

THE PERILS AND PITFALLS OF PRACTICING LAW IN A TEXAS LIMITED LIABILITY PARTNERSHIP

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I. INTRODUCTION

A limited liability partnership (LLP) is a partnership that has availed itself of statutory procedures so as to alter the traditional rule that the general partners have personal liability for all of the partnership's debts and obligations.¹ The statutory provisions applicable to general partnerships (or those applicable to limited partnerships in the case of a limited partnership that has registered as an LLP) continue to apply to a partnership after it registers as an LLP—it is the same entity as it was prior to registration.² The LLP provisions of the Texas Business Organizations Code (TBOC)

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1. See generally 19 ROBERT W. HAMILTON, ELIZABETH S. MILLER & ROBERT A. RAGAZZO, TEXAS PRACTICE SERIES: BUSINESS ORGANIZATIONS §§ 12.01-12.43 (2d ed. 2004 & Supp. 2010) (discussing the general nature of an LLP and the liability protection provided to the partners).

2. See *Formation of Texas Entities FAQs—Limited Liability Partnerships (LLPs) and Limited Liability Limited Partnerships (LLLPs)*, SECRETARY OF STATE, Nos. 1, 6, and 7, <http://www.sos.state.tx.us/corp/formationfaqs.shtml> (last visited Jan. 10, 2011). The common misconception that an LLP is “formed” by filing an application for registration with the Secretary of State is addressed on the Secretary of State’s website. See *id.* (pointing out that “an LLP is merely an optional registration made by an underlying, pre-existing partnership,” that “[a]n LLP is not an entity separate and apart from the underlying partnership,” that “[r]egistering an LLP does not create a partnership,” and that the statutory conversion provisions cannot be used to convert into an LLP).

merely modify the rule regarding liability of partners and specify the requirements for obtaining and maintaining LLP status.³

Texas was the first jurisdiction to pass LLP legislation in 1991.⁴ The concept was quickly copied in other states, and all states and the District of Columbia have since added LLP provisions to their partnership statutes.⁵ The major accounting firms were a significant force in lobbying for such legislation across the country.⁶ Although the states were quick to borrow the LLP concept from Texas, they were not reluctant to vary and refine it, and there are significant variations in the LLP statutes around the country.⁷ For example, most states, like Texas, permit any type of partnership to become an LLP, while a few states permit only professional partnerships to become LLPs.⁸ Some states limit the liability protection provided by an LLP to liabilities arising out of some type of tortious or wrongful conduct, while LLPs in Texas and many other states provide partners liability protection extending to contractual obligations of the partnership.⁹

II. GENERAL RULE: FULL LIABILITY LIMITATION

The feature that distinguishes an LLP from a partnership that is not an LLP is the limitation on the personal liability of partners in an LLP. The TBOC provides that a partner in an LLP is not individually liable for debts and obligations of the partnership incurred while the partnership is an LLP.¹⁰ As originally enacted in the Texas Uniform Partnership Act and carried forward in the Texas Revised Partnership Act, the Texas LLP provisions only shielded partners from liability arising out of the errors, omissions, negligence, incompetence, or malfeasance of other partners or representatives of the partnership.¹¹ In 1997, the LLP provisions in the

3. See TEX. BUS. ORGS. CODE ANN. §§ 152.801-152.805 (West 2010).

4. For a detailed account of the origin of the LLP concept in Texas and its progression through the 1991 Legislature, see Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1066-74 (1995); Susan Saab Fortney, *Seeking Shelter in the Minefield of Unintended Consequences—The Traps of Limited Liability Law Firms*, 54 WASH. & LEE L. REV. 717, 724-26 (1997) [hereinafter Fortney, *Seeking Shelter*].

5. ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS, THE REVISED UNIFORM PARTNERSHIP ACT, AND THE UNIFORM LIMITED PARTNERSHIP ACT (2001) § 1.01(e), at 16 (2010).

6. See Robert R. Keatinge, Allan G. Donn, George W. Coleman & Elizabeth G. Hester, *Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization*, 51 BUS. LAW. 147, 158-61 (1995).

7. See BROMBERG & RIBSTEIN, *supra* note 5, § 1.01(b)-(c), at 10-15.

8. See, e.g., CAL. CORP. CODE § 16101(6)(A) (West Supp. 2010); N.Y. P'SHIP LAW § 121-1500(a) (Consol. 2002).

9. See BROMBERG & RIBSTEIN, *supra* note 5, at 165-68 tbl.3-1 (summarizing the types of liability shields provided in all of the state LLP statutes).

10. TEX. BUS. ORGS. CODE ANN. § 152.801(a) (West 2010).

11. See Act of May 25, 1991, 72d Leg., R.S., ch. 901, § 84, 1991 Tex. Gen. Laws 3161, 3234 (amending § 15 of the Texas Uniform Partnership Act (Article 6132b, Vernon's Texas Civil Statutes)) (expired Jan. 1, 1999, pursuant to Act of May 31, 1993, 73d Leg. R.S., ch. 917, § 2, 1993 Tex. Gen.

Texas Revised Partnership Act were amended to provide protection from all debts and obligations of the partnership as a general rule, and this approach was carried forward in the TBOC.¹² Thus, the current language in the TBOC generally shields partners from tort and contract obligations of the partnership.¹³ Language was also added in 1997 to prevent indirect attempts to hold partners liable through indemnity and contribution.¹⁴ The LLP provisions do not shield a partner from liability imposed by law or contract independently of the partner's status as a partner, such as when a partner personally commits a tort or personally guarantees a contractual obligation.¹⁵ The limitation of partner liability also does not affect the liability of the partnership to pay its debts and obligations out of partnership property or the manner in which service of citation or other civil process may be served in an action against a partnership.¹⁶

III. EXCEPTIONS TO TORT-TYPE LIABILITY PROTECTION

As mentioned above, the Texas LLP provisions originally only shielded partners from liability arising out of the errors, omissions, negligence, incompetence, or malfeasance of other partners or representatives of the partnership.¹⁷ Even this protection was subject to certain exceptions. Under these exceptions, a partner's liability was not limited with respect to another's errors, omissions, negligence, incompetence, or malfeasance if such conduct occurred under the partner's supervision, the partner was directly involved in the specific activity in

Laws 3887, 3912-13 (amending the Texas Uniform Partnership Act (Article 6132b, Vernon's Texas Civil Statutes) by adding § 47); Act of May 31, 1993, 73d Leg., R.S., ch. 917, § 1, 1993 Tex. Gen. Laws 3887, 3887-3912 (enacting the Texas Revised Partnership Act, codified at TEX. REV. CIV. STAT. ANN. arts. 6132b-1.01 to 6132b-10.03 (LLP provisions codified at TEX. REV. CIV. STAT. ANN. arts. 6132b-3.08)) (expired Jan. 1, 2010, pursuant to Act of May 13, 2003, 78th Leg., R.S., ch. 182, § 11, 2003 Tex. Gen. Laws 267, 596 (amending Article XI of the Texas Revised Partnership Act (Article 6132b-11.01 et seq., Vernon's Texas Civil Statutes) by adding § 11.05)).

12. Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 113, 1997 Tex. Gen. Laws 1516, 1594-95 (amending § 3.08 of the Texas Revised Partnership Act (Article 6132b-3.08, Vernon's Texas Civil Statutes)) (expired Jan. 1, 2010, pursuant to Act of May 13, 2003, 78th Leg., R.S., ch. 182, § 11, 2003 Tex. Gen. Laws 267, 596 (amending Article XI of the Texas Revised Partnership Act (Article 6132b-11.01 et seq., Vernon's Texas Civil Statutes) by adding § 11.05)); Act of May 13, 2003, 78th Leg., R.S., ch. 182, § 1, 2003 Tex. Gen. Laws 267, 526 (effective Jan. 1, 2006) (current version at TEX. BUS. ORGS. CODE ANN. § 152.801(a) (West 2010)).

13. TEX. BUS. ORGS. CODE ANN. § 152.801(a) (West 2010).

14. Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 113, 1997 Tex. Gen. Laws 1516, 1594-95 (amending § 3.08 of the Texas Revised Partnership Act (Article 6132b-3.08, Vernon's Texas Civil Statutes)) (expired Jan. 1, 2010) (current version at TEX. BUS. ORGS. CODE ANN. § 152.801(a) (West 2010)).

15. TEX. BUS. ORGS. CODE ANN. § 152.801(e)(2) (West 2010).

16. *Id.* § 152.801(e)(1), (3).

17. See Act of May 25, 1991, 72d Leg., R.S., ch. 901, § 84, 1991 Tex. Gen. Laws 3161, 3234 (amending § 15 of the Texas Uniform Partnership Act (Article 6132b, Vernon's Texas Civil Statutes)) (expired Jan. 1, 1999).

which the conduct occurred, or the partner had notice or knowledge of the conduct at the time of its occurrence.¹⁸

When the 1997 amendments broadened the liability protection to all debts and obligations of the partnership, the language dealing with the exceptions to the protection from tort-type liabilities was retained.¹⁹ Though the construction of this provision of the Texas Revised Partnership Act was awkward, the apparent intent was to retain the pre-1997 exceptions from tort-type liability protection, i.e., a partner's liability for another's errors, omissions, negligence, incompetence, or malfeasance if such occurred under the partner's supervision, the partner was directly involved in the specific activity, or the partner had notice or knowledge and failed to take reasonable steps to prevent or cure the errant conduct.²⁰ The TBOC states this principle in a more straightforward and less awkward fashion.²¹

The exceptions to an LLP partner's protection from liability present some interesting questions of interpretation. First, a partner who "supervis[es]" or "direct[s]" the errant partner or partnership representative is not shielded from liability.²² Does this mean that managing partners are always liable? Professor Bromberg's comments accompanying the 1991 amendments suggest that the answer to this question is "no" and that the supervision should be fairly specific for liability to attach to a supervising partner.²³ Additionally, a partner is not shielded from liability if the partner was "directly involved" in the "specific activity" in which the error, omission, negligence, incompetence, or malfeasance was committed, or had "notice or knowledge" of and "failed to take reasonable action to prevent or cure" the error, omission, negligence, incompetence, or malfeasance.²⁴

18. *Id.* The liability associated with having notice or knowledge of the errors, omissions, negligence, incompetence, or malfeasance of another partner or representative was tempered somewhat when the provisions were re-enacted in the Texas Revised Partnership Act, which added as a condition to a partner's liability in this situation that the partner "then failed to take reasonable steps to prevent or cure the errors, omissions, negligence, incompetence, or malfeasance." Act of May 31, 1993, 73d Leg., R.S., ch. 917, § 1, 1993 Tex. Gen. Laws 3887, 3887-3912 (enacting the Texas Revised Partnership Act, codified at TEX. REV. CIV. STAT. ANN. arts. 6132b-1.01 to 6132b-10.03 (LLP provisions codified at TEX. REV. CIV. STAT. ANN. arts. 6132b-3.08)) (expired Jan. 1, 2010). The current LLP provisions include similar language. TEX. BUS. ORGS. CODE ANN. § 152.801(b)(3) (West 2010) (providing for liability of partner who has notice or knowledge of the error, omission, negligence, incompetence, or malfeasance of another partner or representative at the time of the occurrence if the partner "then failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence, or malfeasance").

19. See Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 113, 1997 Tex. Gen. Laws 1516, 1594-95 (amending § 3.08 of the Texas Revised Partnership Act (Article 6132b-3.08, Vernon's Texas Civil Statutes)) (expired Jan. 1, 2010) (current version at TEX. BUS. ORGS. CODE ANN. § 152.801(a), (b) (West 2010)).

20. *Id.*

21. See TEX. BUS. ORGS. CODE ANN. § 152.801(b) (West 2010).

22. § 152.801(b)(1).

23. See TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999).

24. TEX. BUS. ORGS. CODE ANN. § 152.801(b)(2), (3) (West 2010).

Arguably, the provisions imposing liability with respect to supervision, direct involvement, and notice or knowledge state nothing more than the principle that persons are always liable for their own torts.²⁵ Given the revolutionary effect of the LLP provisions on the traditional rule of partner personal liability, it is somewhat understandable that the legislation included this sort of reassuring language. The LLP provisions were initially drafted to be available only to professional partnerships.²⁶ Although the provisions enacted were not limited to professional partnerships, the language describing the types of debts and obligations for which partners' liability was limited (i.e., debts and obligations arising from "errors, omissions, negligence, incompetence, or malfeasance") was taken from the Texas Professional Corporation Act and Texas Professional Association Act, and it was recognized that professional firms would be the primary beneficiaries of the provisions.²⁷ That said, the resulting LLP provisions are somewhat anomalous given the approach of the Texas professional corporation statutes to liability issues.²⁸

The TBOC, like its predecessor, the Texas Professional Corporation Act, makes clear that the duties owed to a client by an individual professional acting on behalf of a professional corporation are not affected by the statute, and that the individual professional and the corporation have liability for the individual professional's errors, omissions, negligence, incompetence, or malfeasance.²⁹ The professional corporation statutes,

25. See *id.* On the other hand, the statute might be read to impose a type of strict, vicarious liability on a supervising partner for the errors, omissions, negligence, incompetence, or malfeasance of a person acting under the partner's supervision (i.e., liability regardless of whether the supervision was reasonable or negligent) inasmuch as the statute does not expressly couch the supervisory liability in terms of negligent supervision. It seems unlikely that the drafters intended to saddle partners who take on supervisory responsibilities with the risk of this type of strict liability, and such an interpretation suffers from the obvious policy infirmity that it may serve as a disincentive to partners to take on supervisory and mentoring roles. For further discussion of possible approaches toward supervisory liability under LLP statutes and reference to divergent views of commentators on the subject, see Susan Saab Fortney, *Professional Responsibility and Liability Issues Related to Limited Liability Law Partnerships*, 39 S. TEX. L. REV. 399, 439-42 (1998) [hereinafter Fortney, *Professional Responsibility*]. For arguments that practicing law as an LLP discourages partners from working with and supervising others, see Allan W. Vestal, *Special Ethical and Fiduciary Challenges for Law Firms Under the New and Revised Unincorporated Business Forms*, 39 S. TEX. L. REV. 445, 470-77 (1998); Fortney, *Seeking Shelter*, *supra* note 4, at 732-37.

26. See TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999) (explaining that the 1991 amendments began as a bill that would have applied only to certain professional partners); BROMBERG & RIBSTEIN, *supra* note 5, § 1.01(a), at 2-3 (describing the legislative path of the 1991 amendments and quoting the bill originally introduced, which would have eliminated vicarious liability of partners in a professional partnership).

27. See TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999).

28. See TEX. BUS. ORGS. CODE ANN. §§ 301.001(b), 301.010(a), 303.002 (West 2010).

29. TEX. BUS. ORGS. CODE ANN. §§ 301.001(b), 301.010(a) (West 2010); Act of May 26, 1989, 71st Leg., R.S., ch. 801, § 79, 1989 Tex. Gen. Laws 3610, 3663 (amending § 16 of the Texas Professional Corporation Act (Article 1528e, Vernon's Texas Civil Statutes)) (expired Jan. 1, 2010,

however, expressly disavow any implication that the statutes impose a supervisory duty.³⁰ The Texas Professional Corporation Act stated that “[a] shareholder of a professional corporation, as such, shall have no duty to supervise the manner or means whereby the officers or employees of the corporation perform their respective duties.”³¹ Similarly, the TBOC states that “[a] shareholder of a professional corporation is not required to supervise the performance of duties by an officer or employee of the corporation.”³² The TBOC also states that “[a] shareholder of a professional corporation is subject to no greater liability than a shareholder of a for-profit corporation” and is not subject to the vicarious liability imposed on the corporation for errors, omissions, negligence, incompetence, or malfeasance committed by another person.³³ The extent to which the LLP liability protection for errors, omissions, negligence, incompetence, or malfeasance differs from that provided by a professional corporation is debatable, but the different articulation is bound to prompt plaintiffs to target partners in addition to the errant partner or employee.

In *Software Publishers Association v. Scott & Scott, LLP*, a federal district court declined to dismiss claims against the managing partner of an LLP law firm that allegedly engaged in cybersquatting and copyright and trademark infringement and dilution.³⁴ The court noted that the Texas LLP statute provides for liability of a partner who is directly involved in the specific activity in which the negligence or malfeasance of another occurred or who had notice or knowledge of negligence or malfeasance at the time of the occurrence and failed to take reasonable steps to prevent or cure the negligence or malfeasance.³⁵ The court also pointed out that the liability of a partner independent of the person’s status as a partner is not affected by the statute.³⁶ The plaintiff alleged that the managing partner “control[led]” the activities of the law firm complained of in the complaint.³⁷ The court found this allegation sufficient to survive a motion to dismiss because the

pursuant to Act of May 13, 2003, 78th Leg., R.S., ch. 182, § 7, 2003 Tex. Gen. Laws 267, 595 (amending the Texas Professional Corporation Act (Article 1528e, Vernon’s Texas Civil Statutes) by adding § 21).

30. TEX. BUS. ORGS. CODE ANN. § 303.002(a) (West 2010); Act of May 25, 1991, 72d Leg., R.S., ch. 901, § 48, 1991 Tex. Gen. Laws 3161, 3217 (amending § 5 of the Texas Professional Corporation Act (Article 1528e, Vernon’s Texas Civil Statutes)) (expired Jan. 1, 2010, pursuant to Act of May 13, 2003, 78th Leg., R.S., ch. 182, § 7, 2003 Tex. Gen. Laws 267, 595 (amending the Texas Professional Corporation Act (Article 1528e, Vernon’s Texas Civil Statutes) by adding § 21).

31. Act of May 25, 1991, 72d Leg., R.S., ch. 901, § 48, 1991 Tex. Gen. Laws 3161, 3217 (amending § 5 of the Texas Professional Corporation Act (Article 1528e, Vernon’s Texas Civil Statutes)) (expired Jan. 1, 2010).

32. TEX. BUS. ORGS. CODE ANN. § 303.002(a) (West 2010).

33. *Id.* §§ 301.010(b), 303.002(b).

34. *Software Publishers Ass’n v. Scott & Scott, LLP*, No. 3:06-CV-0949-G, 2007 WL 92391, at *1 (N.D. Tex. Jan. 11, 2007).

35. *Id.* at *6.

36. *Id.*

37. *Id.*

allegation supported recovery under the theory that the managing partner was directly involved in the wrongful conduct or had knowledge of the wrongful conduct but failed to take reasonable steps to prevent it.³⁸ In the course of its discussion, the court commented that no limited liability partnership law in any state extends so far as to shield a partner from the partner's own wrongful conduct.³⁹

A few cases in other jurisdictions have addressed liability based on supervision or control.⁴⁰ A Connecticut court held that two partners in a three partner LLP law firm did not have liability for the third partner's wrongful acts toward a client where the two partners shared no benefit in the dealings of the third partner in question, did not have supervision or control over him, and did not know of the matter until after it occurred.⁴¹

IV. EXPIRATION OF PROTECTION AND OTHER TIMING ISSUES

To become an LLP, a partnership must file an application with the secretary of state containing specified information.⁴² The application must be executed by a majority-in-interest of the partners or by one or more partners authorized by a majority-in-interest of the partners, and it must be accompanied by a \$200 per-partner fee.⁴³ An initial application filed with the secretary of state expires one year after the date of registration unless it is timely renewed.⁴⁴ An effective registration may be renewed by filing a renewal application before the expiration of the prior registration.⁴⁵ The renewal application must be accompanied by a fee of \$200 per partner.⁴⁶

38. *Id.*

39. *Id.*

40. *See* *Kus v. Irving*, 736 A.2d 946 (Conn. Super. Ct. 1999); *see also* *Connolly v. Napoli, Kaiser & Bern, LLP*, 817 N.Y.S.2d 872 (N.Y. Sup. Ct. 2006) (refusing to dismiss claims against partners in an LLP because the allegations implicated partners in misconduct or supervision of the firm's operations, and the New York LLP statute provides for personal liability of partners for wrongful conduct committed by them or persons under their direct supervision and control); *Lewis v. Rosenfeld*, 138 F. Supp. 2d 466 (S.D.N.Y. 2001), *dismissed on other grounds on reconsideration*, 145 F. Supp. 2d 341 (S.D.N.Y. 2001) (acknowledging that partners in a New York LLP could not be held vicariously liable for liabilities of the partnership when the plaintiff had not alleged that any of the tortious acts were committed by the defendants or any individual acting under their control); *Schuman v. Gallet, Dreyer & Berkey, LLP*, 719 N.Y.S.2d 864 (N.Y. App. Div. 2001) (holding a general release of an LLP and its partners was sufficient to release the partner in his capacity as partner but did not release the partner from negligence, breach of fiduciary duty, and legal malpractice alleged against the partner individually because a partner is liable for any negligent or wrongful act committed by the partner or under the partner's supervision or control under the New York LLP provisions).

41. *See* *Kus*, 736 A.2d at 947.

42. *See* TEX. BUS. ORGS. CODE ANN. § 152.802 (West 2010).

43. *Id.* §§ 4.158(1), 152.802(b).

44. § 152.802(e).

45. § 152.802(g).

46. § 4.158(2).

The renewal application is effective for one year after the date the effective registration would otherwise expire.⁴⁷

The difference between the LLP registration procedure and the effect of filing a certificate of formation for a corporation, limited liability company, or limited partnership is obvious. The filing of a certificate of formation results in the formation of a corporation, limited liability company, or limited partnership, and the entity exists until affirmative action is taken to wind up and terminate the entity.⁴⁸ The liability protection provided the owners in these entities is inherent in their status as owners of the entity.⁴⁹ A general partnership is formed by two or more persons associating to carry on as co-owners a business for profit, and the partnership exists whether or not it complies with the LLP requirements.⁵⁰ That a partnership initially complies with the LLP requirements does not indefinitely imbue the partnership with the characteristics of an LLP. There is a risk that the LLP renewal will be overlooked, causing an interruption in the liability protection.⁵¹ If the registration expires without renewal, the partnership may register again, but the statute does not have a procedure for any retroactive cure or reinstatement if a partnership neglects to renew its registration.⁵²

As explained above, the underlying existence of the partnership is not affected by whether it is registered as an LLP, and the LLP shield may come and go during the life of a partnership, but a partnership must be an LLP at the time a debt or obligation is incurred for the liability limitations to apply.⁵³ Thus, becoming an LLP does not affect a partner's liability for a debt or obligation incurred prior to the partnership's registration as an LLP.⁵⁴ By the same token, if the registration is not timely renewed, the liability protection ceases and partners will have personal liability for liabilities incurred after the expiration of the registration.⁵⁵ When a debt or obligation is "incurred" for purposes of the LLP statute is thus a critical question.

If a partnership enters into a contract before the partnership registers as an LLP, but the partnership does not breach the contract until after the registration, are the partners protected from liability? Presumably not.

47. § 152.802(g).

48. *See id.* §§ 3.001(c), 11.102.

49. *See id.* §§ 21.223, 101.114, 153.101.

50. *Id.* §§ 152.051(b), 152.802(a), (e).

51. *See Apcar Inv. Partners VI, Ltd. v. Gaus*, 161 S.W.3d 137 (Tex. App.—Eastland 2005, no pet.) (holding partner personally liable on a lease executed by the partnership in its LLP name three years after failure to renew its initial LLP registration and rejecting "substantial compliance" argument based on the clear language of the LLP statute).

52. *See* TEX. BUS. ORGS. CODE ANN. § 152.802 (West 2010).

53. *Id.* § 152.801(a).

54. *See id.*

55. *See Apcar*, 161 S.W.3d at 140-41.

Although the debt or obligation may not be due or mature until a later time, the contractual debt or obligation certainly seems to be incurred at the time the partnership enters into the contract.⁵⁶

Conversely, if the partnership is an LLP when the partnership enters into a contract and its registration has expired at the time of the breach, the partners might persuasively argue that they are protected from liability.⁵⁷ That result would be consistent with the philosophy that is employed in the statutory provisions dealing with the personal liability of a person who is admitted into an existing partnership.⁵⁸ In such a case, the incoming partner is not liable for an obligation of the partnership that arises after the partner's admission if the obligation is pursuant to a contract entered into before the partner's admission.⁵⁹ Following that rationale, expiration of the LLP registration prior to entry of a judgment on the breach of contract would not expose the partners to liability if the registration was in effect (and the partnership was otherwise in compliance with the LLP provisions) at the time the partnership entered into the contract.⁶⁰

Similarly, the partners might expect that LLP status at the time tortious conduct occurs protects the partners from liability even though the expiration expires without renewal prior to the entry of a judgment against the partnership. Again, such a result would be consistent with the approach taken regarding the liability of a partner admitted into an existing partnership, where a partnership obligation relates to an action taken or omission occurring before the partner's admission into the partnership.⁶¹ Unfortunately, the only case to date analyzing the issue of when a partnership debt or obligation is incurred for purposes of the Texas LLP provisions presents some problematic implications.

Interpreting the LLP provisions of the Texas Revised Partnership Act, the Fifth Circuit Court of Appeals in *Evanston Insurance Co. v. Dillard Department Stores, Inc.* concluded that partners were personally liable on a judgment obtained by Dillard Department Stores (Dillard's) against the partnership for trademark infringement that occurred when the partnership was an LLP because the judgment was entered after the registration expired.⁶² While the Texas statute does not specify when a debt or obligation is incurred for purposes of the LLP provisions, commentary to the Revised Uniform Partnership Act, case law in other jurisdictions, and

56. Cf. TEX. BUS. ORGS. CODE ANN. § 152.304(b)(3) (West 2010) (stating that "a person who is admitted as a partner into an existing partnership does not have personal liability . . . for an obligation . . . [that] arises . . . under a contract or commitment entered into before the partner's admission).

57. See *id.*

58. See *id.*

59. *Id.*

60. See *id.*

61. See *id.* § 152.304(b)(2).

62. *Evanston Ins. Co. v. Dillard Dep't Stores, Inc.*, 602 F.3d 610, 616 (5th Cir. 2010).

other provisions of the Texas partnership statutes suggest that the determination would be made with reference to when a contract is entered into and when tortious conduct is committed, as opposed to when a breach of contract occurs or a judgment is entered.⁶³ In *Dillard Department Stores*, the court interpreted subsections (a)(1) and (a)(2) of § 3.08 of the Texas Revised Partnership Act (which have been recodified in § 152.801(a) and (b) of the TBOC) and stated that the underlying conduct that was the basis of the judgment only gave rise to the possibility of a future debt because the conduct may have gone undetected, may have been adjudged innocent, or the injured party may have opted not to sue.⁶⁴ According to the court, 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.⁶⁵

The ramifications of the court's analysis are troubling in a number of respects. For example, one obvious implication of the court's analysis is that a partnership may wait until after tortious conduct is committed to register as an LLP and thereby protect its partners from liability so long as a registration is in effect when a judgment is entered. Another implication is that a partner who withdraws from a partnership prior to entry of a judgment on a tort claim that accrued during the partner's tenure with the partnership would avoid liability. The discovery of tort liability within a partnership would then present the unseemly prospect that the partner who is the slowest to bail out is stuck with the liability; however, perhaps any remaining partners can register as an LLP prior to entry of the judgment and avoid liability under the court's reasoning.

Subsection (a)(2) of § 3.08 of the Texas Revised Partnership Act and its successor provision in subsection (b) of § 152.801 of the TBOC appear to support the interpretation that a debt or obligation arising out of tortious

63. See UNIF. P'SHIP ACT § 306 cmt. 3, 6 U.L.A. 1, 118-19 (2001) (stating that "[p]artnership obligations under or relating to a tort are generally incurred when the tort conduct occurs" so as to prevent a culpable partnership from engaging in wrongful conduct and then filing an LLP registration to sever vicarious liability of the partners from future injury or harm caused by conduct prior to filing); *Griffin v. Fowler*, 579 S.E.2d 848, 849 n.1 (Ga. Ct. App. 2003) (denying LLP partners' motion for summary judgment regarding liability for another partner's alleged malpractice and breach of fiduciary duty on the basis that there were legal services performed prior to the partnership's registration as an LLP); TEX. BUS. ORGS. CODE ANN. § 152.304(b) (West 2010) (providing that an incoming partner is not liable for a partnership obligation that relates to an act or omission occurring before the partner's admission or an obligation arising before or after the partner's admission under a contract or commitment entered into before the partner's admission); TEX. BUS. ORGS. CODE ANN. § 152.505 (West 2010) (providing in subsection (a) that "[w]ithdrawal of a partner does not by itself discharge the partner's liability for an obligation incurred before the date of withdrawal," implying in subsection (d) that a future obligation under an existing contract remains binding on the withdrawn partner, and presumably precluding partners from avoiding liability by withdrawal from a partnership discovering tortious conduct and prior to assertion or litigation of the claim).

64. See *Dillard Dep't Stores*, 602 F.3d at 615; see also TEX. BUS. ORGS. CODE ANN. § 152.801(a), (b) (West 2010).

65. *Dillard Dep't Stores*, 602 F.3d at 615-16.

conduct is incurred when the tort is committed inasmuch as these subsections are an exception to the general rule of liability protection for debts and obligations incurred while the partnership is an LLP set forth in subsection (a)(1) of § 3.08 and subsection (a) of § 152.801.⁶⁶ The exception applies (i.e., a partner who would otherwise be protected from liability for a debt or obligation incurred while the partnership is an LLP is nevertheless liable) in the case of a debt or obligation arising from an error, omission, negligence, incompetence, or malfeasance committed while the partnership is an LLP if the partner had the requisite supervisory role, involvement, or notice or knowledge with respect to the error, omission, negligence, incompetence, or malfeasance.⁶⁷ For this provision to be an exception to the rule that a partner is protected from liability for a debt or obligation incurred while the partnership is an LLP, the debt or obligation arising from an error, omission, negligence, incompetence, or malfeasance committed while the partnership is an LLP must be a debt or obligation incurred while the partnership is an LLP.⁶⁸

Neither party in the *Dillard Department Stores* case relied upon subsection (a)(2) of § 3.08 of the Texas Revised Partnership Act, but the court, rather than viewing “committed” as indicating when a tort obligation is “incurred,” found the difference in language supported its interpretation that the partnership debt was not “incurred” until the judgment was entered.⁶⁹ Instead of viewing the exception in subsection (a)(2) as an exception to the rule of *limited liability* in subsection (a)(1) and, as such, an explanation of when a tort debt or obligation is incurred, the court seemed to view it as an exception to the *personal liability* that a partner would have for a debt or obligation incurred (as the court interpreted “incurred”) while the partnership was *not* an LLP, thus seemingly turning subsection (a)(2) into a type of affirmative defense for a partner rather than a basis for liability notwithstanding the liability protection provided in subsection (a)(1).⁷⁰ Given that the two partners who were held liable were apparently the only partners of the law firm LLP involved in the case, it is likely that they indeed were supervising, directly involved, or had notice or knowledge of the fact that the law firm’s website (which was designed to solicit clients with racial discrimination claims against Dillard’s) contained the Dillard’s

66. See Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 113, 1997 Tex. Gen. Laws 1516, 1594-95 (amending § 3.08 of the Texas Revised Partnership Act (Article 6132b-3.08, Vernon’s Texas Civil Statutes)) (expired Jan. 1, 2010); TEX. BUS. ORGS. CODE ANN. § 152.801(a), (b) (West 2010).

67. See sources cited *supra* note 66.

68. See sources cited *supra* note 66.

69. *Dillard Dep’t Stores*, 602 F.3d at 615-16.

70. *Id.* at 616 (“[The legislature] chose, however, to use different language, and created a regime in which partners could be held individually liable for debts and obligations incurred when the partnership was not a registered LLP [TEX. REV. CIV. STAT. ANN. § 3.08(a)(1)], but in which partners would not bear liability for one another’s independent malfeasance committed while the LLP existed [TEX. REV. CIV. STAT. ANN. § 3.08(a)(2)].”).

mark (perhaps explaining why the partners did not draw attention to the interplay between subsections (a)(1) and (a)(2)).⁷¹ Unfortunately for the jurisprudence in this area, the partners' own involvement was not the basis on which they were held liable, and the court's analysis and holding lead to the thorny questions and potentially troubling scenarios discussed above.⁷²

The court's analysis of the course of the litigation and the statute of limitations in *Dillard Department Stores* also provides partners, whether in an LLP or a traditional partnership, reason to pause.⁷³ After rejecting the partners' argument that they were protected from liability under the LLP provisions of the Texas Revised Partnership Act, the court addressed the partners' argument that Dillard's was required to sue the partners in the suit against the partnership in order to hold them liable for the trademark infringement and tort claims.⁷⁴ The partners relied upon § 3.05 of the Texas Revised Partnership Act, which provides that a judgment against a partnership is not itself a judgment against the partners but permits a judgment to be entered against a partner who has been served in a suit against the partnership.⁷⁵ The court did not find this provision to be helpful to the partners because Dillard's did not rely on the judgment against the partnership "by itself."⁷⁶ Dillard's relied upon a judgment it obtained against the partners in a separate suit against them to enforce a pre-existing judgment against the partnership by holding the partners individually liable for the partnership's debt.⁷⁷ The court also distinguished *Kao Holdings, L.P. v. Young*, in which the Texas Supreme Court interpreted § 3.05 of the Texas Revised Partnership Act and held that its purpose was to make clear that a judgment against a partnership is not automatically a judgment against a partner and that a judgment cannot be entered against a partner who has not been served merely because a judgment has been entered against the partnership.⁷⁸ Here, the court pointed out, the partners were defendants in a separate action brought by Dillard's, which the partners lost after mounting a vigorous defense, and a judgment was not "automatically" entered against them.⁷⁹

71. *See id.* at 612.

72. *See supra* text accompanying notes 65-66.

73. *Dillard Dep't Stores*, 602 F.3d at 616-18.

74. *Id.* at 616-17.

75. *Id.* at 616 (citing TEX. REV. CIV. STAT. ANN. art. 6132b-3.05, which has been recodified at TEX. BUS. ORGS. CODE ANN. § 152.306 (West 2010)).

76. *Id.* at 616.

77. *Id.* at 616-17.

78. *Id.* (discussing *Kao Holdings, L.P. v. Young*, 261 S.W.3d 60 (Tex. 2008)).

79. *Id.* at 617. There are several Texas cases supporting the notion that partners may be sued in a subsequent action after a judgment has been entered against the partnership and that the partners will be unable to relitigate the merits of the underlying claim against the partnership. *See In re Jones*, 161 B.R. 180, 184 (Bankr. N.D. Tex. 1993) (holding that partners were barred by res judicata principles from relitigating the partnership's liability for which they were liable under partnership law); *Edward B. Elmer, M.D., P.A. v. Santa Fe Props., Inc.*, No. 04-05-00821-CV, 2006 WL 3612359 (Tex. App.—San

Finally, the partners in *Dillard Department Stores* argued that the action against them was barred by the statute of limitations because the claims against them were the same as the claims against the partnership, i.e., claims based on tort and trademark infringement.⁸⁰ Dillard's argued, however, that its action was one for debt, i.e., to enforce the judgment against the partners based on their statutory joint and several liability.⁸¹ The court agreed with Dillard's, relying on a bankruptcy court decision predating the Texas Revised Partnership Act (but applying the entity theory of partnerships) in which the trustee first obtained a judgment against a partnership and then sought to enforce the judgment against the partners simply by virtue of their status as partners.⁸² The court quoted the bankruptcy court for the proposition that a party can either sue the partners along with the partnership so that a judgment can be entered against the partners when liability against the partnership is established, or a party can sue the partnership and bring a subsequent suit against the partners on their liability for the partnership's obligation after liability of the partnership is established.⁸³ Dillard's chose the latter course of action, and the court stated that Dillard's was thus seeking to impose liability on the partners for partnership debt by operation of law.⁸⁴

The court concluded that the applicable statute of limitations was the four-year statute of limitations for suit on a debt and that it began to accrue, at the earliest, upon entry of the judgment against the partnership on November 2, 2004.⁸⁵ The suit against the partners was brought January 10, 2008, and the action thus was not time-barred.⁸⁶ It is interesting to ponder whether an attempt to hold a partner of an LLP liable on the basis of the partner's supervision of, direct involvement in, or notice or knowledge of a tortious act would constitute direct liability of the partner, which seemingly should be asserted within the statute of limitations applicable to the underlying tort claim, or is a type of vicarious liability that can be asserted in a subsequent suit on a judgment against an LLP based on the tort.

Antonio Dec. 13, 2006, no pet.) (mem. op., not designated for publication) (commenting that partnership creditors can use offensive collateral estoppel in a subsequent suit against a partner who was not part of the original proceeding to prevent a partner from relitigating liability issues previously determined in the creditor's favor); cf. *Carlyle Joint Venture v. H.B. Zachry Co.*, 802 S.W.2d 814 (Tex. App.—San Antonio 1990, writ denied) (holding that summary judgment against a partner based on a prior arbitration proceeding against the partnership was appropriate even though the partner did not participate in the prior proceeding).

80. *Dillard Dep't Stores*, 602 F.3d at 617.

81. *Id.*

82. *Id.* at 617-18 (citing *In re Jones*, 161 B.R. at 183).

83. *Id.* (quoting *In re Jones*, 161 B.R. at 183-84).

84. *Id.* at 617.

85. *Id.*

86. *Id.*

V. INSURANCE OR FINANCIAL RESPONSIBILITY

Although common in the first generation of LLP statutes, insurance requirements have been dropped from most LLP statutes.⁸⁷ The Texas LLP provisions still include an insurance requirement.⁸⁸ An LLP must carry at least \$100,000 of liability insurance designed to cover the kind of error, omission, negligence, incompetence, or malfeasance for which liability is limited or, in lieu of carrying such insurance, provide \$100,000 of funds specifically designated and segregated for the satisfaction of judgments against the partnership.⁸⁹ Such funds may be in cash, certificates of deposit, or U.S. treasury obligations deposited in trust or in bank escrow or may be represented by a bank letter of credit or insurance company bond.⁹⁰

To the extent an LLP's insurance generally covers the types of tort-type liabilities for which partners' personal liability is limited, the LLP liability protection should be available notwithstanding certain standard exclusions in the policy's coverage.⁹¹ As noted below, however, a plaintiff might make an issue of policy exclusions, deductibles, etc. in an attempt to attack the liability protection.⁹² In this regard, it might be advantageous to establish segregated funds or obtain a letter of credit to avoid some of these issues.

One Texas court of appeals 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.⁹³ The plaintiff sued the partnership and its two partners for breach of a commercial lease.⁹⁴ The plaintiff obtained a judgment against the partnership, and that judgment was severed and became final.⁹⁵ After the plaintiff was not able to collect the judgment from the partnership, the plaintiff obtained a summary judgment against one of the partners.⁹⁶ 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.⁹⁷

87. See BROMBERG & RIBSTEIN, *supra* note 5, § 2.06(a), at 64-66.

88. TEX. BUS. ORGS. CODE ANN. § 152.804(a) (West 2010).

89. *Id.*

90. *Id.*

91. See TEX. REV. CIV. STAT. ANN. art. 6132b, § 45-C, cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999) (stating that actual coverage of the misconduct which occurs is not an absolute necessity).

92. See *infra* notes 104-06 and accompanying text.

93. Elmer, M.D., P.A. v. Santa Fe Props., Inc., No. 04-05-00821-CV, 2006 WL 3612359, at *2 (Tex. App.—San Antonio Dec. 13, 2006, no pet.) (mem. op., not designated for publication).

94. *Id.* at *1.

95. *Id.*

96. *Id.*

97. *Id.*

The court held that the partner was not protected from individual liability because the partnership was not a properly registered limited liability partnership under the Texas Revised Partnership Act at the time it incurred the lease obligations.⁹⁸ As is the case under current law, the LLP provisions of the Texas Revised Partnership Act required that an LLP carry insurance or meet certain financial responsibility requirements.⁹⁹ The court noted that, in contrast to the limited partnership statute at the time, the LLP provisions contain no substantial compliance language.¹⁰⁰ Therefore, the court concluded that strict compliance with the statute is required.¹⁰¹ Although the partner itself carried errors and omissions insurance, the court pointed out that the policy did not appear to cover the partnership or the other partner.¹⁰² 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.¹⁰³

Numerous issues might be raised in connection with the application of the insurance provisions of the LLP provisions. For example, has an LLP complied with the insurance requirement if it has a \$100,000 policy with a \$1,000,000 deductible? What about a \$10,000,000 deductible? Or a \$50,000,000 deductible?¹⁰⁴ How does exhaustion of policy limits by one claim affect the partners' liability protection on a subsequent claim?¹⁰⁵ How does the nature of a policy as a "claims made" policy versus an "occurrence" policy factor into the analysis of compliance with the insurance requirement at any given point in time? How does the failure to have a general liability policy (i.e., covering injuries on the law firm's premises or car accidents involving law firm runners) factor into compliance with the insurance requirement?¹⁰⁶ How long must an LLP that

98. *Id.*

99. *Id.* at *1-2; *see also* TEX. BUS. ORGS. CODE ANN. § 152.804 (West 2010).

100. *Elmer*, 2006 WL 3612359, at *2.

101. *Id.*

102. *Id.*

103. *Id.*

104. Professor Bromberg's commentary to the original LLP provisions states that "[t]he \$100,000 figure refers to the liability limit of the insurance, above and beyond any deductibles, retentions or similar matters." TEX. REV. CIV. STAT. ANN. art. 6132b, § 45-C cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999). Obviously, however, there is a point at which a court might view a policy that literally provides \$100,000 in liability coverage as failing to comply with the intent and spirit of the statute if, based on other terms of the policy, it is unlikely ever to provide a source of recovery. *Cf. id.* (stating that "[t]he insurance requirement is intended to provide some source of recovery as a substitute for the assets of partners who are shielded from liability by § 15(2)").

105. *See id.* ("The statute is not explicit about the effect on one claim of exhaustion of the policy limits by a prior claim Renewal or replacement of policies on their periodic expirations is probably enough to satisfy § 45-C.")

106. *See* TEX. BUS. ORGS. CODE ANN. § 152.804 (West 2010). An LLP is required to carry insurance (or satisfy the provisions regarding alternate means of financial responsibility) "of a kind that is designed to cover the kind of error, omission, negligence, incompetence, or malfeasance for which

winds up its business carry insurance for its partners to be protected on claims brought after the business has ceased?¹⁰⁷

VI. NAME

An LLP's name must contain an appropriate designator, such as the abbreviation "LLP."¹⁰⁸ The TBOC requires the name of an LLP to contain the phrase "limited liability partnership" or an abbreviation of the phrase.¹⁰⁹ The secretary of state will not accept the partnership's LLP application for filing unless the name complies with this requirement; therefore, the public record will reflect a name in compliance with the statute.¹¹⁰ An LLP that is careless about the use of the designator in its dealings with third parties, however, might find that a plaintiff makes an issue of it.¹¹¹ A failure to use the designator in a business transaction might result in personal liability of the partner or other agent transacting the business under agency principles regarding a contract entered into on behalf of a partially disclosed principal.¹¹² The extent to which an LLP jeopardizes its actual status as an LLP by failing to consistently identify itself as an LLP is unclear.¹¹³ Presumably, an LLP may use an assumed or trade name that does not

liability is limited." *Id.* Thus, § 152.804 suggests that malpractice insurance coverage is required, but it is certainly arguable that compliance requires other types of foreseeable negligence or malfeasance to be insured as well. *See id.*

107. *See infra* notes 142-45 and accompanying text. For that matter, should a partnership continue to renew its LLP registration, thus necessitating the filing of franchise tax reports, after it has wound up and ceased to carry on its business if there is any possibility that a claim against the partnership might be asserted? Who will be responsible for such administrative matters? *See infra* notes 142-61 and accompanying text.

108. *See* TEX. BUS. ORGS. CODE ANN. § 5.063 (West 2010).

109. *Id.* §§ 5.063, 152.803.

110. *See Business and Nonprofit Forms, Form 701—Limited Liability Partnership Application*, TEXAS SECRETARY OF STATE (2010), http://www.sos.state.tx.us/corp/forms_boc.shtml.

111. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 45-B cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999) (characterizing the inclusion of the LLP designator in the partnership name as "one of three requirements a partnership must satisfy in order to have the liability shield" and stating that the requirement is "intended to signal to persons dealing with the partnership that the liability shield may be in effect"). For criticism of the view that inclusion of the initials "LLP" in the law firm name is sufficient to place "clients on notice that their lawyer is practicing in a particular business form, and encourages them to inquire if they are in doubt as to its implications for them" see Fortney, *Professional Responsibility*, *supra* note 25, at 412-19.

112. *See, e.g.,* Burch v. Babcock, 56 S.W.3d 257, 261-62 (Tex. App.—Tyler 2001, no pet.); Wynne v. Adcock Pipe & Supply, 761 S.W.2d 67, 69 (Tex. App.—San Antonio 1988, writ denied); Lachmann v. Houston Chronicle Publ'g Co., 375 S.W.2d 783, 785 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.); *see also* Elizabeth S. Miller, *Agents Take Heed: The Perils of Identifying a Principal by Its Trade Name*, 60 TEX. B.J. 540, 542-43 (1997); Elizabeth S. Miller, *Agents Take Heed: A Principal by Any Other Name is Not a Disclosed Principal*, 13 CORP. COUNSEL REV. 281 (1994).

113. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 45-B cmt. (West Supp. 2009) (Source and Comments by Alan R. Bromberg—1991 Amendments) (expired Jan. 1, 1999) ("Registered limited liability partnerships should be careful to use the initials wherever the name is used, e.g., on directory listings, signs, letterheads, business cards and other documents.").

include the designator without automatically exposing its owners to liability.¹¹⁴

VII. BACK DOORS AND END-AROUNDS: BUY-OUT, CONTRIBUTION, AND INDEMNIFICATION OBLIGATIONS IN THE PARTNERSHIP AGREEMENT

In 1997, when the LLP provisions were amended to broaden the scope of liability protection beyond tort liability, language was added to make clear that partners were protected from indirect vicarious liability by way of contribution or indemnity.¹¹⁵ Various other provisions of the Texas Revised Partnership Act were also amended to be consistent with the liability protection provided by the LLP provisions.¹¹⁶ Consistent with the statutory scheme, one Texas court of appeals in an unpublished decision rejected a partner's attempt to hold his co-partner liable for half of the LLP's overhead and expenses, noting that partners in a registered limited liability partnership ordinarily have no personal liability for the debts and obligations of the partnership and concluding there was no evidence the partners agreed to be personally liable for the expenses and overhead of the partnership as opposed to merely having their partnership interests equally burdened by the financial obligations of the partnership.¹¹⁷

In 2009, the TBOC was further amended to confirm that partners are protected with respect to partnership liabilities owed to other partners as well as to third parties.¹¹⁸ This amendment was prompted by *Ederer v.*

114. See *Chamberlain v. Irving*, No. 4001394, 2006 WL 3290446, at *3 (Conn. Super. Ct. Oct. 26, 2006) (stating that partners in an LLP have limited liability even if the designator is not used and the third party does not know the partnership is an LLP).

115. Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 113, 1997 Tex. Gen. Laws 1516, 1594-95 (amending § 3.08 of the Texas Revised Partnership Act) (Article 6132b-3.08, Vernon's Texas Civil Statutes) (expired Jan. 1, 2010) (recodified in TEX. BUS. ORGS. CODE ANN. § 152.801(a), (f) (West 2010)).

116. See Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 107, 1997 Tex. Gen. Laws 1516, 1592-93 (amending § 1.03 of the Texas Revised Partnership Act (Article 6132b-1.03, Vernon's Texas Civil Statutes) (expired Jan. 1, 2010) (clarifying that an election by a partnership to become an LLP was not precluded by the provision prohibiting the partnership agreement from restricting rights of third parties under the Act) (recodified in TEX. BUS. ORGS. CODE ANN. § 152.002(b)(7) (West 2010)); Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 112, 1997 Tex. Gen. Laws 1516, 1594 (amending § 3.05 of the Texas Revised Partnership Act (Article 6132b-3.05, Vernon's Texas Civil Statutes) (expired Jan. 1, 2010) (clarifying that the provisions regarding enforcement of liabilities against the partnership and the partners did not limit the effect of an LLP registration) (recodified in TEX. BUS. ORGS. CODE ANN. § 152.306(d) (West 2010)); Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 118, 1997 Tex. Gen. Laws 1516, 1596-97 (amending § 8.06 of the Texas Revised Partnership Act (Article 6132b-8.06, Vernon's Texas Civil Statutes) (expired Jan. 1, 2010) (clarifying that contribution obligations on winding up were not applicable with respect to obligations incurred while the partnership is an LLP) (recodified in TEX. BUS. ORGS. CODE ANN. §§ 152.707(d), 152.708(a) (West 2010)).

117. *Bennett v. Cochran*, No. 14-00-01160-CV, 2004 WL 852298, at *2-4 (Tex. App.—Houston [14th Dist.] Apr. 22, 2004, no pet.) (not designated for publication).

118. See Act of May 11, 2009, 81st Leg., R.S., ch. 84, § 47, 2009 Tex. Gen. Laws 128, 145 (current version at TEX. BUS. ORGS. CODE ANN. § 152.801(a) (West 2010)).

Gursky, in which New York's highest court held that the New York LLP statute does not protect partners from liability to another partner on a claim against the partnership.¹¹⁹ In *Ederer*, a withdrawn partner sued the partnership and its partners for breach of contract and an accounting of funds owed the withdrawn partner under a withdrawal agreement between the partner and the partnership.¹²⁰ The partners claimed that they did not have personal liability because the partnership was an LLP, but the court concluded that the New York LLP shield only applies to debts and liabilities to third parties and does not protect partners from liability for obligations of the partnership to other partners.¹²¹

The court in *Ederer* reviewed the background and history of the LLP legislation, including the enactment of the first LLP statute in Texas, and rejected the defendants' argument that the statutory protection from liability for "any debts" applies to debts of the partnership to the partners as well as debts to third parties.¹²² The court concluded that the liability protection under the LLP provisions is restricted to liability to third parties because the phrase "any debts" is part of a provision that has always governed only a partner's liability to third parties and is part of Article 3 of the New York Uniform Partnership Act ("Relations of Partners to Persons Dealing with the Partnership") rather than Article 4 ("Relations of Partners to One Another").¹²³ The court also rejected the defendants' arguments reconciling the right to an accounting in a winding up with their interpretation of the LLP provisions.¹²⁴ Two judges dissented, arguing that a former partner is a third party where a partnership is concerned and that there is no good reason to treat such a person more favorably than any other third party.¹²⁵ The dissenting opinion also described how the majority's approach could favor withdrawn partners over other third parties and thus lead to "perverse results."¹²⁶

Although many felt that the Texas statute already provided partners with liability protection from debts and obligations of the partnership to other partners as well as third parties, the Texas statute was clarified in 2009 in light of the *Ederer* decision to remove any doubt.¹²⁷ As amended, the statute reads:

119. *Ederer v. Gursky*, 881 N.E.2d 204, 205 (N.Y. 2007).

120. *Id.* at 206-07.

121. *Id.* at 208-12.

122. *Id.*

123. *Id.* at 211.

124. *Id.* at 211-12.

125. *Id.* at 212-13.

126. *Id.* at 213.

127. See Act of May 11, 2009, 81st Leg., R.S., ch. 84, § 47, 2009 Tex. Gen. Laws 128, 145 (current version at TEX. BUS. ORGS. CODE ANN. § 152.801 (West 2010)).

Except as provided by Subsection (b) or the partnership agreement, a partner in a limited liability partnership is not personally liable to any person, *including a partner*, directly or indirectly, by contribution, indemnity, or otherwise, for a debt or obligation of the partnership incurred while the partnership is a limited liability partnership.¹²⁸

Because the partners have the freedom in the partnership agreement to waive their liability protection (as to both third parties and other partners), special attention should be paid to provisions of the partnership agreement that might constitute an agreement waiving or varying the statutory protection from liability.¹²⁹ Contribution, indemnity, and buy-out obligations imposed under the partnership agreement of an LLP should be carefully reviewed to ensure that unintended holes in the liability shield are not created by the agreement.

The typical partnership agreement is made “by and among” the partners, who are signatories to the agreement.¹³⁰ If the partnership agreement provides for a buy-out of a withdrawing partner, the agreement should be clear that the buy-out obligation is the obligation of the partnership only and not the other partners. Provisions of the partnership agreement that provide for reimbursement and indemnification of a partner for liabilities incurred by the partner in the course of partnership business should be expressed in terms that make clear the indemnification obligation is that of the partnership only unless otherwise intended by the partners. With respect to some types of liabilities, e.g., where partners have been required to guarantee partnership debt, the partners may want to have an agreement regarding indemnification and proportionate responsibility that imposes liability on the partners in addition to the partnership.¹³¹ Additionally, partners who bear greater risk of personal liability by virtue of supervisory responsibilities may wish to negotiate for provisions that obligate the other partners to contribute to the partnership or indemnify the supervising partner directly, in the event the partnership’s assets are insufficient to satisfy an indemnification obligation to the supervising partner.¹³²

Presumably, a partnership agreement of an LLP would not contain provisions generally requiring a partner to contribute to the partnership with

128. TEX. BUS. ORGS. CODE ANN. § 152.801(a) (West 2010) (emphasis added).

129. See Subcomm. on Prototype L.L.P. Agreement, Am. Bar Ass’n, *Prototype Partnership Agreement for a Limited Liability Partnership Formed Under the Uniform Partnership Act (1997)*, 58 BUS. LAW. 689, 715-18 (2003); Keatinge, Donn, Coleman & Hester, *supra* note 6, at 193-96.

130. See, e.g., Subcomm. on Prototype L.L.P. Agreement, *supra* note 129, at 701.

131. See, e.g., *id.* at 715-16.

132. See Jennifer J. Johnson, *The Oregon Limited Liability Partnership Act*, 32 WILLAMETTE L. REV. 147, 172 (1996) (suggesting that partners in an LLP may be unwilling to assume supervisory responsibility without provisions in the partnership agreement requiring both indemnification by the firm and contribution by each partner).

respect to liabilities, losses, or a negative capital account, as such provisions could partially or completely gut the protection provided by the LLP shield.¹³³ Careful review of the partnership agreement in this regard, however, is merited. Particularly in cases where an LLP election is made by a partnership that has been operating without the LLP feature, the partnership agreement may have been drafted without these issues in mind. Under the Revised Uniform Partnership Act, an LLP registration automatically negates pre-existing contribution provisions in the partnership agreement (though the partners may thereafter amend the partnership agreement to reestablish contribution obligations).¹³⁴ The Texas statute does not have such a provision, but it might be argued in a typical case that the election to become an LLP reflected an intent to eliminate contribution provisions and constituted an oral amendment of the partnership agreement to do so.

VIII. COMPARATIVE COST OF LLP VERSUS PROFESSIONAL LIMITED LIABILITY COMPANY OR PROFESSIONAL CORPORATION

Prior to 2008, partnerships were not subject to the Texas franchise tax, whereas corporations and limited liability companies (LLCs) were subject to the tax.¹³⁵ The LLP thus provided a state tax advantage over a corporation or LLC if the business generated more than \$150,000 in annual gross receipts, the threshold under the old franchise tax for exemption from the tax.¹³⁶ After the Texas Legislature overhauled the franchise tax in a third called special session in 2006, law firms that previously avoided the franchise tax by operating as LLPs found themselves subject to the revised franchise tax (also known as the “margin tax”).¹³⁷ Thus, a law firm is subject to the current Texas franchise tax whether it is operating as an LLP, professional LLC (PLLC), or professional corporation (PC).¹³⁸

In addition to being subject to the franchise tax, the LLP faces another “tax” in the form of the annual filing fee associated with maintenance of the

133. *See id.* at 172-73.

134. UNIF. P'SHIP ACT § 306(c), 6 U.L.A. 1, 117 (2001); *see also id.*, prefatory note, addendum cmt. 3, at 8.

135. Act of June 2, 2003, 78th Leg., R.S., ch. 209, §§ 31-32, 2003 Tex. Gen. Laws 979, 987, *amended by* Act of May 2, 2006, 79th Leg., 3d C.S., ch. 1, § 2, 2006 Tex. Gen. Laws 1, 1-7 (amending § 171.001 of the Texas Tax Code, which, prior to amendment, imposed a franchise tax on each corporation and each limited liability company chartered or doing business in Texas) (current version at TEX. TAX CODE ANN. § 171.001(a) (West 2008)).

136. Act of May 30, 1999, 76th Leg., R.S., ch. 394, § 10, 1999 Tex. Gen. Laws 2451, 2454-55, *amended by* Act of May 2, 2006, 79th Leg., 3d C.S., ch. 1, § 2, 2006 Tex. Gen. Laws 1, 1-7 (current version at TEX. TAX CODE ANN. § 171.002(d)(2) (West 2008)).

137. *See* TEX. TAX CODE ANN. §§ 171.0002(a), 171.001(a) (West 2008) (as amended by Act of May 2, 2006, 79th Leg., 3d C.S., ch. 1, § 2, 2006 Tex. Gen. Laws 1, 1-7).

138. *Id.* § 171.0002(a).

LLP status.¹³⁹ PLLCs and PCs pay a one-time \$300 fee to the secretary of state at the time of formation, and they maintain their status as PLLCs or PCs until a voluntary or involuntary winding up; there is no annual renewal requirement or automatic cessation of their status without notice to the entity.¹⁴⁰ An LLP, however, pays a filing fee of \$200 per partner at the time of the initial registration with the secretary of state and must renew its registration, at a cost of \$200 per partner, on an annual basis.¹⁴¹ Thus, to obtain and maintain LLP status over a ten-year period, a firm with twenty-five partners pays filing fees of \$50,000, versus the one-time initial filing fee of \$300 associated with becoming and operating during that time as a PLLC or PC.

IX. WINDING UP ISSUES IN LLP VERSUS PROFESSIONAL LIMITED LIABILITY COMPANY OR PROFESSIONAL CORPORATION

An LLP facing winding up encounters some thorny questions. How long should the partnership continue to renew its registration and maintain insurance? Presumably, the partners will want to maintain the partnership's LLP status until the winding up is completed, but it is sometimes hard to ascertain when winding up is completed. If litigation is pending against an LLP, an abundance of caution would dictate that the partnership maintain its LLP status until the completion of the litigation, especially in view of the *Dillard Department Stores* decision.¹⁴² Of course, maintaining the LLP registration in effect means that the LLP may have to file reports with the comptroller even if there is no longer any revenue to subject the LLP to tax liability.¹⁴³

Even after the business activities have been completely wound up, all known liabilities and claims satisfied, and any remaining assets distributed, there remains the possibility that someone may assert a claim against the partnership. Is there still a partnership that can be sued? If the partnership has allowed its LLP registration and insurance to lapse, must it re-register and obtain insurance prior to entry of a judgment for its partners to be protected from liability? *Dillard Department Stores* would suggest so, at least in the case of a tort claim.¹⁴⁴ And what about a two-person partnership where one partner has died or otherwise withdrawn and the remaining partner is conducting the winding up? Is there a "partnership" that can continue to be registered as an LLP?¹⁴⁵

139. TEX. BUS. ORGS. CODE ANN. §§ 4.158(1)-(2), 152.802(a), (e), (g) (West 2010).

140. *Id.* §§ 3.001(c), 4.152(1), 4.154, 4.157, 11.102.

141. *Id.* §§ 4.158(1)-(2), 152.802(a), (e), (g).

142. *See supra* notes 62-65 and accompanying text.

143. TEX. TAX CODE ANN. § 171.204 (West 2008).

144. *See supra* notes 62-65 and accompanying text.

145. *See* TEX. BUS. ORGS. CODE ANN. § 152.051(b) (West 2010) ("[A]n association of two or more persons to carry on a business for profit as owners creates a partnership"); *id.* § 152.056 ("A

In the case of a PLLC or PC, the phases of winding up and termination are more well-defined than in the case of a general partnership. After a decision by its owners to wind up, the PLLC or PC winds up the business and files a certificate of termination with the secretary of state.¹⁴⁶ The filing of a certificate of termination terminates the existence of the PLLC or PC subject to a three-year survival period during which the entity continues to exist for limited purposes.¹⁴⁷ After the filing of a certificate of termination, the PLLC or PC is only liable for an “existing claim” that is brought within the three-year survival period.¹⁴⁸ An existing claim is: (1) a claim that existed prior to the filing of the certificate of termination and is not barred by limitations, or (2) a contractual obligation incurred after termination.¹⁴⁹ There is not ordinarily a basis to hold the owners of the PLLC or PC liable on a claim against the terminated entity, even assuming the claim is an existing claim.¹⁵⁰ If an action on an existing claim is not brought before the expiration of the three-year survival period, the claim is extinguished.¹⁵¹ There are also provisions available to a PLLC or PC for an expedited claims resolution process.¹⁵² Overall, the winding up and termination provisions applicable to PLLCs and PCs appear to provide more certainty and finality than one finds in the LLP context.

The fact that an LLP shield may not be in effect during the entire life of the partnership presents the possibility for strategic payment of liabilities in ways that may disadvantage certain creditors. For instance, assume that an LLP is winding up and does not have sufficient assets to satisfy all its liabilities. Further, assume that there are some liabilities that were incurred before the partnership became an LLP (pre-LLP liabilities) and some that were incurred after the partnership became an LLP (post-LLP liabilities). If the partnership applies the partnership assets to discharge the pre-LLP liabilities and no assets remain to pay the post-LLP liabilities, the unpaid post-LLP creditors are generally precluded from recovering against the partners because the LLP shield protects the partners.¹⁵³ If the assets had

partnership is an entity distinct from its partners.”); *id.* § 152.701(1) (stating that a partnership continues after an event requiring winding up “until the winding up of its business is completed, at which time the partnership is terminated”).

146. *See id.* §§ 11.052, 11.101(a).

147. *See id.* §§ 11.102, 11.356.

148. *See id.* §§ 11.351, 11.359.

149. *See id.* § 11.001(3).

150. *See id.* §§ 101.114, 303.002(b). Potential liability for a fraudulent transfer may exist if the assets of the entity were distributed to the owners, rendering the entity unable to satisfy the liability owed the claimant. *See* TEX. BUS. & COM. CODE ANN. § 24.006(a) (West 2009).

151. *See* TEX. BUS. ORGS. CODE ANN. § 11.052(a)(2) (West 2010). The survival period may be extended with respect to a “known claimant” if the required statutory notice of winding up is not provided to the claimant. *See Martin v. Texas Woman’s Hosp., Inc.*, 930 S.W.2d 717 (Tex. App.—Houston [1st Dist.] 1996, no writ) (en banc).

152. *See* TEX. BUS. ORGS. CODE ANN. § 11.358 (West 2010).

153. *Id.* § 152.801(a).

been applied to discharge the post-LLP liabilities instead, a pre-LLP creditor would still be able to hold the partners personally liable.¹⁵⁴ Is there any duty owed to creditors in this situation? Outside of preference arguments that might be available in the bankruptcy context, the unpaid, post-LLP creditor does not appear to have any explicit remedy.

Under provisions based on the corporate dissolution provisions of the Texas Business Corporation Act that now apply to partnerships by virtue of their placement in Chapter 11 of the TBOC, an entity that is winding up is charged with applying its property to the discharge of its liabilities in a “just and equitable” manner when the property is insufficient to discharge all of the entity’s liabilities.¹⁵⁵ Conceivably, a creditor that perceives it has been treated unfairly might try to assert a claim under this language.¹⁵⁶ The Texas Supreme Court has commented in dicta that the “just and equitable” standard in the dissolution provisions of the Texas Business Corporation Act (on which the current TBOC provision in Chapter 11 is based) may provide more flexibility than the pro rata standard that was imposed under corporate law prior to the adoption of the Texas Business Corporation Act.¹⁵⁷

The potential liability of some partners based on their supervision of, involvement in, or notice or knowledge of an error, omission, negligence, incompetence, or malfeasance may present incentives to apply the property in a manner that disadvantages certain partners or creditors if the partnership does not have sufficient assets to satisfy all its liabilities.¹⁵⁸ Assuming there is a large claim against the partnership (exceeding its insurance coverage) based on malpractice for which a partner may be found liable because of the partner’s supervisory role or other relationship to the matter, it is obviously in that partner’s interest for the firm to apply the property to satisfy this liability, although the other creditors, whose recourse is limited to partnership assets, will be left with no other source of payment. Do the partners have any duty to their fellow partner who is facing personal liability to apply the property of the partnership in a manner that protects that partner? Or, conversely, do the partners owe any duty to creditors who have no recourse beyond partnership assets to satisfy their claims first? Beyond the standard of a “just and equitable” discharge, the

154. *Id.* § 152.304(a).

155. *See id.* § 11.053(b)(1) (derived from Article 6.04A(3) of the Texas Business Corporation Act, as indicated by the source law set forth following § 11.053 in the Revisor’s Report to the Business Organizations Code, *available at* <http://www.texasbusinesslaw.org/committees/business-organizations-code/revisors-report-on-the-business-organizations-code> and http://www.tlc.state.tx.us/legal/bocode/bo_revisors_report.html).

156. *See id.* Such a claim would raise difficult questions as to the applicability of the corporate trust fund doctrine, the extent to which a creditor has standing to assert such a claim, what type of remedy is available, and against whom a remedy is recoverable.

157. *Henry I. Siegel Co., Inc. v. Holliday*, 663 S.W.2d 824, 826-27 n.1 (Tex. 1984).

158. *See* TEX. BUS. ORGS. CODE ANN. § 152.801(b) (West 2010).

TBOC provides no answers.¹⁵⁹ In the final analysis, the scenario may boil down to a race to the courthouse by the creditors.

X. CONCLUSION

From its inception in 1991 until relatively recently, the LLP enjoyed a state tax advantage over PLLCs and PCs that generally made it the preferred choice of entity for a law firm in Texas.¹⁶⁰ Today, an LLP pays more to the State of Texas for the privilege of providing owners liability protection than a PLLC or PC because it has the cost of its annual LLP renewal in addition to franchise tax liability.¹⁶¹ Partnership tax treatment for federal income tax purposes, which is not available to a PC, may be desirable, but a PLLC has the same tax classification options as an LLP for federal income tax purposes: Subchapter K (partnership), Subchapter C (C corporation), or Subchapter S (S corporation).¹⁶² Because of these changes, it is time for firms that are structured as LLPs to take a look at the differences between an LLP and a PLLC and reconsider their form of business. Questions and risks associated with the requirements for LLP status and the scope of the liability shield, along with the additional annual cost associated with the LLP renewal requirement, may be enough to prompt a firm to undertake a conversion of its partnership to a PLLC.

159. *See id.* § 11.053(b)(1).

160. *See supra* notes 135-36 and accompanying text.

161. *See supra* notes 139-41 and accompanying text.

162. *See* 26 C.F.R. § 301.7701-3 (2010).