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LIMITED LIABILITY PARTNERSHIPS

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I. Status of Limited Liability Partnership ("LLP") Legislation.

LLP legislation was first enacted in Texas in 1991. Virginia adopted its statute in 1994, and statutes now exist in approximately 37 states.

A number of states, including Virginia, permit limited partnerships to form "limited liability limited partnerships."

II. LLPs and Partner Liability.

A. Liability of Partners of a General Partnership.

General partners face the following types of liability:

1. Joint and Several Liability for Certain Partnership Obligations.

Under § 15(a) of the UPA, a partner is jointly and severally liable for obligations of the partnership arising from the wrongful acts or omissions of another partner acting either in the partnership's ordinary course of business or with the authority of other partners, and for breaches of trust by a partner acting within the scope of his or her apparent authority or by the partnership in the course of its business.

2. Joint Liability for Other Obligations.

Under § 15(b) of the UPA, a partner is jointly liable for all other debts and obligations of the partnership.

3. Statutory Contribution Obligations.

Partners have contribution obligations under UPA §§ 18, 34 and 40. Under § 18, partners have a general obligation to contribute toward the losses sustained by the partnership. Under §§ 34 and 40, partners have contribution obligations after the dissolution of the partnership.

4. Contractual Obligations.

Many partnership agreements contain specific contribution and indemnification provisions that effectively make each partner liable for his or her pro rata share of partnership liabilities. These contractual obligations among partners are in addition to direct obligations that partners may incur by reason of other agreements (such as guaranties) to be liable for partnership obligations.

B. Liability of Members and Managers of Limited Liability Companies.

Each of the limited liability company statutes provides that members and managers of LLCs are not liable, by reason of their status as members or managers, for the acts or omissions of the limited liability company or of other members, managers, agents or employees of the limited liability company. For typical statutory language, see Uniform Limited Liability Company Act § 303; ABA Prototype Limited Liability Company Act, § 304; Va. Code Ann. § 13.1-1019.

C. Liability Protection Afforded by Limited Liability Partnership Status.

LLP statutes permit a general partnership to elect limited liability partnership status by making a filing with the appropriate state filing agency and by conforming with other limited requirements of the statute.

1. Scope of Limited Liability.

As a general rule, the LLP statutes amend UPA § 15 by limiting the partner's liability for certain partnership's obligations. The following

statutory formulations provide examples of the different statutory approaches:

a. Texas.

A partner in a registered limited liability partnership is not individually liable for debts and obligations of the partnership arising from errors, omissions, negligence, incompetence, or malfeasance committed while the partnership is a registered limited liability partnership and in the course of the partnership business by another partner or a representative of the partnership not working under the supervision or direction of the first partner unless the first partner:

(A) was directly involved in the specific activity in which the errors, omissions, negligence, incompetence, or malfeasance were committed by the other partner or representative; or

(B) had notice or knowledge of the errors, omissions, negligence, incompetence, or malfeasance by the other partner or representative at the time of occurrence and then failed to take reasonable steps to prevent or cure the errors, omissions, negligence, incompetence, or malfeasance.

Tex. Rev. Civ. Stat. Ann. art. 6132b, § 3.08(a)(1).

b. Virginia.

B. A partner in a registered limited liability partnership is not individually liable, directly or indirectly, including by way of indemnification, contribution or otherwise, for debts, obligations and liabilities chargeable to the partnership, whether sounding in tort, contract or otherwise, arising from negligence, malpractice, 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, 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, malpractice, wrongful acts or misconduct, or for the negligence, malpractice, wrongful acts or misconduct of any employee, agent or representative acting under his direct supervision and control in the specific activity in which the negligence, malpractice, wrongful acts or misconduct occurred.*

Va. Code Ann. § 50-15.

c. **Minnesota.**

A partner of a limited liability partnership is not, merely on account of this status, personally liable for anything chargeable to the partnership under [the equivalent of the UPA sections providing for joint and joint and several liability], or for any other debts or obligations of the limited liability partnership, if the charge, debt, or obligation arose or accrued while the partnership had a registration in effect under [the Minnesota LLP statute]. This subdivision does not limit or impair the right of the partnership or its partners to make claims against any particular partner on the grounds that the particular partner:

(1) *has, in its capacity as a partner, breached a duty to the partnership or to the other partners; or*

(2) *is obligated to contribute so that partners share losses of capital according to [the equivalent of UPA §18] and share the liabilities stated in [the equivalent of UPA §40(b)(III) & (IV)].*

Minn. Stat. § 323.14(2).

d. **New York.**

Except as provided by subdivisions (c) and (d) of this section, no partner for partnership which is a registered limited liability partnership is liable or accountable, directly or indirectly (including by way of indemnification, contribution or otherwise), for any debts, obligations or liabilities of, or chargeable to, the

registered limited liability partnership or each other, whether arising in tort, contract or otherwise, which are incurred, created or assumed by such partnership while such partnership is a registered limited liability partnership, solely by reason of being such a partner or acting (or admitting to act) in such capacity or rendering professional services or otherwise participating (as an employee, consultant, contractor or otherwise) in the conduct of the other business or activities of the registered limited liability partnership.

[Subdivision (c) provides that partners, employees and agents of a professional LLP will be personally liable for their own negligent or wrongful acts or misconduct or for such behavior by any person under their direct supervision and control. Subdivision (d) provides that unless otherwise provided in a partnership agreement, a majority of the partners may agree that all or specified partners of a LLP may be liable in their capacity as partners for all or specified debts, obligations or liabilities of the LLP.]

N.Y. Partnership Law § 26(b)-(d).

2. **Limitations on the Protection Afforded by LLPs, or, Top Twelve Reasons LLPs Won't Make You Sleep Better at Night.**

Although LLP provisions can help insulate a general partner from personal liability for the actions of his or her co-partners and the other representatives of the partnership, a number of limitations must be kept in mind:

12. Pre-LLP Obligations. The partners remain liable for all obligations arising prior to the partnership's election of LLP status. This liability may include, for as long as Congress continues to extend the statute of limitations, claims that can be asserted by the federal banking agencies.

11. Partnership Assets at Risk. Just as with any limited liability entity, even if the individual partner is shielded from certain liability,

all of the partnership's assets remain at risk for all partnership obligations.

10. Veil Piercing. Obviously, there is not yet any case law delineating when the "veil" of an LLP may be pierced. Given that a partnership has no statutory obligation to follow particular formalities, it would be expected that opportunities for veil-piercing would be limited. Nevertheless, Minnesota's statute contains an awkward provision that explicitly provides for the application to LLPs of existing corporate law cases involving veil-piercing. Minn. Stat. § 323.14(3).

9. Partner's Own Actions. A partner remains liable, even after a partnership elects LLP status, for his or her own actions. Moreover, LLP status does not affect any personal guarantees given by the partners, including loan and lease guarantees.

8. Indirect Liability for the Behavior of Others. Most of the LLP statutes provide that an individual partner may remain liable for behavior that may be primarily attributable to others. The statutes phrase this liability in a variety of ways. Under some statutes, a partner remains liable for those under his or her direct supervision or control, while under other statutes, the general exculpation language makes clear that the statute does not change supervisory liability (whatever it is now). Questions involving the scope of supervisory liability have particular importance in a professional context. It is not at all clear the extent to which a partner in a professional firm might be liable for negligent hiring, or for "supervisory" liability arising out of a partner's status as a practice group head or managing partner.

Several examples of the statutory standards applicable to indirect liability highlight the different standards.

- Texas - partner is always liable if supervising or directing work. Partner is also liable if directly involved in the specific activity or if partner had notice or knowledge of the behavior and failed to take reasonable steps to prevent or cure;
- D.C. - partner is liable if supervising or directing work. Partner is also liable if directly involved in the specific

activity or if partner had written notice or knowledge of the behavior;

- Delaware and Virginia - statutory limitation on liability does not eliminate liability for behavior of any person under a partner's direct supervision or control. This means that a partner in an LLP is always vicariously liable for a person under direct supervision and control, even if no negligence on the part of the supervising partner is involved;
- North Carolina - partner is liable if supervising or directing or if directly involved in the specific activity;
- New York - partner is liable for actions of those under the partner's direct supervision or control.

7. Contribution Obligations, including Internal Partnership Contractual Obligations. Several of the original LLP statutes failed to limit the effect of UPA §§ 18, 34 and 40, which impose contribution obligations on partners. Most of the statutes modify these UPA rules by carving out the liability for which a partner is not liable as a consequence of the LLP statute's change to UPA § 15. However, the Minnesota statute, while negating general contribution liability for partnership losses, appears to leave in place a partner's statutory contribution obligations for losses of capital and for amounts owing to partners in respect of partnership profits. Minn. Stat. §§ 323.14(2), 323.17, 323.39(2)(c) and (d).

Even the negation of the statutory contribution obligations may not suffice to eliminate this type of liability. Many partnerships converting to LLPs are doing so without a thorough review of their existing partnership agreements, and most partnership agreements contain parallel contribution and indemnification provisions. To the extent that these partnership agreement provisions remain in place after the partnership elects LLP status, the partners may not have given themselves any new protection at all because a partner who is personally liable may still have contribution and/or indemnification rights against other partners.

6. General Contract Liability. Only a handful of the existing statutes (including the Minnesota and New York statutes described above) give partners protection from general contract liability of the sort that arises under leases, loan documents, etc. Because the other

LLP statutes address only "negligence" type liability, the partners of an LLP will still have unlimited liability for contractual obligations.

5. **Tort Claims Plead in Contract.** There is also a substantial risk that an LLP's liability shield can be avoided by pleading tort claims under a contractual theory. Most of the statutes shield partners from liability arising out of the "errors, omissions, negligence" of their co-partners and other agents of the partnership. This exculpation language has a "tort" sound, as has been noted by a commentator on the Texas statute. Consequently, a number of statutes do not make it clear that the exculpation from liability will attach to the underlying behavior even if a plaintiff pleads a claim as a breach of contract. For example, most claims against professionals that can be asserted as negligence claims can also be characterized as breach of contract claims. This is true even if an engagement letter is not in place, but is even more likely in the engagement letter context.

4. **Obligation for Improperly Paid Distributions.** Under most corporate, limited partnership and LLC statutes, a shareholder, partner or member may have an obligation under certain circumstances to return improperly paid dividends or distributions. *See, e.g.,* Model Business Corporation Act § 8.33; Revised Uniform Limited Partnership Act § 608(b); Uniform Limited Liability Company Act § 407. The UPA does not include such a provision, presumably because general partners are jointly and jointly and severally liable for various partnership obligations. Despite the lack of a statutory provision, it is possible that a court might require the partners of an LLP to return partnership distributions made at a time when the partnership was technically insolvent. Minnesota actually codifies such an obligation by requiring the return by a partner of any distribution from the LLP that would have violated the distribution restrictions applicable to corporations. Minn. Stat. § 323.14(5). The Minnesota statute does not contain the limitation, found in many corporate and LLC statutes, that makes the return obligation contingent on the knowledge of the party receiving the distribution.

3. **Professional Liability.** Although an LLP is a form of general partnership, some state professional licensing authorities may take the position that the mere legal authorization of LLPs is not sufficient to enable professionals to practice in LLPs, or to shield partners in a professional partnership from liability for the behavior of their co-partners and other agents of the partnership. With respect to other types of limited liability entities, some states have taken the position that some professionals can never shield themselves from vicarious

liability regardless of the organizational form they utilize. Moreover, because many LLP statutes are new, state bars and supreme courts and other professional licensing agencies may need to adopt special rules before a professional firm is allowed to utilize the LLP form. The Virginia State Bar requires LLPs to complete a registration; the State Board for Accountancy has no LLP registration requirements.

2. Interstate Recognition of LLPs. The partners of an LLP may not enjoy the LLP's purported protections in other states, and it is not clear that LLPs will be recognized at all in the states that still do not have LLP legislation. Even in states with LLP legislation, it is not clear that a state will be obligated to recognize limitations on liability that are broader than those available under its own statute. For example, a state that does not protect partners against general contract liability may not recognize the broader scope of limitations on liability of the type enacted in New York and Minnesota, notwithstanding the general statements in these and other statutes exhorting other jurisdictions to give effect to such provisions. Finally, in states where as a matter of common law or state licensing policy professionals are not entitled to rely on the LLP's liability shield, LLP status may not be meaningful for certain professional firms.

1. Changes in Partnership Composition. Under the Uniform Partnership Act, whenever a partner leaves the partnership, the partnership dissolves and the continued partnership is technically a new partnership for legal (if not tax) purposes. This rule will change gradually as and if states adopt the Revised Uniform Partnership Act, but is presently the law in virtually every state, and many LLP statutes do not address this issue. Virginia changed its statute in 1995 to eliminate this question. For this reason, as a technical matter, it would be possible for a plaintiff to take the position that the "new" partnership cannot avail itself of the LLP liability shield if it fails to reregister as a "new" LLP each time a partner leaves the partnership. Technically, the subsequent partnership would not be the same partnership that registered as an LLP, and a reasonable, albeit technical, argument could be made that the LLP status of the original partnership lapsed. This is a significant problem for large professional partnerships, where changes in partners occur on a continuous basis.

Moreover, even if a partnership is willing to reregister as an LLP each time a partner withdraws, the filing fees could be prohibitively expensive. As noted below, a number of states charge annual registration fees on a per partner (as high as \$200 per partner)

basis, and do not allow the fees to be limited to the partners located in that state.

Note that this problem does not apply to changes to a partnership's composition that occur as a result of the addition of partners. Under the Uniform Partnership Act, the addition of a partner does not dissolve the partnership.

III. Mechanics of Registering as and Remaining a Limited Liability Partnership.

Each of the LLP statutes imposes filing and other requirements.

A. Registering as an LLP.

A general partnership becomes an LLP by filing an application with the secretary of state or other state filing agency.

1. Information to be Filed.

The LLP statutes typically require that the application include:

- the partnership's name, which typically must include either the words "registered limited liability partnership" or the abbreviations "L.L.P." or "LLP". Most states require that these designations be at the end of the LLP's name.
- the number of partners at the time of the application.
- a description of the partnership's business.

Some statutes have other filing requirements, which variously include the partnership's federal tax i.d. number, address, and/or registered address and agent information. No state requires the listing of each partner, but Virginia requires the filing of a certified copy of the partnership's locally filed partnership certificate.

The New York statute requires the application to state whether all or specified partners remain liable for all or specified liabilities of the partnership.

2. Execution of Application.

The statutes generally require the LLP application to be executed by a majority in interest of the partners or by one or more partners

authorized to do so by the partners. Some of the statutes require that the signing partner or partners be authorized to do so by a majority in interest of the partners. None of the statutes appear to require any proof of authority.

B. Filing Fees and Publication.

The LLP statutes require filing fees that run the range of \$200 per partner (the 1993 Texas statute) to a flat \$100 filing fee (e.g., Louisiana, Virginia and North Carolina). Delaware's \$100 per partner fee is capped at the maximum corporate franchise fee, which is presently \$150,000.

The New York LLP statute, which requires a flat \$250 filing fee and a \$60 biennial fee, also imposes a publication requirement (once a week for six consecutive weeks in two newspapers) that will add to the expense of forming a New York LLP (or qualifying a foreign LLP in New York). The New York statute also contains a tax provision for LLPs with New York source income that requires LLPs to pay an annual fee of \$50 per partner (subject to a minimum of \$325 and a maximum of \$10,000).

C. Renewal.

The LLP statutes other than New York's require an annual renewal. New York's LLP statute requires biennial filings. Upon renewal, the LLP must pay additional fees (per partner fees in states where the original filing fees are on a per partner basis). The annual fee in Virginia is \$50. The renewals are generally not tied to a common annual renewal date, but to the original filing of the LLP's application. There is no indication that the state will prompt renewal with a billing, or that an inadvertent failure to effect a timely renewal may be cured other than by a new filing. The Virginia State Corporation Commission will not provide notice to "expiring" LLPs.

D. Changes in Composition of Partnership.

Although an LLP generally must specify the number of its partners in its original application, most (Texas is an exception) do not address what should happen when partners are added to the partnership.

E. Insurance Requirements.

Most of the state statutes require, as a condition to obtaining and maintaining the limited liability afforded by LLPs, the maintenance by the partnership of a minimum amount of insurance or alternate security. For example:

- The Texas statute requires an LLP to maintain at least \$100,000 of liability insurance that will cover the type of liability for which partners are not liable under the amended version of UPA § 15, or to provide an escrow, letter of credit or bond in the same amount. The similar limits under the Delaware and Virginia statutes are \$1 million and \$500,000, respectively.
- The D.C. statute requires \$100,000 in insurance, or if greater, an amount of insurance not less than the amount carried by the individual partner carrying the greatest amount of individual liability insurance.

Although the Virginia statute provides for the LLP to carry insurance or similar credit of at least \$500,000, in addition to any insurance deductible amount, neither the Virginia statute nor any other statute addresses or explicitly restricts the possibility that an LLP might be self-insured for a relatively large deductible amount.

The New York and Minnesota statutes do not contain insurance requirements.

IV. Foreign LLPs.

Foreign LLP provisions generally impose registration requirements similar to those required of domestic LLPs. The foreign LLP provisions in states where LLPs pay registration fees on a per partner basis generally do not limit the registration fees payable by a foreign LLP to partners located in the foreign state. Accordingly, the registration of a multistate LLP could be extraordinarily expensive.