Division reversed that determination, finding (a) the N.J. Partnership Act did not impose the loss of limited liability as a consequence of the failure to have insurance; and (b) likewise the New Jersey Supreme Court, in adopting Rule 1:21-C(a)(3), did not impose a similar consequence. As to the first point:

> The Legislature has been aware of Rule 1:21–1C since 1996. The Legislature has decided not to amend the UPA to require an LLP to revert to GP status as a sanction for failing to purchase a tail insurance policy when attorneys practice as an LLP. Therefore, our interpretation of the available sanctions is supported by a long period of legislative acquiescence by failing to amend the UPA.
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> Thus, if attorneys practice as an LLP, and the LLP fails to maintain malpractice insurance as required by the court rules, then the Supreme Court may terminate or suspend the LLP's right to practice law or otherwise discipline it. As currently written, however, the court rules do not authorize a trial court to sanction a partner of an LLP for practicing law as an LLP without the required professional liability insurance by converting an otherwise properly organized LLP into a GP.[8]

As to the second point:

> Our Supreme Court has chosen to discipline attorneys without malpractice insurance that are organized as professional corporations, rather than dissolve their corporate structure. *See*, *e.g.*, *In re Aponte*, 215 N.J. 298, 298–99, 72 A.3d 243 (2013) (censuring an attorney for failing to maintain liability insurance while practicing as a professional corporation in violation of R. 1:21–1A(a)(3)); *In re Muldoon*, 213 N.J. 79, 61 A.3d 145 (2013) (same); *see also In re Tiffany*, 217 N.J. 519, 520, 90 A.3d 1254 (2014) (disbarring an attorney for, among other things, violating the rule requiring professional corporations to file a certificate of insurance with the Clerk of the Supreme Court).[9]

From there an appeal to the New Jersey Supreme Court was filed. It would hold that: (a) the obligation to maintain malpractice insurance does not apply during the winding-up phase (*i.e.*, after dissolution); (b) deprivation of the liability shield afforded by LLP status is not an available remedy for failure to maintain malpractice insurance; and (c) for purposes of determining whether the firm had in place malpractice coverage, the focus is upon the time of the attorney's actions, not the filing or resolution of the client's claim. These points will be reviewed *seriatim*.[10]

The Obligation to Maintain Malpractice Insurance Does Not Apply During a Firm's Winding-Up Phase

On the basis that during the winding-up phase the firm and its attorneys are not practicing law, the Court held that the malpractice insurance requirement is not applicable. As to this holding, the Court focused first upon the language of the rule setting forth the requirements for organization of a law firm as an LLP, noting:

> Effective January 1, 1997, we added *Rule* 1:21–1C to permit attorneys to organize as LLPs. The LLP structure establishes a shield from personal liability for LLP partners. *See R.* 1:21–1C(a)(1) (incorporating UPA by reference); *N.J.S.A.* 42:1A–18(a) & (c).
>
> *Rule* 1:21–1C conditions practice by law-firm LLPs on compliance with partnership law, adherence to the rules of professional responsibility, and maintenance of malpractice insurance. Specifically, section (a) provides that "[a]ttorneys *may engage in the practice of law* as limited liability partnerships" provided that:
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> [t]he limited liability partnership shall obtain and maintain in good standing one or more policies of lawyers' professional liability insurance which shall insure the limited liability partnership against liability imposed upon it by law for damages resulting from any claim made against the limited liability partnership by its clients *arising out of the performance of professional services by attorneys* employed by the limited liability partnership in their capacity as attorneys.[11]

From there the Court concluded that "We find no indication that the administrative activities characterizing a windup are included within that term."[12] It then reviewed the language of the New Jersey adoption of the Revised Uniform Partnership Act (identified by the Court as "UPA") for the effect of a firm's dissolution and the activities that may be undertaken during the winding-up phase, namely, "During the windup period, the LLP continues to exist, but only to wind up the partnership's affairs."[13] From there the Court determined:

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> [W]e conclude that under the circumstances here, where a law-firm LLP has entered the windup period and has ceased to provide any legal services, the windup period does not constitute practicing law and therefore no acts of malpractice could be committed during this period. Such a law firm is not required to maintain professional liability insurance under *Rule* 1:21–1C(a)(3). Therefore, W & O fully complied with the Rule's insurance mandate by maintaining malpractice insurance the entire time it was engaged in the practice of law.[14]

As is discussed below, this is a restricted and oft-inaccurate understanding of what takes place in the winding-up phase.

Deprivation of the LLP Liability Shield Is Not an Available Remedy

The New Jersey Supreme Court took an interesting approach to the question of preserving or not the LLP liability shield, both restricting itself and deferring to the Legislature.

The Court, *inter alia*, held itself restricted to "disbarment, indeterminate suspension, term of suspension, censure, reprimand, and admonition" as remedies for a firm's failure to maintain the malpractice insurance otherwise required by Rule 1:21-1C;[15] in effect finding that the Court lacked the faculty to deprive attorneys of the benefit of LLP status. Rather:

> Because only this Court may use Rule 1:21-1C to discipline a law firm organized as an LLP, and the Court Rules do not list conversion of business organizational form as a type of sanction, we conclude that conversion of W & O from an LLP to a GP was improper under the Rule.[16]

This treatment is based upon the unjustified treatment of the loss of LLP protection as being a "conversion," a point discussed below.[17]

Then turning its attention to New Jersey's UPA, the Court found a tendency toward preservation of limited liability:

> The UPA's provisions that govern revocation of LLP status reflect a tendency to preserve the liability shield. In the event that the State Treasurer seeks to revoke an LLP's status for failure to file an annual report or pay the filing fee, the UPA requires that the LLP receive sixty days' notice of the impending revocation. *N.J.S.A.* 42:1A-49(c). During this time period, the LLP has an opportunity to cure the deficiency before the effective date of the revocation. *Ibid*. If the LLP cures, the revocation does not take effect. *Ibid*. The UPA also permits an LLP to apply for reinstatement within two years after the effective date of revocation. *N.J.S.A.* 42:1A-49(e). If the LLP applies and reinstatement is granted, the reinstatement relates back to and takes effect as of the effective date of the revocation, and the LLP's status continues as if the revocation never occurred. *N.J.S.A.* 42:1A-49(f). The National Conference explains that "[t]he relation back doctrine protects gaps in the reinstated partnership's liability shield." RUPA (1997), comment to Section 1003, at 147.
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> In sum, the UPA offers many mechanisms to preserve LLP status once obtained, and those mechanisms apply retroactively to sustain the partnership's liability shield even during gaps in LLP status. Those provisions combined with the lack of any language in this statutory scheme giving authority to the judiciary to convert a properly recognized LLP into a GP, lead us to conclude that the UPA provides no support for the trial court's conversion of W & O from an LLP to a GP.[18]

Many states, including New Jersey and Kentucky, require that, in order for a law firm to elect LLP status, it must have in place malpractice insurance or similar protections for clients.

As discussed below, this aspect of the *Mortgage Grader* decision suffers from both the mischaracterization of the loss of limited liability as being a "conversion" and a stilted view of its own authority to police the bar.

When the Claim Arose

In an almost casual manner, the Court determined that the question of LLP status and the maintenance of malpractice insurance would be determined as of the "date the alleged malpractice occurred."[19] In consequence, if the act or failure to act that gave rise to the malpractice claim occurred on a date when the LLP had in place malpractice coverage, the subsequent cancelation of that coverage will not eliminate or otherwise impact the benefits of LLP status.

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Further, it is expressly provided that there is no obligation to maintain tail coverage.[20] For reasons discussed below, this holding opens the door for depriving those injured by legal malpractice of a means of recovery.

Other Decisions

The *Mortgage Grader* decision follows on at least four other cases where courts have had to consider the effect of no longer being an LLP. While each may be distinguished, none of these decisions were addressed by the *Mortgage Grader* decision.

In *Apcar Inv. Partners VI, Ltd. v. Gaus*,[21] a partner was held personally liable on a lease executed by the partnership in its LLP name three years after failure to renew its initial LLP registration. The court rejected a "substantial compliance" argument based on the clear language of the LLP statute.

A partnership electing into or out of LLP status does not undergo a "conversion" or otherwise change its organizational form.

In *Edward B. Elmer, M.D., P.A. v. Santa Fe Properties, Inc.*,[22] the court concluded that an LLP's failure to carry the required insurance rendered the liability shield ineffective even though the liability in issue stemmed from breach of a lease and thus was not the type of liability that would have been covered by the insurance. The plaintiff sued the partnership and its two partners for breach of a commercial lease. The plaintiff obtained a judgment against the partnership, and that judgment was severed and became final. After the plaintiff was not able to collect the judgment from the partnership, the plaintiff obtained a summary judgment against one of the partners. The partner appealed, arguing that the plaintiff's suit against the partner was barred because the plaintiff initially obtained judgment against the partnership alleging it was an LLP. The court held that the partner was not protected from individual liability because the partnership was not a properly registered LLP under the Texas Revised Partnership Act at the time it incurred the lease obligations. The Texas LLP provisions required that an LLP carry insurance or meet certain financial responsibility requirements. Therefore, the court concluded that strict compliance with the statute is required. Although the partner himself carried errors and omissions insurance, the court pointed out that the policy did not appear to cover the partnership or the other partner. Because the partnership did not have the required insurance or other forms of financial responsibility designated by the statute, it was not a properly registered LLP, and the partner was not protected from liability.[23]

Evanston Ins. Co. v. Dillard Dep't Stores, Inc.[24] involved a claim of trademark infringement by a law firm that had been an LLP. After the firm dissolved and allowed its LLP election to terminate, judgment against the firm was entered. In response to the argument that the operative conduct took place while the firm was an LLP, and therefore that limited liability should apply, the court would rule that the debt was not incurred until the judgment against the partnership was entered, at which time the LLP registration had expired, and the partners thus were not protected from liability. [25]

Davis v. Heubeck[26] addressed a challenge, *inter se* a partnership, with respect to the effect of failing to register a law firm LLP with the California Supreme Court. In this suit regarding the dissolution of that law firm, one of the partners sought to hold the other liable on certain claims that would otherwise be barred by the LLP statute on the basis that the LLP had never registered with the Supreme Court and therefore that status should be ignored. This argument was rejected on the basis that, while registration of an LLP with the Supreme Court is necessary in order to afford the partners therein limited liability with respect to client claims of malpractice, "The State Bar registration requirements for a registered limited liability partnership performing legal services do not affect the rights or obligations of the partners amongst themselves or to the partnership … The failure to register with the State Bar narrows the general limit on liability, but does not completely eviscerate the partners' liability shield or terminate the registered limited liability partnership."[27]

Vis-à-vis the *Mortgage Grader* decision, the failure to address the *Elmer* and *Evanston* decisions is striking. In the former case, a licensed professional was deprived of the benefits of LLP status where the firm failed to have in place required insurance. Clearly, loss of the claimed benefits may be a remedy for failure to satisfy legal requirements. More on point, the *Evanston* decision goes to the crucial question of when the availability of malpractice insurance coverage should be assessed. In that case, it was held that the question of status should be determined as of the time the judgment is entered against the firm.[28] As this holding is in direct opposition to that in *Mortgage Grader*, it is curious that there was no discussion of the *Evanston* decision.

Grading the *Mortgage Grader* Decision

The *Mortgage Grader* case seems tailor-made by a malicious law school professor. Initially, it requires either reconciliation or ranking of business organization and professional regulation law. Are they to be treated, particularly in the context of law firms, as being equal magisterium entitled to equal deference or, in the alternative, does professional regulation control over generally applicable entity law? How should constitutional dictates allocating to the legislature the faculty to draft the law of business organizations and to the state Supreme Court that to regulate the legal profession to be reconciled?[29]

The "Conversion" of an LLP into a GP

A disturbing aspect of the language used by both the Appellate Division and the New Jersey Supreme Court is the notion that the loss of LLP status and the treatment of the firm as a general partnership is some sort of "conversion."[30] That characterization is at least a misnomer. An LLP is a general partnership that has elected into a special status—it is still a general partnership but for the rule of partner limited liability.[31] This is the rule under New Jersey RUPA—an LLP is a partnership and is the same partnership as it was prior to electing LLP status.[32] The corollary is as well true, namely that a partnership that has ceased to qualify as an LLP continues to be the same partnership. The point may be narrow, but that does not mean it is unimportant. To the world at large, it is the exact same partnership before or afterward. A partnership electing into or out of LLP status does not undergo a "conversion" or otherwise change its organizational form.[33]

Understanding the Winding-Up Phase

Another problem with the Court's analysis is an overly simplistic explanation of the winding-up phase of a partnership. As imagined by the *Mortgage Grader* court, until some point in time at which time there takes place the firm's dissolution, it is engaged in active business activities. From, however, that point in time, the firm is in the winding-up phase and is no longer practicing law such that claims for malpractice could arise. That is not, however, how it happens.

First, the court did not specify from what point it was considering dissolution to have taken place. Is this the point at which the partners have decided to go their separate ways, the point at which statement of dissolution[34] is filed with the Secretary of State, after both the determination to dissolve and notification of clients, or some other time? The decision's ambiguity as to this point significantly detracts from its apparent effort to draw bright lines as to when malpractice insurance must be maintained versus when it need not.

> *Life was once so simple; attorneys practiced as either general partners or sole practitioners and stood behind their work and that of their firms to the full extent of their personal assets.*

That said, the assumption made by the *Mortgage Grader* Court to the effect that there is a clear demarcation between the doing business phase and the winding-up phase, with it being presumed that during the winding-up phase neither legal services are being rendered nor that malpractice can take place, is factually wrong. Initially, there is nothing that precludes the rendering of legal services during the winding-up phase. Rather, during the winding-up, the firm will want to complete its work in process. By way of example, assume that on Monday either new or existing client made an appointment for that Friday to have some estate planning documents reviewed and updated. On Wednesday, the firm's partners determined to dissolve the farm. Notwithstanding the fact that the firm is, on Friday, in the winding-up phase, it would be entirely appropriate for the attorney to keep that appointment and advise the client with respect to updating those estate planning documents. Furthermore, notwithstanding that the firm is in the winding-up phase, it would be entirely appropriate for the attorney, after that meeting, to undertake the drafting of the revised documents and to otherwise complete the work on behalf of the client.

Likewise, the *Mortgage Grader* Court's assumption that malpractice will not take place during the winding-up phase is similarly unsupportable. Returning to the fact pattern outlined above, assume that, in the course of revising those estate planning documents, the attorney reverses the names of the current and contingent beneficiaries for a newly organized trust. With that mistake, not only are the client's wishes frustrated but also a significant

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generation-skipping tax benefit is lost. Positing that this error constitutes malpractice, it takes place during the winding-up phase. By way of another example, assume that a litigation client, learning of the firm's dissolution, directs that the file be directed elsewhere. However, instead of the file being transmitted to the newly identified counsel, it is inadvertently transferred to opposing counsel. Again positing that this misdelivery constitutes malpractice,[35] it has clearly taken place during the winding-up phase when, all else being equal, the *Mortgage Grader* Court would, it would seem, hold that malpractice insurance need not be maintained.[36] There can be no question that services such as these performed during the winding-up phase involve "the performance of professional services by attorneys" as contemplated by Rule 1:21-1C of the New Jersey Supreme Court. In effect, the New Jersey Supreme Court is allowing the benefit of LLP status to linger in a period when insurance is not required but malpractice may still take place.

Malpractice Insurance Need Be Maintained Only While the Firm Is Actively Practicing Law

The professional regulatory rules that impose the malpractice insurance requirement as a condition precedent to LLP election are intended to preclude attorneys from practicing through an entity shell that would in effect be abandoned in the case of a malpractice claim, leaving the client with only its few assets and a judgment against the attorney who was directly engaged in the malpractice. Where that outcome does come to pass, a policy argument may be made that the benefits of the LLP election should be lost. To those who would assert that professional discipline delivered by a state Supreme Court, and not the loss of limited liability, should be the remedy when the required malpractice insurance is not maintained, a question. What would be the effective discipline other than the Supreme Court directing that the liability shield be waived. A public reprimand to the attorney or attorneys who failed to maintain the malpractice coverage does nothing to benefit the client who bears the consequence of attorney malpractice. This futility is even more obvious when, as is the case of Ward & Olivo, the firm has dissolved.

Ultimately, the New Jersey Supreme Court may have nullified the consequences of not maintaining malpractice coverage. Essentially, if the failure to maintain coverage will not result in the loss of LLP status and consequent partner limited liability, where is the *in terrorem* incentive to maintain that coverage? While a firm may be subject to discipline by the Court, that discipline will not result in the loss of limited liability. Attorneys could determine that the risk of censure if and when it is determined they lacked coverage is less expensive than is practicing through an LLP that forgoes the expense of malpractice insurance. While the New Jersey legislative could amend its adoption of RUPA to provide that the liability protection afforded by LLP status is contingent upon satisfaction of additional requirements imposed by professional regulatory boards, what contingency would propose and push a provision? Might not the New Jersey Supreme Court, in reliance upon its constitutional authority over the bar, determine that the legislature lacks the capacity to so regulate attorneys?[37]

It is curious that the New Jersey Supreme Court looked to New Jersey RUPA to assess the question of what happens when attorneys do not maintain malpractice coverage. As recently observed by the Kentucky Court of Appeals in *DeMoisey v. Ostermiller*,[38] "We believe that our Supreme Court's ethical rules regulating the practice of law in this Commonwealth are expressions of public policy." In support of this proposition, the Kentucky Court of Appeals observed that, applying the Restatement (Second) of Contracts, ethical rules governing lawyers should qualify as "legislation" articulating public policy, going on to observe that "*The Restatement (Third) of the Law Governing Lawyers* similarly takes the position that a violation of an ethical rule of the legal profession may result in forfeiture of the lawyer's fee because the ethical rules are a source of the lawyer's duty to the client." Irrespective of the legislature's failure to define the loss of limited liability as a statutory consequence of the failure to satisfy a professional ethics rule (and why would they?), surely the New Jersey Supreme Court had that capacity. As goes the adage, "The Supreme Court is not last because it is infallible, but it is infallible because it is last." The Court here missed an opportunity to give teeth to the rules as to the maintenance of coverage.

When the Claims Arose

While the holding that the assessment of whether or not insurance coverage was in place will be limited to the time of the attorney's actions or inactions giving rise to the claim has the apparent benefit of simplicity, it gives far too little weight to the purpose of the malpractice coverage requirement. A client who has suffered malpractice does not know of their injury at the same time it is suffered, and they are not in possession of a remedy therefor. Rather, the client must recognize the injury, bring suit for its redress and be awarded a judgment therein. It is upon bringing the

action for malpractice that the potential recovery against the insurer is fixed.[39] An expired policy, in effect where the attorney made the error, does nothing to protect the client or redress the wrong they have suffered.

Restricting Remedies; Letting the Perfect Be the Enemy of the Good

The maintenance of insurance coverage can be expensive, and there is a legitimate question as to how long any firm should have to bear that burden. With respect to a personal injury firm that cycles its clients in and out relatively quickly, combined with a short statute of limitations/statute of repose with respect to the bringing of the malpractice claim, tail coverage may be affordable. But what about a law firm that engages in sophisticated estate planning? The problems with the documents they create may not be discovered for decades until, as they say, the will matures. Could and more importantly should the rules with respect to the maintenance of malpractice coverage apply conceivably 20 or 30 years after the dissolution of the firm at which the lawyer who drafted that will was practicing?

Seeking to justify its determination to not require tail coverage,[40] the *Mortgage Grader* Court wrote:

> Because a claims-made policy provides coverage only for claims made while the policy is in effect, we cannot impose a requirement for an LLP to purchase tail coverage without deciding how long the tail coverage must last. Even if such a requirement were tailored to meet the six-year statute of limitations for malpractice actions, it would fail to ensure coverage for all possible claims. For example, a malpractice claim involving an attorney who handled a claim on behalf of a minor could result in the tolling of the statute of limitations until the minor reached adulthood, meaning the minor could file a timely claim more than six years after the malpractice. Similarly, a dispute regarding a will an attorney drafted in all likelihood would not arise until after the client's death, which may occur much longer than six years after the drafting of the will.[41]

True, but is that a reason for not providing some level of protection? If the statute of limitations is six years, requiring tail coverage for an equal period will protect most of the former client population.[42] If, however, the policy lapses between the action or inaction occasioning the malpractice action and the filing of the claim, a judgment in the client's favor will not be insured. Rather, the attorney who made the error will be liable to the extent of nonexempt personal assets,[43] but the client will be otherwise without remedy except to the extent of firm assets distributed in liquidation.[44]

The fact that some former clients will have claims not discovered prior to the expiration of the period is no reason to not benefit the others. Simply put, the Court's rule makes the perfect the enemy of the good.[45]

The Court sought to buttress its argument by means of an argument of under-inclusiveness, writing:

> This insurance requirement for law-firm LLPs marks a departure from the general rule that malpractice insurance is not required for attorneys in New Jersey. Our rules do not require tail coverage for professional corporations or GPs, nor do they require single practitioners to carry any insurance, including tail coverage.
>
> We decline to impose a tail requirement on attorneys who choose to practice as LLPs, particularly because a mandate to purchase tail coverage still would not fully protect the public from uninsured risks due to the types of scenarios outlined above.[46]

This argument based on potential inconsistency of treatment across organizational forms is unconvincing. The obligations consequent to practicing law through a professional service corporation, just as are the obligations imposed if attorneys practice through an LLP, are written by the New Jersey Supreme Court. The spectra of inconsistency across organizational forms is illusory—the Court need only write a rule that addresses all forms. Further, the inclusion of general (non-LLP) partnerships and sole practitioners in a red herring; since neither enjoy limited liability, there is no concern with the availability of insurance as the partners or sole practitioners are liable for the malpractice claim.[47]

Lessons for Everyone Else

Most of us do not practice in New Jersey, even as most of us do practice in firms organized as PSCs, LLPs or LLCs. We need to be aware of the issues presented in *Mortgage Grader* with the appreciation that different laws and different courts could come to different outcomes. For example, in California, no comfort may be taken in the declaration that tail coverage is not necessary; in California it is mandated.[48] Other states may have, and courts may add similar obligations, once they become aware of the *Mortgage Grader* decision.[49] In the case of litigation, a different court could well find that the maintenance of

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liability insurance is the *quid-pro-quo* for limited liability, and where the former is absent the latter is as well.[50]

For those and similar reasons, persons departing a professional firm organized as an LLP need to consider the potential lingering exposure should the firm either (i) continue but fail to maintain both a valid LLP election and required insurance or (ii) dissolve and not maintain in place both an LLP election and tail insurance for a period sufficient to address potential claims that arguably accrued during their tenure at the firm.

At the same time, there must be considered the legitimate concerns of both those who are leaving a firm (irrespective of whether it is continuing or not) and of clients. An attorney leaving a firm, particularly one that is continuing, has little bargaining position with respect to its ongoing operations including the maintenance of a valid LLP election and the maintenance of required insurance. Depriving those partners, *ex post* departure, of the benefits of the LLP election has every appearance of unfairness. Altering the facts slightly, in the context of a firm that is dissolving, all of the partners have an incentive to ensure that they remain protected from liability with respect to actions undertaken during the partnership's active existence. This differential may justify a differential in treatment of a withdrawing partner (or partners) from a firm otherwise continuing versus a firm that is dissolving.

Conclusion

Life was once so simple; attorneys practiced as either general partners or sole practitioners and stood behind their work and that of their firms to the full extent of their personal assets. Then, in response to tax classification issues, there arose the professional service corporation.[51] The impact of the LLC and LLP upon the practice of law and firm cohesion has been commented upon,[52] and it was with the rise of those forms that the maintenance of malpractice insurance was made a precondition for the benefits of limited liability. The *Mortgage Grader* decision directs the bench and the bar to further consider the operation (and limits) of that *quid-pro-quo*.[53]

ENDNOTES

1 *See, e.g.*, Rev. Unif. Part. Act §1001(a), 6 (pt. 1) U.L.A. 239 (2001) ("A partnership may become a limited liability partnership pursuant to this section."); Ky. Rev. Stat. Ann. §362.1-931(1) ("A partnership may become a limited liability partnership pursuant to this section."); *id.*, §362.1-306(3) (limited liability consequent to LLP status); Ind. Code §23-4-1-45(a) ("To qualify as a limited liability partnership, a partnership under this chapter must do the following."); N.J. Code §42-1A-47(a) ("A partnership may become a limited liability partnership pursuant to this section."). With respect to the historical development of the LLP, *see* Robert Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. Colo. L. Rev. 1065 (1994–1995). *See also* Christine Hurt & D. Gordon Smith, Bromberg and Ribstein on Limited Liability Partnerships, The Revised Uniform Partnership Act, and the Uniform Limited Partnership Act (2001), at §1.01 (2016 ed.).

2 In New Jersey, that is Rule 1:21-1C, *Limited Liability Partnerships for the Practice of Law*. *See also* Kentucky SCR 3.022, *Forms of Practice of Law*, and SCR 3.024, *Requirements of Practicing Law in Limited Liability Entities*; Massachusetts Supreme Judicial Court Rule 3:06: *Use of Limited Liability Entities*; Nebraska SCR 3-201, *Permissible business organizations; name restrictions; membership professional liability; insurance required; dissolution*.

3 *Mortgage Grader, Inc. v. Ward & Olivo, LLP*, 139 A3d 30 (2016). This column incorporates aspects of a previously published discussion of this case through the decision of the Appellate Division. *See* Thomas E. Rutledge, *Potential Problems with the LLP Structure for Professional Firms*, 6 The Transaction Lawyer 1 (April 2016).

4 *See Mortgage Grader, Inc. v. Ward & Olivo, LLP*, 438 N.J. Super. 202, 206; 102 A3d 1226, 1228 (N.J. Super. Ct. 2014).

5 *Id.*

6 438 N.J. Super. at 207; 102 A3d at 1228.

7 438 N.J. Super. at 208; 102 A3d at 1229.

8 438 N.J. Super. at 211–212; 102 A3d at 1231 (citation omitted).

9 438 N.J. Super. at 212; 102 A3d at 1231.

10 Justice Albin wrote separately to concur in part and dissent in part. That opinion is considered below as part of the critique of the *Mortgage Grader* decision.

11 139 A3d at 37 (emphasis in original, footnote and citation omitted).

12 *Id.*

13 *Id.,* at 38. *See also id.* ("In sum, the important distinction pertaining to LLP liability is the point in time at which an LLP enters dissolution, commences winding up its affairs, and thus ceases to engage in the business for which it was created.")

14 *Id.*, at 39.

15 *Id.*

16 *Id.*

17 *See infra* notes 32 through 35 and accompanying text.

18 139 A3d at 40.

19 *Id.,* at 39.

20 *Id.,* at 40 ("Practical considerations and public policy concerns lead us to hold that tail coverage is not required."). *See also id.*, at 41 ("We hold that the mandate on *Rule* 1:21-1C for LLPs to purchase professional liability insurance does not include any requirements to purchase tail coverage.").

21 161 SW3d 137 (Tex. App.—Eastland 2005, no pet.).

22 2006 Tex. App. LEXIS 10593 (Tex. App.—San Antonio 2006, no pet.).

23 This summary is adopted from Elizabeth S. Miller, *Owner Liability Protection and Piercing the Veil of Texas Business Entities*, Nov. 5, 2012, at 33, available online at *www.baylor.edu/content/services/document.php/187922.pdf*.

24 *Evanston Ins. Co. v. Dillard Dep't Stores, Inc.*, CA-5, 602 F3d 610, 616 (2010).

25 *See also generally* Elizabeth S. Miller, *The Perils and Pitfalls of Practicing Law in a Texas Limited Liability Partnership*, 42 Texas Tech. L. Rev. 570, 571–575 (2011).

26 B225432, 2012 Cal. App. Unpub. LEXIS 4462 (Calif. Ct. App. Second Dist. June 14, 2012).

27 *Id.*, *31–*32. *But see Ederer v. Gursky*, 881 NE2d 204, 851 NYS2d 108, 9 NY3d 514 (N.Y. 2007) (LLP liability protections apply only as to third-party claims against the partnership and are inapplicable to *inter se* disputes and obligations).

28 Presumably that status needed to as well be in place at the time of the operative conduct. Otherwise, an attorney could commit malpractice, then elect LLP status and claim the benefit of limited liability.

29 *Contrast* Ky. Const. §190 ("Except as otherwise provided by the Constitution of Kentucky, the General Assembly shall, by general laws only, provide for the formation, organization, and regulation of corporations. Except as otherwise

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provided by the Constitution of Kentucky, the General Assembly shall also, by general laws only, prescribe the powers, rights, duties, and liabilities of corporations and the powers, rights, duties, and liabilities of their officers and stockholders or members.") *with* Ky. Const. §116 ("The Supreme Court shall, by rule, govern admission to the bar and the discipline of members of the bar.").

[30] *See, e.g.*, *Mortgage Grader*, 139 A3d at 36 ("Neither the rule nor the UPA authorize a remedy of *converting* a law-firm LLP into a GP for failure to maintain malpractice insurance.") (emphasis added); *id.*, at 39 ("Because … the Court rules do not list *conversion* of business organization form as a type of sanction, we conclude that conversion of W & O from an LLP to a GP was improper under the Rule") (emphasis added). *See also Mortgage Grader, Inc. v. Ward & Olivo, LLP*, 438 N.J. Super. 202 at 211; 102 A3d 1226 at 1231 (N.J. Super. Ct. 2014). ("The Court did not include as a sanction the conversion of an LLP into a GP, thereby removing the protection afforded to a partner in an LLP under the UPA, when attorneys practice as an LLP without maintaining professional liability insurance."); *id.*, at 1231 ("As currently written, however, the court rules do not authorize a trial court to sanction a partner of an LLP for practicing law as an LLP without the required professional liability insurance by converting an otherwise properly organized LLP into a GP.").

[31] *See, e.g.*, RUPA §201(b), 6 (pt. 1) U.L.A. 91 (2001) ("A limited liability partnership continues to be the same entity that existed before the filing of a statement of qualification under Section 1001."); Ky. Rev. Stat. Ann. §362.1-201(2) ("A limited liability partnership is a partnership and continues to be the same entity that existed before the filing of a statement of qualification under KRS 362.1-931."); RUPA §1001(a), 6 (pt. 1) U.L.A. 239 (2001) ("A partnership may become a limited liability partnership pursuant to this section."); Ky. Rev. Stat. Ann. §362.1-931(1) ("A partnership may become [an LLP] pursuant to this section").

[32] The law of New Jersey could not be more clear as to the point. *See* N.J. Rev. Stat. §42:1A-9(6) ("A limited liability partnership continues to be the same entity that existed before the filing of a statement of qualification under section 47 of this act.").

[33] New Jersey law does provide for "conversions," a transaction by which a venture changes its organizational form. *See, e.g.*, N.J. Rev. Stat. §42:2C-78 ("An organization, other than a limited liability company or a foreign limited liability company, may convert to a limited liability company, and a limited liability company may convert to an organization other than a foreign limited liability company pursuant to this section, sections 79 through 81 of this act, and a plan of conversion, if:"). Tellingly, New Jersey's RUPA does not provide for the conversion of partnerships. *Contrast* Rev. Unif. Part. Act §902, 6 (pt. 1) U.L.A. 214 (2001) (providing for conversion of partnership into limited partnership). The conversion of a partnership into an LLC is provided for not in New Jersey's RUPA, but in the New Jersey LLC Act.

[34] *See* N.J. Rev. Stat. §42:1A-43(a) ("After dissolution, a partner who has not wrongfully dissociated may file a statement of dissolution stating the name of the partnership and that the partnership has dissolved and is winding up its business."). *See also* Rev. Unif. Part. Act §805, 6 (pt. 1) 202 (2001); Ky. Rev. Stat. Ann. §362.1-805.

[35] *See also Dow v. Jones*, 311 FSupp2d 461, 472 (D. Md. 2004) (partnership could be held responsible for post-dissolution malpractice).

[36] *See supra* note 19 and accompanying text.

[37] N.J. Const. Art. VI, §2, ¶ 3 ("The Supreme Court shall make rules governing the administration of all courts in the State and, subject to the law, the practice and procedure in all such courts. The Supreme Court shall have jurisdiction over the admission to the practice of law and the discipline of persons admitted.").

[38] ___ SW3d ___, 2016 Ky. App. LEXIS 71 (Ky. App. May 6, 2016).

[39] That the coverage is on a claims made basis is here assumed.

[40] *See supra* notes 11–14 and accompanying text.

[41] 139 A3d at 40–41.

[42] *See also Mortgage Grader*, Albin, J., concurring in part and dissenting in part, 139 A3d at 45.

> Because we cannot protect those clients whose malpractice claims may arise six years after an LLP's dissolution is no reason not to protect those clients who file claims within a reasonable period after the dissolution. I do not accept the majority's position that because we cannot protect everyone, we should protect no one.

[43] It is understood, but has not been confirmed, by this author that Olivio is functionally judgment proof consequent to pre-existing federal tax liens.

[44] *See, e.g.*, Ky. Rev. Stat. Ann. §362.1-932 (imposing disgorgement liability upon partners who receive distribution from LLP that is insolvent or otherwise unable to satisfy its debts and obligations); Rev. Unif. Part. Act (Harmonized 2013) §406, 6 (pt. II) U.L.A. 93 (2015).

[45] Alternatively, as observed by Confucius, "Better a diamond with a flaw than a pebble without." *See* M.P. Singh, Quote Unquote (A Handbook of Quotations), at 223 (2005). *See also* William Shakespeare, King Lear 1:4 ("Striving to better, oft we mar what's well."); Louis Brown, Technical and Military Imperatives, A Radar History of World War 2, at 64 (1999) ("Give them the third best to go on with; the second best comes too late, and the best never comes.").

[46] 139 A3d at 41.

[47] *See* N.J. Rev. Stat. §42:1A-18(a); RUPA §306(a), 6 (pt. 1) U.L.A. 117 (2001).

[48] *See* 139 A3d at 37:

> Cal. Corp. Code § 16956(a)(2)(A) (stating that "[u]pon the dissolution and winding up of the partnership, the partnership shall, with respect to any insurance policy or policies then maintained pursuant to this subparagraph, maintain or obtain an extended reporting period endorsement or equivalent provision in the maximum total aggregate limit of liability required to comply with this subparagraph for a minimum of three years if reasonably available from the insurer").

[49] *See also Mortgage Grader*, Albin, J., concurring in part and dissenting in part, 139 A3d at 43:

> Lawyers operating as a limited liability partnership (LLP) … are shielded from vicarious liability for the malpractice of their partners. The rule's quid pro-quo is that the LLP must carry adequate insurance 'to protect consumers of legal services.' … Therefore, I would amend *Rule* 1:21-1C to make explicit that lawyers operating as an LLP will be treated as a general partnership if they fail to maintain malpractice insurance. Additionally, I would amend the rule to require that an LLP carry malpractice insurance for a six-year period after its dissolution, if such insurance is reasonably available. Tail coverage will ensure that the law firm's last client has as much financial protection as the firm's first client. (Citation omitted, footnote omitted.)

[50] *See, e.g.*, *Evanston Ins. Co. v. Dillard Dep't Stores, Inc.*, *supra* notes 24–25 and accompanying text.

[51] *See* Rutledge, , 58 Bus. Law. 1413 (Aug. 2003).

[52] *See, e.g.*, Robert R. Keatinge, *The Floggings Will Continue Until Morale Improves: The Supervising Attorney and His or Her Firm*, 39 S. Tex. L. Rev. 279, 300–302 (1998); Robert R. Keatinge et al., *Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization*, 51 Bus. Law. 147, 187–191 (1995):

> If one assumes (i) a partnership has an obligation to indemnify a partner for obligations incurred or paid as a result of the partner's simple negligence or for which the partner is responsible and (ii) each partner is obligated to contribute to pay the obligations of a partnership, then each partner who is directly liable as a result of that partner's negligence or responsibility as a "responsible partner" may look to all the partners for indemnification in the event of a simple mistake or some other personal liability. As a result, each responsible partner may have the added security of having the individual assets of his or her partners as additional protection against a massive claim. In an LLP or other organization limiting vicarious liability, each partner gives up this right to look to the other partners for indemnification. Put one way, the partner could be said to be exchanging the relationship of "all for one" for one characterized as "every man for himself." Partners engaged in

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activities that risk massive liabilities or who may have greater exposure as a result of their supervisory responsibility may be reluctant to change the relationship and forgo this protection. To evaluate this concern, the partners should consider the benefits and costs of mutual indemnification.

[53] *See also Mortgage Grader*, Albin, J., concurring in part and dissenting in part, 139 A3d at 45–46:

> This case has illuminated deficiencies in the rule that place clients and the public at risk. This court therefore should exercise its constitutional authority and amend the current rule. Lawyers practicing in LLPs should no longer be able to invoke the liability shield of an LLP if they have not maintained adequate malpractice liability insurance during the life of the LLP and for a six-year period after its dissolution. In the event of non-compliance, the lawyers should be treated as though they were practicing in a general partnership and be subject to vicarious liability in cases of legal malpractice.

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