LIMITED LIABILITY PARTNERSHIPS: AN (OVERLOOKED) HOLE IN THE SHIELD

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ABSTRACT

There is a split of judicial authority on whether limited liability applies when the creditor is a partner of a limited liability partnership. The New York Court of Appeals narrowly interpreted the partnership statute and denied the applicability, but the California Court of Appeals upheld it. The difference has been overlooked by the legal and business communities. This paper shows that the narrow interpretation is inconsistent with the legislative intent, laden with procedural obstacles in enforcement, and inharmonious with settled legal doctrines and tenets of law-making.

I INTRODUCTION

Limited liability partnership (LLP) is a popular form of business association for licensed professionals such as lawyers, accountants, architects, and doctors.[1] At least eighty-five percent of the top 350 law firms in the U.S. are formed as LLPs, and the rest are mostly professional corporations or professional associations.[2] The fundamental attribute of these business forms is limited liability that purportedly shields the personal assets of the owners from the reach of the creditors of the business entities.

The first LLP legislation was born in 1991 in Texas, shortly after the savings and loan crisis in which more than 1,000 such institutions failed due their imprudence in lending and the resulting vulnerability to surging inflation.[3] A deluge of lawsuits were filed against law firms and their partners who allegedly helped the thrift institutions circumvent lending limits and other regulations designed to prevent excessive risk-taking.[4] The

1. *See* Ronald E. Mallen, LEGAL MALPRACTICE § 5:24 (2020 ed. 2020) ("The limited liability partnership ('LLP') is the newest form of a law firm business structure and is now recognized in every state. The LLP has become the entity of choice, as statutes and court rules have extended its availability."). *See also Why Choose a Limited Liability Partnership (LLP)?*, NOLO, https://www.nolo.com/legal-encyclopedia/why-choose-limited-liability-partnership-llp.html [https://perma.cc/KU7K-KR9K] (last visited Feb. 26, 2020).

2. *See America's 350 Largest Law Firms*, PUBLICLEGAL (July 2019), https://www.ilrg.com/nlj250? [https://perma.cc/8MC7-7F7P] (observing that almost all of the first largest 100 law firms have LLP attached to their names. The report does not show organization types for law firms that rank above 100. We randomly selected fifty of these firms and manually checked their organization forms. We found that at least eightyfive percent of the firms are LLPs.).

3. *See The S&L Crisis, A Chrono-Bibliography*, FDIC (Dec. 20, 2002), https://www.fdic.gov/bank/historical/sandl/ [https://perma.cc/N5HK-6B7W].

4. *See* Harris Weinstein, A*ttorney Liability in the Savings and Loan Crisis*, 1993 U. Ill. L. Rev. 53 (1993). *See also* Linda P. Campbell, *U.S. Suing Lawyers to Recoup S&L Losses,* CHI. TRIB. (Nov. 20, 1989), https://www.chicagotribune.com/news/ct-xpm-1989-11-20-8903

law firms were organized as general partnerships, which meant each partner was vicariously liable for the wrongdoing of other partners despite lacking any personal involvement, even newly minted partners owning insignificant shares of the partnerships.[5] The chilling effect of vicarious liability spurred the efforts of the partners of a twenty-one person Texas law firm to change the partnership law. The Texas legislature was persuaded to enact the first LLP statute in the nation, [6] followed soon by Louisiana and Delaware.[7] Within a few years, the movement away from general partnerships and toward limited liability partnerships swept the United States.[8] Now LLP as a form of business entity is recognized in every jurisdiction.[9]

To form an LLP, a certificate of limited liability partnership must be filed with a chosen state. This registration subjects the LLP to the partnership law of the state. Most states' LLP statutes model after the Revised Uniform Partnership Act (RUPA), a sample statute drafted in 1997 and most recently revised in 2013 by the National Conference of Commissioners on Uniform State Laws.[10] While most provisions of this model statute apply to general partnerships, some provisions specifically relate to limited liability partnerships. Section 306 (c) of RUPA provides in part:

> A debt, obligation, or other liability of a partnership incurred while the partnership is a limited liability partnership is solely the debt, obligation, or other liability of the limited liability partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the limited liability partnership solely by reason of being or acting as a partner.[11]

Most jurisdictions follow the RUPA in applying the liability shield broadly to both tort claims and contractual debts, while some jurisdictions

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110242-story.html [https://perma.cc/K3BF-A2UH].

5. *See* Susan Saab Fortney, *Am I My Partner's Keeper? Peer Review in Law Firms*, 66 U. Colo. L. Rev., 329, 329 n.2 (1995).

6. *See* 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 (1997).

7. *See* Mallen, *supra* note 1 ("Louisiana was the second state to pass LLP legislation, and then Delaware.")

8. Fortney, *supra* note 6, at 718, 718 n.38 ("The accounting profession, led by the Accountants' Coalition, joined the push for enactment of LLP legislation.").

9. *See* Mallen, *supra* note 1.

10. UNIF. P'SHIP. ACT (UNIF. L. COMM'N 2013) [hereinafter RUPA].

11. *Id*. § 306(c).

use the shield narrowly for tort claims only.[12] Limited liability prevents a partner from being sued vicariously due to his association with the actual wrongdoer, but continues to hold the latter personally liable.[13] In 2007, the New York Court of Appeals gave an even narrower interpretation of the liability shield in *Ederer v. Gursky*,[14] by holding that limited liability did not apply to debts owed to a partner of the firm. Subsequent New York cases followed this precedent.[15] In contrast, a case decided by a California Court of Appeals in 2011 held that limited liability barred a claim by one partner against other partners for debts owed by the partnership.[16] This issue has not been considered by courts in other jurisdictions.

Whether or not debts owed to partners are protected by limited liability is critically important. Currently there is a general understanding among lawyers and business participants that liability of LLP partners is limited regardless of the status of the creditors. Statements like, "[o]ne big advantage to a limited liability partnership is that the partners are not personally liable and cannot be forced to pay a business debt or liability with personal property or assets" are present on websites of law firms, popular legal search platforms, and even in articles featured by the American Bar Association.[17] *Ederer v. Gursky*, if widely followed, would render such

12. *See Id.* at cmt. c at *Full Liability Shield,* ("This act provides a full liability shield – i.e., the shield applies regardless of the law giving rise to a claim against an LLP. A few jurisdictions provide only a partial shield. See, e.g., 15 PA. CONS. STAT. ANN. § 8204 (West 2013)"). *See also*, Christine M. Przybysz, Note, *Shielded beyond State Limits: Examining Conflict-of-Law Issues in Limited Liability Partnerships*, 54 CASE W. RSRV. L. REV. 605, 606 (2003).

13. RUPA, *supra* note 10, at cmt. c at *Full Liability Shield* ("This subsection provides a corporate/LLC-like liability shield for partners, protecting them from (and only from) the debts, obligations and liabilities of the partnership – i.e., against a partner's alleged vicarious liability for the obligations of the entity.").

14. Ederer v. Gursky, 881 N.E.2d 204 (2007).

15. Kuslansky v. Kuslansky, 50 A.D.3d 1100 (2008); Grewal v. Cuneo, 2016 WL 308803 (S.D. N.Y. Jan. 25, 2016).

16. Rappaport v. Gelfand, 197 Cal.App. 4th 1213 (2011).

17. *See, e.g.*, Ki Akhbari, *Advantages of Limited Liability Partnerships*, LEGALMATCH (Jun. 1, 2018, 02:39:34), https://www.legalmatch.com/law-library/article/advantages-of-limited-liability-partnerships.html [https://perma.cc/ZZ2P-BYDJ]; *Limited Liability Partnership – LLP formations*, *Benefits of an LLP*, SIMPLE FORMATIONS, https://www.simpleformations.com/llp-benefits-and-disadvantages.htm [https://perma.cc/6JS5-TJ82] (last visited Feb. 26, 2021); Meredith Hart, *What's an LLP? Limited Liability Partnerships Explained in Under 5 Minutes*, HUBSPOT (Oct. 17, 2019 7:30 AM), https://blog.hubspot.com/sales/limited-liability-partnership [perma.cc/B8KT-ANYU]; 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 (1995) ("An LLP is a general partnership in which the vicarious liability of the partners for the obligations of the partnership has been limited.").

advice detrimentally misleading.

The scope of liability is an important consideration in the selection of a business form. As discussed later in this article, members of limited liability companies (LLC) are shielded by limited liability even for debts owed by the LLC to other members. That means the protection granted to LLC members is markedly broader than that to LLP partners in a jurisdiction that follows *Ederer v. Gursky*. However, in comparing LLCs with LLPs, lawyers have overlooked this distinction and frequently opined that the two forms are equal in the liability protection.[18] Such misinformation has also appeared in documents of influential organizations such as the Uniform Law Commission.[19]

The narrow interpretation of limited liability as endorsed by *Ederer v. Gursky* (hereinafter, the "Narrow Interpretation") has hitherto eluded the attention of the legal and business communities. If duly noticed, it likely will impact partnerships' management structures and business decisions. For example, partners may insist on a unanimous vote if a decision can remotely lead to any indebtedness to a partner, even on matters that are otherwise "ordinary" and worthy of a mere majority vote under the RUPA. The partners may vote to buy out the interests of wrongfully dissociated partners instead of exercising their statutory right of postponement to avoid incurring a personal liability for the buyout price. The partners may also forego business expansions to preserve capital for paying off loans from fellow partners, even though the expansions serve the best interest of the partnership.

The purpose of this paper is to alert the legal and business communities about the Narrow Interpretation of limited liability and to argue *against* it. The rest of the paper is organized as follows: Part II discusses the opposing views held by courts on the scope of limited liability for LLPs; Part III shows that the Narrow Interpretation is inconsistent with the legislative intent and other provisions of partnership statutes, and contradictory to established doctrines on guaranty; Part IV discusses the procedural impediments to enforcing personal liabilities under the Narrow Interpretation; Part V argues

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18. *See*, *e.g*., Jean Murry, What Are the Key Differences Between an LLC and an LLP?, THE BALANCE (Oct. 10, 2019), https://www.thebalancesmb.com/what-are-the-key-differences-between-an-llc-and-an-llp-4692438 [perma.cc/47UG-L9KA] ("LLC and LLP business types are set up to offer their owners protection against liability for debts of the business, and the owner's personal liability is limited to his or her investment in the business.").

19. *See* UNIFORM LIMITED LIABILITY COMPANY ACT (UNIF. L. COMM'N 2013) *Prefatory Note to ULLCA (2006)*, (stating that in jurisdictions that limit liability for both tort and contract based claims, "LLPs and member-managed LLCs offer entrepreneurs very similar attributes and, in the case of professional service organizations, LLPs may dominate the field.").

that the Narrow Interpretation defies widely-accepted tenets of law-making that exalt efficiency, information sharing, low agency costs, meeting reasonable expectations of interested parties, harm prevention, and cost internalization; and Part VI concludes this paper.

II OPPOSING VIEWS

A. New York's View

Ederer v. Gursky involved a law firm that started in 1998 as a professional corporation (PC) with one owner (Gursky) and a salaried non-equity employee (Ederer). Later, Gursky orally agreed to make Ederer a thirty percent shareholder of the PC. The two owners registered an LLP in 2001 to continue the legal practice. The PC billed and collected work-in-progress and pre-existing accounts receivable, while the LLP billed all new legal services. Ederer received his share of the PC's profit in 2001 and 2002. In 2002, both Ederer and Gursky loaned the PC a portion of their shares of the PC's profits. These loans were later assumed by the LLP in exchange for the furniture, fixtures and equipment that it acquired from the PC.[20] Three new partners were later admitted to the LLP. Ederer, Gursky, and the new partners (collectively) held thirty percent, fifty-five percent, and fifteen percent interest of the LLP.[21] There was no written partnership agreement.[22]

In June 2003, Ederer sought to withdraw from the PC and the LLP when the business was cash-strapped and unprofitable.[23] He entered into an agreement with the PC and LLP, which agreements were signed by Gursky as the President of the PC and a partner of the LLP.[24] Under these agreements, Ederer agreed to temporarily remain a partner of the LLP so as to continue serving as the lead counsel for a trial scheduled to commence soon. In exchange, the LLP agreed to compensate him according to existing arrangements until the time of his final departure.[25] Ederer won the case and generated a $600,000 contingency fee for the LLP. Ederer then departed, at which time the LLP still owed him the following debts: (1) his share of the PC's profit from an earlier year, (2) his share of the contingency fee for the case won immediately prior to his departure, and (3) the loan he made in 2002 by reducing the distribution of his profit share in the PC. In December

20. Ederer v. Gursky, 881 N.E.2d 204 (2007).
21. *Id*.
22. *Id*. at 516.
23. *Id*. at 517.
24. *Id*.
25. *Id*.

2003, Ederer brought a lawsuit against the PC, the LLP, and each of the LLP's partners individually for, among others, breach of contract relating to these debts.[26] The individual partners moved to dismiss the lawsuit on the ground that New York Partnership Law Section 26 (b) shielded them from personal liability.[27] The trial court ruled for Ederer, and the partners appealed.

Section 26 of the New York Partnership Law[28] was added to the statute in 1994, following the national trend of limiting vicarious liabilities for partnerships that are registered as LLPs.[29] Specifically, Section 26 (b)[30] provides:

> Except as provided by subdivisions (c) and (d) of this section, no partner of a 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.

Section 26 (c) excludes from Section 26 (b)'s liability shield any person who is in a direct supervisory role of the person who committed the wrongdoing.[31] Section 26 (d) allows partners to opt out from or modify Section 26 (b)'s protection by agreement.[32]

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26. *Id*. at 518.
27. *Id.*
28. N.Y. Partnership Law art. 3 § 26 (LexisNexis 2020).
29. Ederer, 851 N.Y.S.2d at 521–23.
30. N.Y. Partnership Law, *supra* note 28, at art. 3 § 26(b).
31. This section provides in part:

> "Notwithstanding the provisions of subdivision(b) of this section, (i) each partner, employee or agent of a partnership which is a registered limited liability partnership shall be personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services on behalf of such registered limited liability partnership."

32. Section 26(d) provides in part:

> "Notwithstanding the provisions of subdivision(b) of this section, all or specified partners of a partnership which is a registered limited liability partnership may be liable in their capacity as partners for all or specified debts, obligations or liabilities of a registered limited liability partnership to the extent at least a majority of the partners shall have agreed unless otherwise provided in any

The partners argued that the plain language of Section 26 (b) precluded their personal liability for debts owed by the partnership to Ederer. In rebuking this argument, the New York Court of Appeals relied primarily on the structure of the New York Partnership Law that includes Section 26 as part of Article 3 ("Relations of Partners to Persons Dealing with the Partnership") as opposed to Article 4 ("Relations of Partners to One Another"). The court concluded: "[t]he logical inference, therefore, is that 'any debts' refers to any debts owed a third party, absent very clear legislative direction to the contrary."[33] The court also sought to strengthen its opinion by highlighting the fact that New York was among few jurisdictions that had adopted limited liability at the time for both tort and contract-based claims of a vicarious nature. In the court's opinion, there was no basis for further stretching this extraordinary generosity to the extent argued by the partners.[34]

The New York Court of Appeals repeated its position on this issue in *Kuslansky v. Kuslansky, Robbins, Stechel and Cunningham, LLP*,[35] which involved a lawsuit for breach of contract brought by a withdrawing partner of a medical practice LLP against the LLP and the other partners individually for compensation owed to the plaintiff. Citing *Ederer v. Gursky*, the court refused to dismiss the plaintiff's claim against individual partners on the ground that limited liability is not intended to preclude personal liability for debts owed to fellow partners.[36]

B. California's View

The California Appellate Court holds the opposite view. In *Rappaport*

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agreement between the partners."

33. Ederer, 881 N.E.2d at 211.

34. *Id*. (pointing out that unlike New York, most states had adopted a partial liability shield protecting the partners only from vicarious tort liabilities at the time of the litigation).

35. Kuslansky v. Kuslansky, 50 A.D.3d 1100 (2008).

36. *Id.* at 1101

> ("The Court of Appeals recently made clear that the 'liability shield' created by Partnership Law § 26(b) for general partners of a registered limited liability partnership only applies to a partner's liability to third parties, and, in fact, is part of article 3 of the Partnership Law ('Relations of Partners to Persons Dealing with the Partnership'), not article 4 ('Relations of Partners to One Another.')"

(Ederer v. Gursky, 9 NY3d 514, 524 [2007]). Thus, Partnership Law § 26(b) "does not shield a general partner in a registered limited liability partnership from personal liability for breaches of the partnership's or partners' obligations to each other." (Ederer v. Gursky, 9 NY3d at 516).

v. Gelfand,[37] a law firm LLP had three partners, holding thirty-one percent (Rappaport), fourty-six percent (Gelfand), and twenty-three percent (the third partner), respectively. Rappaport withdrew from the partnership and demanded compensation for his share of the partnership's assets. The major assets of the LLP included general accounts receivable, possible recovery of a contingency fee from representing clients in a lawsuit, and receivables from four separate litigation matters on behalf of a client.[38] The trial court found that Rapport was entitled to $230,758 from the partnership for his buyout, and that the partnership as well as the other two partners individually were liable for this payment.[39] The appellate court reversed the personal liability of the other partners based on California Corporations Code, Title 2. Partnerships, Section 16306 (c). This section provides:

> Notwithstanding any other section of this chapter, and subject to subdivisions (d), (e), (f), and (h), a partner in a registered limited liability partnership is not liable or accountable, directly or indirectly, including by way of indemnification, contribution, assessment, or otherwise, for debts, obligations, or liabilities of or chargeable to the partnership or another partner in the partnership, whether arising in tort, contract, or otherwise, that are incurred, created, or assumed by the partnership while the partnership is a registered limited liability partnership, by reason of being a partner or acting in the conduct of the business or activities of the partnership.[40]

Section 16306(d) allows the partners to opt out of or modify the limited liability protection by agreement in writing,[41] Section 16306(e) clarifies that partners remain personally liable for their own tortious conducts,[42] Section 16306(f) states that law firms must maintain an effective registration with

37. Rappaport v. Gelfand, 197 Cal. App. 4th 1213 (2011).
38. *Id*. at 1218.
39. *Id.* at 1224.
40. 2 CAL. CORP. CODE. §16306(c) (West 2018)
41. 2 CAL. CORP. CODE § 16306(d) provides:

> "Notwithstanding subdivision (c), all or certain specified partners of a registered limited liability partnership, if the specified partners agree, may be liable in their capacity as partners for all or specified debts, obligations, or liabilities of the registered limited liability partnership if the partners possessing a majority of the interests of the partners in the current profits of the partnership, or a different vote as may be required in the partnership agreement, specifically agreed to the specified debts, obligations, or liabilities in writing, prior to the debt, obligation, or liability being incurred."

42. 2 CAL. CORP. CODE § 16306(e) provides: "Nothing in subdivision (c) shall be construed to affect the liability of a partner of a registered limited liability partnership to third parties for that partner s tortious conduct."

the California State Bar in order to benefit from the liability shield,[43] and Section 16306(h) provides that any partner may choose to act as a surety or guarantor and subject himself to personal liability as such.[44] Since the plaintiff failed to establish personal liability under these explicit exceptions, the appellate court concluded that personal liability was barred by Section 16306(c).[45] Although the California statute mimics the New York statute in both semantics and structure - Section 16306 is contained in Article 3 ("Relations of Partners to Persons Dealing with Partnership")[46] as opposed to Article 4 ("Relations of Partners to Each Other and to Partnership")[47] - the comparable statutes have led to opposite conclusions by courts in these two jurisdictions. The discussion below shows why New York's Narrow Interpretation is wrong.

III LEGAL INCONSISTENCIES UNDER THE NARROW INTERPRETATION OF LIMITED LIABILITY

A. *Inconsistency with the Legislative Intent*

Most LLP statutes enacted by state legislatures adopt the language of Section 306(c) of the RUPA almost verbatim by stating that LLP partners are "not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the limited liability partnership . . ."[48] While this language does not explicitly deal with debts

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43. 2 CAL. CORP. CODE § 16306(f) provides:

> "The limitation of liability in subdivision (c) shall not apply to claims based upon acts, errors, or omissions arising out of the rendering of professional limited liability partnership services of a registered limited liability partnership providing legal services unless that partnership has a currently effective certificate of registration issued by the State Bar."

44. 2 CAL. CORP. CODE § 16306(h) provides: "Nothing in this section shall affect or impair the ability of a partner to act as a guarantor or surety for, provide collateral for or otherwise be liable for, the debts, obligations, or liabilities of a registered limited liability partnership."

45. Rappaport, 197 Cal. App. 4th at 1232.

46. 2 Cal. Corp. Code. § 16306 (West 2018)

47. 2 Cal. Corp. Code. § 16401-06 (West 2018)

48. Florida, Connecticut, Colorado, Maryland, and Minnesota have also incorporated the Uniform Partnership Act being into their statutes like New York and California. *See*, *e.g.*, (Florida) Revised Uniform Partnership Act, Fla. Stat. Ann. §§ 620.81001 — 620.9902 (Lexis 2020), Connecticut Uniform Partnership Act, Conn. Gen. Stat. Ann. Section 34-327(c), Colorado Uniform Partnership Act (1997), Section 7-64-306(3) (cited as Colo. Rev Stat § 7-64-306 (2016)), Maryland Revised Uniform Partnership Act, Section 9A-306(c), Minnesota

owed to co-partners, the Uniform Law Commission that drafted the RUPA has elucidated on its intention in a few commentaries. In Comment to Subsection (c) of Section 306, under "*Shield Applicable Regardless of the Identity of the Plaintiff",*[49] the Commission states:

> What makes the shield relevant is the nature of the claim. If the complaint seeks to hold a partner vicariously liable for the LLP's obligations, the shield applies. If not, not. Thus, there is no distinction among a claim arising from an LLP's debt to a commercial creditor, a partner's claim that the LLP has failed to return a contribution as required by the partnership agreement, and a claim by a former partner that the LLP has failed to follow through on a buy-out agreement.

This explanatory comment is consistent with the Uniform Law Commission's manifested intent to "provide a corporate/LLC-like liability shield for partners, protecting them from (and only from) the debts, obligations and liabilities of the partnership – i.e., against a partner's alleged vicarious liability for the obligations of the entity."[50] Numerous sources have also acknowledged that such a motivation is behind state LLP legislations that provide a full liability shield for both tort and contract claims.[51] While

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Uniform Partnership Act, Section 323A.0306(c).

49. *See* RUPA, *supra* note 10.

50. *See* RUPA, *supra* note 10, at § 306 cmt.; *see also Why Your State Should Adopt the Uniform Partnership Act (UPA) (1997) (Last Amended 2013)*, Unif. Law Comm'n,

> ("Limited Liability Partnerships. UPA (1997) provides limited liability protection for general partners of a limited liability partnership. . . . However, *individual partners like shareholders in a corporation*, are personally liable for any tort they may have committed, or for any debts, liabilities or other obligations of the partnership they have personally guaranteed")

(emphasis added).

51. *See* David B. Rae, *Limited Liability Partnerships, The Time to Become One is Now*, 30-Feb. HOUS. LAW. 47, 47 (Jan./Feb. 1993)

> ("LLPs enjoy certain specific benefits of corporate limited liability while still retaining the tax advantage of a general partnership. LLPs are a reaction to limited liability companies (LLCs) and are intended to give partnerships some of the protection afforded LLCs without forcing partnerships to alter their structure to achieve the protection.").

See also Robert Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. Colo. L. Rev. 1065, 1087 (Fall 1995). ("This [broad-shield] version of the LLP essentially eliminates all personal liability of partners for partnership obligations to the same extent that liability is eliminated under the limited liability company statute."). In re Rambo Imaging, L.L.P., No. 07-11190-FRM, 2008 WL 2778846, at *6 (Bankr. W.D. Tex., July 15, 2008)

> ("'Corporation' is defined in the Bankruptcy Code to include a 'partnership

New York legislative documents do not contain any explicit statement about the applicability of limited liability to debts owed to co-partners, the court in *Ederer v. Gursky* acknowledged that the legislature desired to enact a liability protection "the same as that accorded to shareholders of a professional corporation organized under the [Business Corporation Law] [and] as that accorded to members of a professional LLC."[52] Again, it is worth noting that the New York LLP statute follows the same structure as the RUPA by including the limited liability provision in Article 3 ("Relations of Partners to Persons Dealing with Partnership") as opposed to Article 4 ("Relations of Partners to Each Other and to Partnership"). Yet the same structure prompted the New York court to construe a much narrower scope of limited liability than that intended by the Uniform Law Commission. In addition, the New York Partnership Law § 26(c) explicitly carves out an exception to limited liability by holding partners personally liable for the wrongdoing of people who are under their direct supervision.[53] This suggests that if the New York legislature intended to preclude debts owed to partners from the coverage of limited liability, it likely would have explicitly stated so in the statute.

Are LLC members personally liable for debts owed by the LLC to fellow members? Every state has enacted its own LLC statute, and about half of those statutes model after the Uniform Limited Liability Company Act (ULLCA). The ULLCA was promulgated by the Uniform Law Commission in 1994 and amended in 1996 and 2006.[54] Section 304 (a) of the ULLCA provides:

> The debts, obligations, or other liabilities of a limited liability company, whether arising in contract, tort, or otherwise: (1) are solely the debts, obligations, or other liabilities of the company; and (2) do not become the debts, obligations, or other liabilities of a member or manager solely by reason of the member acting as a

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association organized under a law that makes only the capital subscribed responsible for the debts for such association.' *11 U.S.C. § 101(9)(A)(ii)*. By defining 'corporation' to include such partnerships, Congress apparently intended that such limited liability partnerships would be treated as corporations and not as partnerships under the Code.").

52. Ederer, 851 N.Y.S.2d at 524.

53. N.Y. Partnership Law, supra note 28, at § 26(c)(i):

> "[E]ach partner, employee or agent of a partnership which is a registered limited liability partnership shall be personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her direct supervision and control while rendering professional services on behalf of such registered limited liability partnership."

54. UNIFORM LIMITED LIABILITY COMPANY ACT, *supra* note 19.

member or manager acting as a manager.[55]

The Uniform Law Commission's Comment to § 304 states that the relevant consideration under this section is the nature of the claim and that:

> [T]here is no distinction between a claim arising from an LLC's debt to a commercial creditor, a member's claim that the LLC has failed to return a contribution as required by the operating agreement, and a claim by a former member that the LLC has failed to follow through on a buy-out agreement.[56]

There is a discernable similarity between ULLCA § 304(a) and RUPA § 306(c), as well as the Uniform Law Commission's comments to both provisions.

The New York Limited Liability Law[57] parallels the ULLCA for liability of LLC members. Section 609 (a) of the New York statute provides that a member or manager of an LLC is not:

> liable for any debts, obligations or liabilities of the limited liability company or each other, whether arising in tort, contract or otherwise, solely by reason of being such member, manager or agent or acting (or omitting to act) in such capacities or participating (as an employee, consultant, contractor or otherwise) in the conduct of the business of the limited liability company.[58]

This language resembles closely the limited liability provision of § 26 (b) of the New York Partnership Law.[59]

Courts across jurisdictions have consistently held that LLC members are not personally liable for debts owed by the LLC to any member. In *Demir v. Schollmeier*,[60] an LLC had two members who signed an agreement that provided for the return of the second member's capital contribution of $400,000 should he withdraw from the LLC. When the second member sought a return of this amount upon his departure and was refused, he brought a lawsuit against the LLC and the other member for breach of contract. The Florida Court of Appeals held that the contract constituted the LLC's operating agreement as opposed to a personal agreement. Based on Florida's LLC statute that negated any personal liability of members "solely by reason of being a member or serving as a manager or managing member,"[61] the court held that the remaining member of the LLC was not

55. UNIFORM LIMITED LIABILITY COMPANY ACT, *supra* note 19.
56. UNIFORM LIMITED LIABILITY COMPANY ACT, *supra* note 19, at 83.
57. N.Y. Ltd. Liab. Co. Law (McKinney 2020).
58. *Id*. § 609(a).
59. N.Y. Partnership Law, *supra* note 28, § 26(b).
60. Demir v. Schollmeier, 199 So.3d 442, (Fla. 3d. Dist. Ct. App. Aug. 31, 2016).
61. Fla. Stat. § 608.4227(1), (2012), provides:

personally liable for the return of this contribution and was improperly included as a defendant in the lawsuit.[62] The same view was held by the Louisiana Court of Appeals in *Fancher v. Prudhome*,[63] and the Texas Court of Appeals in *Kennebrew v. Harris*.[64] Both cases involved a departing LLC member suing the LLC and other members for money owed, in the form of return of capital, repayment of loans or compensation for membership interest.

A similar conclusion was reached by the New York Supreme Court, Appellate Division in *Hakim v. Hakim*.[65] In that case, an uncle established an LLC to lease real estate in Manhattan, New York. The uncle signed an options agreement with his nephew for the latter to purchase up to one-third membership interest in the LLC. The nephew later sought to exercise the option, but despite his repeated requests, the uncle delayed the execution of an operating agreement and refused to provide an accounting necessary for the exercise of the option. Meanwhile, the nephew performed an array of work on behalf of the LLC, holding himself out as a member of the LLC with the uncle's acquiescence. When the uncle denied the nephew's formal request for a recognition of his membership in the LLC, the nephew brought a lawsuit against the LLC and the uncle for *quantum meruit* and unjust enrichment. The court held that the evidence showed an unambiguous promise to provide long overdue information for the nephew to complete the exercise of his option, and that the uncle gave an unqualified acknowledgement of the validity of nephew's option-based interest in the LLC. However, the court, while sustaining the cause of action against the LLC, denied the claim against the uncle personally on the ground that the nephew's uncompensated services were debts of the LLC, and not of the uncle individually.[66]

Given the legislative intent to equalize LLP partners with LLC members in terms of liability protection, and judicial opinions unequivocally

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> "Except as provided in this chapter, the members, managers, and managing members of a limited liability company are not liable, solely by reason of being a member or serving as a manager or managing member, under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the limited liability company."

Repealed by Laws 2013, c. 2013-180, § 5, eff. Jan. 1, 2015; Laws 2015, c. 2015-148, § 11. Copy of the 2012 version https://www.flsenate.gov/laws/statutes/2012/608.4227 [https://perma.cc/4KC6-8WN3].

62. *Demir*, 199 So.3d at 443.
63. Fancher v. Prudhome, 112 So.3d 909 (La. Ct. 2d. App. Feb. 27, 2013).
64. Kennebrew v. Harris, 425 S.W.3d 588 (Tex. App. Mar. 4, 2014).
65. Hakim v. Hakim, 99 A.D.3d 498 (N.Y. App. Div. 1st. Oct. 11, 2012).
66. *Id.* at 502.

holding that limited liability applies to LLC members irrespective of the status of the creditors, the Narrow Interpretation of the LLP statute to exclude debts owed to LLP partners from the coverage of limited liability contravenes the legislative intent.

B. Inconsistency with Waiver Provisions of LLP Statutes

The LLP status, whether obtained at the inception of the business or upon conversion from a general partnership, impacts the *inter se* relationship among partners. Regardless of the form it takes, a partnership is required to indemnify and hold harmless partners for liabilities incurred while they act on behalf of the partnership.[67] At the same time, the partnership agreement may obligate partners to contribute more capital should the partnership's assets be insufficient to meet its obligations.[68] Without clarification, such indemnification and contribution provisions could have been used to circumvent the protection of limited liability bestowed by the LLP statute. For example, a surgeon-partner of a medical LLP is sued for $10 million for a surgical accident. He pays the entire amount and seeks indemnification from the LLP. If the LLP lacks enough assets to honor its obligation, it could potentially call for additional contribution from the other partners so the money could be forwarded to the surgeon. Likewise, if the LLP borrows from a creditor but has no assets to repay the loan, it could potentially call

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67. RUPA, *supra* note 10, at §401(c)

> ("A partnership shall indemnify and hold harmless a person with respect to any claim or demand against the person and any debt, obligation, or other liability incurred by the person by reason of the person's former or present capacity as a partner, if the claim, demand, debt, obligation, or other liability does not arise from the person's breach of this section or Section 407 or 409").

See also N.Y. Partnership Law *supra* note 28 at § 40 (2) ("Except as provided in subdivision (b) of section twenty-six of this chapter, the partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property"), and Cal. Corp. Code § 16401(c) ("A partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership or for the preservation of its business or property").

68. RUPA, *supra* note 10, at § 404 provides: ((a)

> "A person's obligation to make a contribution to a partnership is not excused by the person's death, disability, termination, or other inability to perform personally. (b) If a person does not fulfill an obligation to make a contribution other than money, the person is obligated at the option of the partnership to contribute money equal to the value of the part of the contribution which has not been made. (c) The obligation of a person to make a contribution may be compromised only by the affirmative vote or consent of all the partners . . .").

for contribution. Such a result renders all partners personally liable for partnership obligations and defeats the purpose of limited liability.

To prevent a de facto nullification of limited liability through the indemnification and contribution provisions, RUPA § 306(c) (and state statutes that model after the RUPA) explicitly states that LLP partners are not vicariously liable "directly or indirectly, by way of contribution or otherwise."[69] That means creditors cannot compel an LLP to call for additional capital from its partners for the purpose of repaying its debts.[70] It also means the indemnification provision reimburses a partner who has paid more than his proportional share of liability only to the extent of the existing assets of the partnership.[71] The registration for an LLP status is regarded as a modification of any pre-existing agreement that is inconsistent with the nature of limited liability.[72] To ensure that partners understand the consequences of the change, the law requires that an LLP registration be approved by the vote that is necessary to amend the contribution provisions if such provisions are part of the partnership agreement.[73]

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69. For examples of state statutes, *see,* e.g., (Florida) Revised Uniform Partnership Act *supra* note 48. (A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner.").

70. RUPA *supra* note 10 at § 306 cmt. c, *Effect of LLP Status on Relations Inter Se the Partners*

> ("Except for contributions promised but not made, partners no longer have contribution obligations Due to: [1] the liability shield, partners are no longer required to contribute capital to enable the partnership to meet its obligations to creditors; and [2] the elimination of loss sharing, partners are no longer required to contribute capital to adjust capital losses *inter se*. In this context, a partnership's obligations include a duty to indemnify partners (and others). Thus, indemnification provisions (whether as provided by this act, Section 401(c), or the partnership agreement) are no longer "backstopped" by the partners. *See* the comment to Subsection (c)(1).")

71. RUPA *supra* note 10 at § 306 cmt. subsec. (c). *See also* Carter G. Bishop, *The Limited Liability Partnership Amendments to the Uniform Partnership Act (1994)*, 53 THE BUSINESS LAWYER 101, 114 (Nov.1997) (noting that partners do not have an obligation to share losses in excess of their assets).

72. RUPA, *supra* note 10, at § 306 (1) ("This subsection applies: (1) despite anything inconsistent in the partnership agreement that existed immediately before the vote or consent required to become a limited liability partnership under Section 901(b)."), and Comment, Subsection (c)(1) -The main part of Subsection (c) overrides contribution obligations under this act. Paragraph 1 overrides contribution obligations created by the partnership agreement).

73. RUPA, *supra* note 10, at § 901(b)

> ("The terms and conditions on which a partnership becomes a limited liability partnership must be approved by the affirmative vote or consent necessary to amend the partnership agreement except, in the case of a partnership agreement that expressly addresses obligations to contribute to the partnership, the

The statutory protection of limited liability can be modified or waived by partners, but only knowingly and intentionally.[74] Some jurisdictions require the waiver to be in writing.[75] For states that follow the RUPA, a change in the liability status by agreement is an extraordinary matter that requires the unanimous vote of all partners.[76] But some states require a mere majority vote.[77] The waiver of limited liability can take the form of an affirmation that the contribution provision survives the conversion into an LLP, a re-insertion of the provision into the partnership agreement *upon or after* the LLP registration,[78] or a partner-to-partner contract for indemnification and contribution to render the obligation personal to the partners as opposed to the partnership.[79] In addition, individual partners may

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affirmative vote or consent necessary to amend those provisions.").

74. Subcomm. on the Prototype Ltd. Liab. P'ship Agreement Formed Under the Unif. P'ship Act (1997) Comm. on P'ships and Unincorporated Bus. Org., Section of Bus. Law, A.B.A., *Prototype Partnership Agreement for a Limited Liability Partnership Formed Under the Uniform Partnership Act (1997)*, 58 The Business Lawyer 689, 717 n. 79 (Feb. 2003), citing Official Comment to 306(c) ("Although the liability shield protections of Section 306(c) may be modified in part or in full in a partnership agreement (and by way of private contractual guarantees), the modifications must constitute an intentional waiver of the liability protections.").

75. *See*, *e.g.*, Cal. Corp. Code § 16306(d) (detailing that the waiver must be in writing).

76. RUPA, *supra* note 10, at § 401(k)

> ("A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the affirmative vote or consent of all the partners.").

77. *See*, *e.g*., N.Y. Partnership Law *supra* note 28 at §26(d) ("Any such agreement may be modified or revoked to the extent at least a majority of the partners shall have agreed"); *see also* Cal. Corp. Code §16306(d) (stating that a majority vote is enough).

78. *See,* Subcomm. on the Prototype Ltd. Liab. P'ship Agreement *supra* note 74 at n. 80. ("RUPA section 306(c) negates pre-existing contribution obligations unless they are agreed to again at the time of the vote to register the partnership as a limited liability partnership"). *See also* Carol J. Miller LLPs: How Limited Is Limited Liability? 53 J. MO. B. 154, 158.

> ("Certainly if any provision requiring contribution were added to the partnership agreement *after* a partnership filed as a LLP, such provision would work to undermine the scope of the LLP liability shield. Even internal partnership agreements designed to partially reinstate the duty of contribution in an LLP may place the partners at risk.").

79. *See* RUPA, *supra* note 10, at § 306(c)(1) cmt. *Effect of LLP Status on Relations Inter Se the Partners*

> ("Paragraph 1 does not, however, override contribution and indemnification requirements running directly from partner to partner. These obligations are not obligations of the LLP but rather personal to each partner. If such obligations remain in the partnership agreement, they might disable the shield as to

undertake to be guarantors of the partnership's debt and subject themselves to personal liability under the law of guaranty.[80]

A Narrow Interpretation of the scope of limited liability to exclude the debts owed to LLP partners from the protection could result in partners being held personally liable for debts incurred without their consent or participation. Suppose an LLP has five partners, A, B, C, D, and E. Partner A is a senior partner who has the sole authority to decide routine business matters according to the partnership agreement. Partner A seeks an office space for the firm and receives three offers, one of which is from Partner B who owns a few office buildings. Partner B's offer is the best in all aspects of the lease (rent, location, term of the lease, etc.), so Partner A signs the lease on behalf of the partnership. There is no concern for conflict of interest in this transaction because the leased property is not owned by Partner A, and the lease terms are most favorable to the partnership. If the partnership becomes unprosperous and unable to pay the rent, all partners are personally liable, including Partners C, D and E who are junior in position, insignificant in ownership, and voiceless in the decision process. Even though the lease benefits the partnership in all aspects, the lingering personal liability may be an overarching concern for Partners C, D and E, so if given a choice, they likely would have preferred to lease from outside landlords. Similarly, in *Ederer v. Gursky*, the three partners who jointly held fifteen percent interest in the partnership likely would have preferred for the partnership to finance its operation by borrowing from outside creditors rather than postponing the distribution to Ederer, even though the latter option was least costly to the partnership.[81]

The problem of inadvertent personal liability under the Narrow Interpretation of limited liability is more conspicuous in large partnerships that typically entrust routine business matters to management committees composed of just a handful of partners.[82] For example, Winston & Strawn

partnership liability arising from the misconduct of a partner.").

80. *See*, *e.g*., N.Y. Partnership Law, *supra* note 28, at §26(d) ("Nothing in this section shall in any way affect or impair the ability of a partner to act as a guarantor or surety for, provide collateral for or otherwise be liable for, the debts, obligations or liabilities of a registered limited liability partnership."), and identical provisions of Cal. Corp. Code § 16306(h) (" Nothing in this section shall affect or impair the ability of a partner to act as a guarantor or surety for, provide collateral for or otherwise be liable for, the debts, obligations, or liabilities of a registered limited liability partnership.").

81. *See supra,* p. 7-10 for discussion on Ederer v. Gursky.

82. *See,* Patrick J. McKenna & David J. Parnell, *The State of Law Firm Leadership*, THOMPSON REUTERS LEGAL EXECUTIVE INST. P. 4, https://images.ask.legalsolutions.thomsonreuters.com/Web/TRlegalUS/%7B55b653fc-cca7-4d3f-a7e2-b98fd8618445%7D_State_of_Law_Firm_Leadership.pdf [https://perma.cc/5VMF-HNSS]

LLP, an international law firm headquartered in Chicago, has about 400 partners worldwide. It is managed by an executive committee of twenty-seven partners.[83] The notion that all partners actively participate in managing the partnership's affairs does not reflect reality. Yet, under the Narrow Interpretation, the remaining hundreds of partners could have lingering personal liability over which they have little or no control.

C. *Inconsistency with the "Clean Severance" Ideal*

The Narrow Interpretation is incompatible with the RUPA's desire to achieve a clean severance in the relationship of partners who withdraw from the partnership and the remaining partners.[84] Such a desire is reflected in RUPA's mandate that the partnership purchase the withdrawing partners' interests within a time limit unless a delay is justified by the wrongful nature of the withdrawal,[85] and its broad indemnity provision that requires the

> ("Is there an "elected" Board/Executive Committee that you report to in your firm? Some 77% of our respondents told us that there was indeed such a Board, and that it ranged in size from smallest of about 5 to, at its largest, approximately 30 partners with an average size of about 10 elected individuals.").

83. *See, Winston & Strawn Announces New Executive Committee Members*, WINSTON & STRAWN LLP, ("Winston & Strawn LLP today announced the election of nine new partners to the firm's 27-member Executive Committee.") (Sep. 5, 2018), https://www.winston.com/en/thought-leadership/winston-and-strawn-announces-new-executive-committee-members.html [https://perma.cc/323M-8L2H].

84. For discussion of the authors of the UNIF. P'SHIP. ACT (2013) intent for a clean severance, *see,* Robert W. Hillman, RUPA and Former Partners: Cutting the Gordian Knot With Continuing Partnership Entities, 58 L. & and Contemp. Probs. 7, 8 (Spring 1995) (suggesting that implicit in RUPA is the ability for a withdrawing partner to get a clean break).

85. RUPA, *supra* note 10, at § 701(a) ("If a person is dissociated as a partner without the dissociation resulting in a dissolution and winding up of the partnership business under Section 801, the partnership shall cause the person's interest in the partnership to be purchased for a buyout price determined pursuant to subsection (b)"); RUPA, *supra* note 10, at § 701(e)

> ("If no agreement for the purchase of the interest of a person dissociated as a partner is reached not later than 120 days after a written demand for payment, the partnership shall pay, or cause to be paid, in money to the person the amount the partnership estimates to be the buyout price and accrued interest, reduced by any offsets and accrued interest under subsection (c)");

RUPA, *supra* note 10, at § 701(h)

> ("A person that wrongfully dissociates as a partner before the expiration of a definite term or the completion of a particular undertaking is not entitled to payment of any part of the buyout price until the expiration of the term or completion of the undertaking, unless the person establishes to the satisfaction of the court that earlier payment will not cause undue hardship to the business of the partnership. A deferred payment must be adequately secured and bear interest.").

partnership to indemnify a withdrawing partner against all liabilities incurred during the partner's tenure with the partnership, regardless of whether the liabilities are known before or after the dissociation.[86]

The Narrow Interpretation of limited liability would create a lasting tie between a dissociated partner with the remaining partners due to the conversion of the former into a creditor if his buyout is delayed until the end of the partnership's term or undertaking. The creditor status is embodied in RUPA §701(f) that permits the partnership to make an offer for payment, stating the time of payment, "the amount and type of security for payment," and "other terms and conditions of the *obligation*" (emphasis added).[87] The Narrow Interpretation renders the buyout debt a personal liability of the remaining partners that could last beyond the dissolution of the partnership. Moreover, the potential personal liability could in turn induce the remaining partners to forego their statutory postponement right and devote vital resources toward the consummation of the buyout, even at the cost of risking the financial soundness of the partnership. This defeats RUPA's intent to minimize disruptions that wrongful dissociations can cause the partnership through adding the postponement provision, which is one of the marked changes from RUPA's predecessor statue.[88]

D. *Inconsistency with the Law of Guaranty*

A guaranty (or guarantee) is a promise to answer for the debt of another person if that person defaults. The guarantor is jointly and severally liable on the debt, and may be sued under the same terms as the principal obligor.[89]

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86. RUPA, *supra* note 10, at § 701(h).

87. RUPA, *supra* note 10, at § 701(f) (provides:

> "If a deferred payment is authorized under subsection (h), the partnership may tender a written offer to pay the amount it estimates to be the buyout price and accrued interest, reduced by any offsets under subsection (c), stating the time of payment, the amount and type of security for payment, and the other terms and conditions of the obligation.");

see also Hillman, *supra* note 84, at 24

> ("The result of deferring a buyout may be particularly harsh because RUPA eliminates the UPA's profits-or-interest election, which means not only that the wrongfully (that is, prematurely) dissociating partner is liable for damages, but also that the former partner effectively converts from an equity participant in the partnership to a creditor (perhaps for the long term) of the partnership venture").

88. The predecessor of RUPA, *supra* note 10, is the Uniform Partnership Act (1914). Section 38 (1) of that statute requires the partnership to pay the buyout price in cash without delay unless the partnership agreement provides otherwise.

89. Ford v. Darwin, 767 S.W.2d 851, 10 U.C.C. Rep. Serv. 2d 426 (Tex. App.— Dallas

The validity of a guaranty is governed by the Statute of Frauds, which requires the guaranty to be in writing and signed by the guarantor.[90] The writing must show an unequivocal intent to guarantee the obligation and contain a clear description of the obligation being guaranteed.[91] A guaranty contract cannot be extended by implication or interpretation and must be strictly construed.[92] In *Addy v. Myers*,[93] the Supreme Court of North Dakota refused to impose a guaranty-based personal liability on two members of an LLC because it found no evidence of writing to support the allegation of a guaranty.[94] The court stated that the managing members of the LLC who signed the line of credit with a bank as the guarantors could only seek recourse against the LLC but not the non-signing members individually.[95] The guaranty must also be supported by consideration, either in the form of a benefit to the guarantor or a detriment to the promisee.[96] In *Lyons v. DBHI, LLC*,[97] an employee of the debtor signed a personal guaranty on a previous loan between the debtor and a lender. The debtor intended to transfer his business to the employee, but the transfer did not consummate. The employee appeared to have signed a personal guaranty at his own initiation without demand from the lender. When the debtor defaulted on the

Sept. 6, 1989), *reh'g denied*.

90. *See* N.E.N.H., L.L.C. v. Broussard-Baehr Holdings, L.L.C. 142 So.3d 91 (La. Ct. App. 5th Cir. May 14, 2014) (ruling that an enforceable guaranty agreement requires the written signature of a guarantor); *See also* In re Gonzalez, 410 B.R. 868 (Bankr. D. Ariz. Feb. 25, 2009) (explaining that a guaranty agreement must be signed by a guarantor).

91. *See* Comar Marine, Corp. v. Raider Marine Logistics, L.L.C., 792 F.3d 564, 578 (5th Cir. 2015) (explaining what constitutes a valid guarantor signature); *see also* Material Partnerships, Inc. v. Ventura, 102 S.W.3d 252 (Tex. App. — Houston 14th Dist. 2003) (explaining further the criteria for a valid guarantor signature).

92. *See* Apex Bank v. Thompson, 826 S.E.2d 162 (Ga. App. 2019) (confirming that lender's obligations will not be enforced unless those obligations are expressly stated in writing); *see also* O'Brien Bros.' P'ship, LLP v. Plociennik, 2007 VT 105, 940 A.2d 692. (ruling obligations in a guaranty contract will be strictly construed).

93. Addy v. Myers, 2000 ND 165, 616 N.W.2d 359.

94. *Id*. at 362.

95. *Id*. at 363.

96. *See* Good v. Martin, 95 U.S. 90 (Oct. 1, 1877) (ruling that both parties won't be bound by a guaranty agreement if it is not supported by consideration); *see e.g.* Cardinal Health 110, Inc. v. Cyrus Pharmaceutical, LLC, 560 F.3d 894 (8th Cir. 2009) (granting summary judgment because an agreement to extend the time for payment of an existing debt is sufficient consideration); *see, e.g.*, Material P'ships, Inc. v. Ventura, 102 S.W.3d 252 (Tex. App. — Hous. 14th Dist. 2003) (ruling that a business's promise to continue shipping was adequate consideration for guaranty); *See e.g.* Fruehauf Corp. v. McIntire, 408 F.2d 910 (5th Cir. 1969) (affirming a lower court decision that an agreement was unenforceable because it was not supported by sufficient consideration).

97. Lyons v. DBHI, LLC, No. CIV.A. U607-12-063, 2010 WL 335634, at *1 (Del. Com. Pl. Jan. 27, 2010).

loan and the lender sought to enforce the guaranty against the employee, the court refused to uphold the guaranty on the ground that it was unsupported by consideration.[98]

The Narrow Interpretation of limited liability will result in an *unus pro omnibus* situation where a guaranty from one LLP partner virtually results in guaranties from all partners. For example, the managing partner of an LLP obtains a $10 million loan on behalf of the partnership and personally guarantees the loan at the insistence of the lender. The lender also seeks personal guaranties from the other partners, but they refuse. When the LLP defaults on the loan, the lender enforces the guaranty against the managing partner. If the managing partner repays the loan, they obtain a claim against the partnership by subrogation.[99] That means the managing partner now becomes a creditor of the partnership who can enforce the rights of the lender under the terms of the original loan.[100] He can force a contribution from other partners when the partnership's assets are insufficient to pay his debt. In terms of liability, that is the same result as if all partners had guaranteed the loan despite the other partners' explicit refusal to do so. From the lender's perspective, obtaining a guaranty from one LLP partner would provide him with almost the same level of security as if all partners had guaranteed the loan.

IV PROCEDURAL IMPEDIMENTS TO ENFORCING PERSONAL LIABILITY

A. Due Process Requirement

Enforcing personal liability against partners of an LLP that engages in interstate commerce may face procedural impediments. Due process requires the defendant in any lawsuit to have minimum contacts with the

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98. *Id*.; *see also* Kansas City Live Block 125 Retail, LLC v. Bhakta, 476 S.W.3d 326 (Mo. Ct. of App. 2015) (ruling that guaranty provision constituted adequate consideration to support guaranty); *see also* AXA Inv. Managers UK Ltd. v. Endeavor Cap. Mgmt, LLC, 890 F.Supp.2d 373 (S,D,N.Y. Aug. 24, 2012) (granting summary motion on the basis that a personal guaranty was supported by adequate consideration); *See also* Tower Inv., LLC v. 111 E. Chestnut Consultants, Inc., 371 Ill.App.3d 1019 (Ill. App. Ct. Mar. 14, 2007) (affirming that forbearance agreement was not supported by adequate consideration).

99. *See* RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 27(1) (AM. LAW INST. 1996). ("Upon total satisfaction of the underlying obligation, the secondary obligor is subrogated to all rights of the obligee with respect to the underlying obligation to the extent that performance of the secondary obligation contributed to the satisfaction.").

100. *See id*. at § 28; *see also* Brian D. Hulse, *After the Guarantor Pays: The Uncertain Equitable Doctrines of Reimbursement, Contribution, and Subrogation*, 51 REAL PROP., TR. & EST. L. J., 2, 64 (2016) (explaining the rights of guarantors' and secondary obligators once they make payment under the guaranty and seek to recover payments from other borrowers).

state in which the lawsuit is adjudicated.[101] Minimum contacts require the defendant to have "purposefully avail[ed] itself of the privilege of conducting activities within the forum State,"[102] resulting from actions by the defendant *himself* that create a "substantial connection" with the forum state.[103] Due process intends to give "a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some minimum assurance as to where that conduct will and will not render them liable to suit."[104] The U.S. Supreme Court has held that mere ownership of shares of a corporation does not satisfy the due process requirement of minimum contacts, even when the corporation is incorporated in the forum state.[105] This is so even if a shareholder's liability is phrased in terms of liability to the corporation that is incorporated in the forum state.[106]

In the influential article entitled *Unlimited Shareholder Liability Through a Procedural Lens*, Professor Janet Cooper Alexander argued that minimum contacts cannot be satisfied merely by the fact the defendant is insured by a company that does business in the forum state, even though the latter is obligated to join the defense.[107] She also argued that due process cannot be satisfied by suing all shareholders as a defendant class unless each shareholder individually has minimum contacts with the forum state.[108] Citing *Phillips Petroleum Co. v. Shutts*,[109] Professor Alexander distinguished cases in which plaintiffs are suing as a class from those in which the defendants are sued as a class. In the former cases, the forum state may have jurisdiction even though some members of the class lack minimum contacts because "an adverse judgment merely extinguishes a claim that would have been 'uneconomical to litigate individually,' rather than subjecting the plaintiff to 'coercive or punitive remedies' including a judgment for damages."[110] In the limited situations where owners of a business enterprise are subject to personal jurisdiction for liabilities of the enterprise, the

101. International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945).

102. World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297 (1980) (quoting Hanson v. Denckla, 357 U.S. 235, 253 (1958)).

103. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 475 (1985) (quoting McGee v. International Life Ins. Co., 355 U.S. 220, 223 (1957)).

104. World-Wide Volkswagen Corp., 444 U.S. at 297–98.

105. Shaffer v. Heitner, 433 U.S. 186 (1977).

106. *Id.* The Supreme Court refused to recognize Delaware's jurisdiction over the director-shareholders of a Delaware Corporation who were sued for breaching fiduciary duties to the corporation because they had no other contacts with Delaware.

107. Janet Cooper Alexander, *Unlimited Shareholder Liability Through a Procedural Lens*, 106 HARV. L. REV. 387, 405 (1992) (citing Rush v. Savchuk, 444 U.S. 320 (1980)).

108. *Id*. at 407.

109. Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 806–14 (1985).

110. Alexander, *supra* note 107, at 407.

personal jurisdiction is premised on their participation in the control of the enterprise or otherwise involved in the decision-making process. This is the case for the personal liability of controlling shareholders under the piecing-corporate-veil doctrine.[111]

Although Professor Alexander's discussion of the procedural impediments to personal liability under the due process requirement was made in the context of corporate shareholders, such impediments also exist for large partnerships operating in multiple jurisdictions. According to 2019 data, the top fifteen U.S. law firms have around 350–1,500 partners and multiple offices scattered across the country.[112] Imagine that a New York partner is sued for malpractice by a New York client on a real estate transaction that took place in New York, and the partner pays the entire amount of damage out of his own pocket. If this were to occur, can one bring a lawsuit in New York against a partner residing in California for contribution if the latter is neither a member of the firm's management committee nor connected with New York personally except for his ownership in the firm? Similarly, if a New York partner leases an office space to the law firm's New York office, can he sue a Nevada partner in a New York court for personal liability when the law firm defaults on the rent? In absence of the partner's control of the partnership's business or other involvement in the decision-making process that transcends above mere ownership of equity interest, due process likely bars such claims.[113] To enforce the personal liability against all partners, the creditor-partner would have to bring a lawsuit in multiple jurisdictions. Simultaneous lawsuits are cost-prohibitive and time-consuming. "For practical purposes, the law would be unenforceable."[114] The difficulty of collecting from small partners results in large partners being targeted for collection, violating the principle that each unit of equity interest in the partnership be accorded equal value.[115]

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111. Alexander, *supra* note 107, at 401.

112. *See America's 350 Largest Law Firms, supra* note 2. For example, Baker & McKenzie has seventy-seven offices global wide and ten locations in the U.S. BAKER MCKENZIE, https://www.bakermckenzie.com/en/locations/north-america/united-states [https://perma.cc/GHR3-DMZ5] (last visited Apr. 6, 2021). DLA Piper has nearly one-hundred overseas offices and nearly thirty U.S. locations. DLA PIPER, https://www.dlapiper.com/en/us/locations/ [https://perma.cc/KU3H-ACKC] (last visited Apr. 6, 2021).

113. *See* Alexander, *supra* note 107, at 401 (stating that jurisdiction over the partnership does not automatically confer jurisdiction over the partners individually; rather, jurisdiction requires a partner's control over the partnership or participation in the decision-making).

114. *See* Alexander, *supra* note 107, at 388.

115. *See* Alexander, *supra* note 107, at 426

> ("Taking into account the realities of obtaining and collecting judgments against public shareholders, it appears that the only shareholders who would genuinely be at risk are those with very large holdings. We can assume that, in any public

B. Bankruptcy Trustee's Standing

Can a creditor-partner of an LLP circumvent the requirement for minimum contacts by forcing the partnership into bankruptcy and resorting to the nationwide jurisdiction of the bankruptcy court? It is settled law that creditors of the partnership cannot pursue individual partners directly when the partnership is in a bankruptcy proceeding – only a trustee for the bankrupt estate has such a power.[116] Under § 723 of the Bankruptcy Code, the trustee of a *general* partnership that is in a Chapter 7 proceeding has standing to sue partners for contribution "to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency."[117] Arguably, LLP partners are essentially general partners in regard to debts owed to co-partners if the state's partnership law imposes personal liability for such debts. However, the trustee can sue individual partners only for debts owed to the partnership.[118] Courts have not had an opportunity to determine whether a personal liability of LLP partners for debts owed to fellow partners is a liability to the individual partners rather than to the partnership. In the corporate shareholder setting, some courts have held that a bankruptcy trustee has no standing to reach the assets of the corporation's shareholders who have been found personally liable for corporation's indebtedness under the alter ego doctrine.[119] In terms of the trustee's standing, there is a plausible analogy between corporate shareholders and

corporation, there are enough large shareholders to make it worthwhile for plaintiffs to pursue them for pro rata excess liability. The resulting regime would still contravene the principle . . . that the expected value of shares should be the same for all holders in order to preserve market liquidity.").

116. *In re* Comark, 53 B.R. 945, 947 (Bankr. C.D. Cal. 1985).

117. 11 U.S.C.A. §723(a) (West 2020)

("If there is a deficiency of property of the estate to pay in full all claims which are allowed in a case under this chapter concerning a partnership and with respect to which a general partner of the partnership is personally liable, the trustee shall have a claim against such general partner to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency.").

118. 11 U.S.C.A. § 323(a) ("The trustee in a case under this title is the representative of the estate"). Metropolitan Creditors' Tr. v. Pricewaterhousecoopers, LLP, 463 F.Supp.2d 1193 (E.D. Wash. Nov.14, 2006).

119. *See*, *e.g.,* Ozark Rest. Equip. Co. v. Anderson (*In re* Ozark Rest. Equip. Co., Inc.), 816 F.2d 1222 (8th Cir. 1987) (holding that a Chapter 7 bankruptcy trustee does not have "standing to assert, on behalf of the debtor corporation's creditors, an alter ego action against the principals of the corporation."); Shaoxing County Huayue Import & Export v. Bhaumik, 120 Cal. Rptr. 3d 303, 311 (Cal. Ct. App. 2011) (holding ". . . claims based on alter ego liability were not the property of ITC's bankruptcy estate . . . ").

LLP partners. Both situations involve debts owed by the enterprise, a deficiency in the enterprise's assets to satisfy the debts, an establishment of personal liability on the part of the enterprise's owners under state laws, and the bankruptcy trustee's endeavor to garner the personal assets of the owners to be forwarded to the creditors. The precedents of alter ego cases at least highlight the uncertainty of the law on this issue. Moreover, even if the trustee has the standing to sue individual partners in Chapter 7 liquidations, he has no right to sue in Chapter 11 re-organizations because the Bankruptcy Code has explicitly limited the trustee's power under § 723 to Chapter 7 cases.[120] Forcing the partnership into a Chapter 7 liquidation may result in a flash sale of partnership assets, hurting the interest of all partners, including the creditor-partner who seeks for a repayment of his loans.

C. A Partner's Standing to Petition for an Involuntary Bankruptcy

There is also a substantial doubt on an LLP partner's standing to force the partnership into bankruptcy. Section 303(b) of the Bankruptcy Code[121] permits fewer than all *general* partners to petition for an involuntary bankruptcy of the partnership, but 303(a) denies the same standing for shareholders of corporations.[122] The question boils down to whether an LLP

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120. 11 U.S.C.A. § 103 (West 2020); *See e.g. Kaveney v. Kaveney (In re* Kaveney*),* 60 B.R. 34, 36 (B.A.P. 9th Cir. 1985) (holding that §723(a) claims are limited to those arising from a Chapter 7 partnership case); *In re Monetary Group,* 55 B.R. 297 (Bankr.M.D.Fla.1985); I-37 Gulf Ltd. P'ship v. Seikel (*In re* I–37 Gulf Ltd. P'ship*),* 48 B.R. 647, 650 (Bankr. S.D. Tex. 1985)

> ("Since §723 would be available in a liquidating bankruptcy (i.e. Chapter 7) and therefore the assets of the general partners could be reached by the liquidating trustee to satisfy any deficiency in payment of the debts of the partnership, it seems clear to this Court that if all of the partners are solvent as alleged herein no plan can be confirmed unless all creditors are paid in full."),

Notchcliff Assoc v. Price (*In re* Notchcliff Assoc.), 139 B.R. 361, 370 (Bankr. D. Md. Apr. 14, 1992) (noting "Section 723, however, has been held to confer no such authority upon a Chapter 11 trustee . . . ").

121. 11 U.S.C.A. § 303(b)(3) (West 2020)

> ("An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title-- (3) if such person is a partnership--(A) by fewer than all of the general partners in such partnership; or (B) if relief has been ordered under this title with respect to all of the general partners in such partnership, by a general partner in such partnership, the trustee of such a general partner, or a holder of a claim against such partnership.").

122. 11 U.S.C.A. § 303(a) (West 2020)

> ("An involuntary case may be commenced only under chapter 7 or 11 of this title,

is regarded as a corporation or a general partnership for purposes of this section. Section 101 (9)(A) of the Bankruptcy Code defines "corporation" to include a "partnership association organized under a law that makes only the capital subscribed responsible for the debts for such association."[123] In *In re Beltway Law Group, LLP*,[124] the bankruptcy court examined this definition against the partnership statute of the District of Columbia that mimicked the provision of the RUPA on LLP partners' limited liability and concluded that the partnership statute had removed all personal liabilities of LLP partners. As a result, the court held that an LLP should be treated as a corporation and hence its partners did not have the standing to force the partnership into a Chapter 7 bankruptcy. The court reasoned that § 303 was for protecting *general* partners who were exposed to personal liability by enabling them to preserve the value of partnership assets through bankruptcy. The court found such a purpose lacking in the context of LLPs because it believed that the plain language of the partnership statute suggested a corporate-style limited liability.[125] The same conclusion was reached in *In Re Rambo Imaging, LLP*.[126] Both decisions were premised on the court's interpretation of the partnership statute as conferring a broad protection against personal liability for LLP partners. Arguably, if the LLP statute is modified to explicitly endorse the Narrow Interpretation of limited liability, the bankruptcy court might be willing to reverse its decisions and grant the standing to a creditor-partner. Until that modification happens, the law as it stands today denies such a standing.

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and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced.").

123. 11 U.S.C.A. §101(9)(A)(ii) (West 2020).

124. *In re* Beltway L. Grp., LLP, 514 B.R. 341 (Bankr. D.C. 2014).

125. *Id*. at 343.

126. *In re* Rambo Imaging, L.L.P., 2008 WL 2778846, at *6–7, 9 (Bankr. W.D. Tex. July 15, 2008) (holding that a partner of a Texas LLP could not force the partnership into bankruptcy under § 303 of the Bankruptcy Code because the Texas LLP statute, by providing that "a partner in a limited liability partnership is not personally liable, 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," provided a full liability protection similar to that afforded shareholders of a corporation).

V CONTRADICTIONS TO ACCEPTED WISDOMS OF LAW-MAKING

A. *Good Law as Gap-Filler for Private Ordering*

People may argue that given the ability of partners to negotiate for a different contract among themselves than the default statutory provisions, or simply file the LLP registration with a state such as California that provides for a broader liability protection,[127] a default rule on liability does not matter much in reality.[128] Such a proposition turns law-making on its head. The ability of contractual parties to deviate through private ordering or forum shopping does not justify promulgating bad laws to begin with.[129] Besides, partnerships often operate under an established hierarchical structure that features the dominance of a few senior partners. When new partners are admitted, they are given the choice of either accepting the status quo or forgoing partner status completely. The latter is hardly a viable choice because the partner status is the result of years of sacrificial hard labor coming to fruition, a symbol of achievement that few people are willing to risk losing for a chance of managerial equality. Bargaining occurs most likely in small partnerships with just a handful of partners.[130] For large

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127. Most LLP statutes have a choice-of-law provision that models after the RUPA Section 104 Governing Law, which provides:

> "The internal affairs of a partnership and the liability of a partner as a partner for a debt, obligation, or other liability of the partnership are governed by: (1) in the case of a limited liability partnership, the law of this state; and (2) in the case of a partnership that is not a limited liability partnership, the law of the jurisdiction in which the partnership has its principal office."

Conflict of law theories also point to the law of the state of registration as the law governing the relationship among partners. *See* Christine M. Przybysz, *Shielded Beyond State Limits: Examining Conflict-of-Law Issues in Limited Liability Partnerships*, 54 Case W. Res. L. Rev. 605, 616 (2003) (noting ". . . limited liability statutes contain a choice-of-law provision stating that a state must recognize and apply the law of the state under which the LLP was formed.").

128. *See, e.g.,* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation,* 52 U. CHI. L. REV. 89, 102 (1985) ("In light of the ability of firms to duplicate or at least approximate either limited or unlimited liability by contract, does the legal rule of limited liability matter? The answer is yes, but probably not much.").

129. *See* Melvin Aron Eisenberg & James D. Cox, BUSINESS ORGANIZATIONS: CASES AND MATERIALS 140 (11th ed. 2014)

> ("Of course, any rule of partnership law, no matter how foolish, could be 'justified' by the argument that it can be contracted around. The point of partnership law, however, should be to make good rules that the parties probably would have agreed to if they had addressed the issue, not to make bad rules that the partners can contract around.").

130. James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U.L.

partnerships (e.g., corporate law firms) with concentrated managerial authorities, the bargaining right by new and subordinated partners is fanciful but titular.[131] In addition, many partners do not know the exact boundary of the law and the need to contract around it.[132] Partners often commence their ventures without a formal partnership agreement.[133] Even if an agreement is signed, it typically regulates the long-term relationship rather than showcasing the bargains in any specific transaction. The lack of any agreement and the inability of partners to anticipate every contingency require the law to fill the gaps with default rules. The role of the partnership statute as the gap-filler is explicitly recognized by the drafters of RUPA.[134]

REV. 257, 262 (2015) ("In the business organizational setting, consent so necessary for contracting can more easily be found within small groups. For example, contract-like construction of the "bargained-for" relationship appears in the case law of close corporation law.").

131. Robert W. Hillman, *Private Ordering Within Partnerships*, 41 U. MIAMI L. REV. 425, 441 (1987)

> ("Consider the plight of the large law firm's associate who labors five, seven, nine, or more years in the quest to become a partner. . . . When the day of her reward arrives and she is invited to be a partner, the associate is presented with a copy of the partnership agreement, which obviously will provide a structure for the partnership quite different from that offered by the U.P.A.'s default provisions. This event is perfunctory; bargaining opportunities are nonexistent; the definitive agreement is an imposed agreement.").

132. Eisenberg & Cox *supra* note 129, at 140

> ("Furthermore, many partners don't know partnership law, and therefore won't realize they need to contract around any given rule. Indeed, because persons can be partners without having an intention to form a partnership, many partners don't even realize that they are partners, let alone realize that they should consider contracting around any given rule of partnership law"). *See also* Hamilton *supra* note 48 at 1093 ("There is a wide gulf, in short, between the theoretical model used by law and economics scholars in which all persons are sophisticated and the real world in which we live where most individuals may not even know what a default rule is, much less that it might be in their interest to seek to negotiate a special deal to change it in the unlikely event that something unexpected happens. The great bulk of society relies, without realizing it, on whatever default rule the legal system provides.").

133. Hillman *supra* note 131 ("For a variety of reasons, some good and others not, partners often commence their ventures with a handshake rather than by formalizing their understandings in partnership agreements. These partnerships will thereafter operate under the 'default' norms.").

134. RUPA *supra* note 10 § 105 cmt. ("Subsection (b) recognizes this act as comprising mostly default rules (i.e., gap fillers for issues as to which the partnership agreement provides no rule.").

B. Guiding Principles for Setting Default Rules

What are the guiding principles for setting default rules? *First*, most scholars argue that good default rules should reflect the wishes of the majority of interested parties if contracting were efficient.[135] This approach is justified on the notion of efficiency because it saves transaction costs by reducing the number of issues that the parties need to bargain over.[136] This approach is seen in RUPA's provision on how partners should share profits and losses in the absence of an agreement.[137] Courts have followed the same approach in construing ambiguous contracts by asking how a person of the majority sensitivity and intelligence would have intended to achieve through the disputed provisions.[138] *Second*, to the extent that incomplete contracts

135. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 89 ("Few academics have gone beyond one-sentence theories stipulating that default terms should be set at what the parties would have wanted."); Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 HARV. L. REV. 1161, 1181–82 (1981) (" . . . statutes provide standard form "contracts" of the sort shareholders would be likely to choose . . . .").

136. Ayres & Gertner, *supra* note 135, at 93 ("Scholars who attribute contractual incompleteness to transaction costs are naturally drawn toward choosing defaults that the majority of contracting parties 'would have wanted' because these majoritarian defaults seem to minimize the costs of contracting."); Randall S. Thomas, *What Is Corporate Law's Place In Promoting Societal Welfare?: An Essay in Honor if Professor William Klein*, 2 Berkeley Bus. L.J. 135, 138 ("The choice of what the right default rules are, though, has efficiency implications because if the parties reject the rule and bargain around it, they incur additional costs.").

137. RUPA *supra* note 10 § 401(a) ("Each partner is entitled to an equal share of the partnership distributions and, except in the case of a limited liability partnership, is chargeable with a share of the partnership losses in proportion to the partner's share of the distributions"). RUPA *supra* note 10 § 401(a) cmt. a ("This rule, carried over from UPA (1914) rests on the assumption that partners would likely agree to share losses on the same basis as distributions, but may fail to say so." Although this is the only explicit acknowledgement of the basis for RUPA's default rules, it is reasonable to believe this approach underlies most, if not all, nonmandatory provisions of the model statute).

138. Mark Moller, *The Rule of Law Problem: Unconstitutional Class Actions and Options for Reform*, 28 HARV. J.L. & PUB. POL'Y 855, 860 ("[I]ntent may be construed by reference to what most people would prefer (so-called majoritarian default rules). Here, interpretation aims to establish individual intent; but proof turns on what most people would have intended and so is not a specific, individualized analysis of the unique transaction."). *See, e.g.*, RLS Assocs., LLC v. United Bank of Kuwait PLC, 380 F.3d 704, 710 (2d Cir. 2004) (construing commercial contract, "[w]ords are . . . interpreted in the way in which a reasonable commercial person would construe them, and the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on niceties of language." (quoting Mannai Inv. Co. v. Eagle Star Life Assurance Co., A.C. 749, 771 (1997))); All. Metals, Inc. v. Hinely Indus., Inc., 222 F.3d 895, 901 (11th Cir. Aug. 15, 2000) quoting Village Beer & Beverage, Inc. v. Vernon D. Cox & Co., Inc., 327 Pa. Super. 99, 475 A.2d 117, 121 (1984) ("In construing a contract, the intention of the parties is paramount and the

can be attributed to the withholding of superior information by one party, the disclosure of which would lead to a utility-enhancing outcome for both parties, it has been argued that the default rules should be set against the informed party so that he has an incentive to bargain around it, disclosing valuable information in the negotiation process.[139] For example, when a sales contract fails to provide for the quantity of goods subject to the transaction, the default rule should set the quantity to be zero (i.e., invalidate the contract) so that the party that values the contract higher has an incentive to specify a quantity *ex-ante*.[140] *Third*, default rules should strive to minimize agency costs when it is difficult to monitor the agent's conducts.[141] That explains why corporate statutes set elaborate default rules to restrict directors' self-dealings.[142] The law presumes that such transactions are unfair to the corporation unless the directors satisfy the burden of proving otherwise.[143] *Fourth*, the law should protect parties' reasonable expectations from their bargains and prevent a stronger bargaining party from unfairly taking advantage of the weaker party. The duty of good faith of fair dealing that cannot be eliminated by partnership agreements exemplifies this

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court will adopt an interpretation which under all circumstances ascribes the most reasonable, probable, and natural conduct of the parties, bearing in mind the objects manifestly to be accomplished." (quoting Village Beer & Beverage, Inc. v. Vernon D. Cox & Co., Inc., 327 Pa. Super. 99, 475 A.2d 117, 121 (1984))); Golf Scoring Sys. Unlimited, Inc. v. Remedio, 877 So. 2d 827, 829 (Fla. Dist. Ct. App. 2004) ("Words should be given their natural meaning or the meaning most commonly understood in relation to the subject matter and circumstances, and reasonable construction is preferred to one that is unreasonable." (citing Thompson v. C.H.B., Inc., 454 So.2d 55, 57 (Fla. 4th DCA 1984))).

139. Ayres & Gertner, *supra* note 135 at 94 ("[T]he possibility of strategic incompleteness leads us to suggest that efficiency-minded lawmakers should sometimes choose penalty defaults that induce knowledgeable parties to reveal information by contracting around the default penalty.").

140. Ayres & Gertner, *supra* note 135, at 96.

141. Susan S. Fortney, *Seeking Shelter in the Minefield of Unintended Consequences - The Traps of Limited Liability Law Firms*, 54 WASH. & LEE L. REV. 717, 749 (1997) ("Supporters of LLP and LLC legislation advocate the limited liability rule, referring to the difficulty of monitoring in large law firms. Basically, they assert that unlimited liability should be eliminated because size makes monitoring difficult in large firms.").

142. For example, Delaware General Corporations Law § 144 permits directors' self-dealings only if an informed board authorizes the transaction by votes of the majority of the disinterested directors, or if the transaction is approved by informed shareholders entitled to vote, and the contract is fair to the corporation. 8 Del. C. § 144. *See also* Thomas, *supra* note 133, at 139 (suggesting that a broad prohibition against self-dealing for public companies is justified by the limited ability of shareholders to monitor the conducts of directors).

143. *See* Lewis v. S. L. & E., Inc., 629 F.2d 764 (2d Cir. 1980) (holding that burden of proof rests on directors to show that self-dealing transactions are entirely fair to the corporation).

paternalistic approach.[144] *Fifth*, default rules should impose the cost of harm on those who are most capable of bearing the cost.[145] That is why the law imposes a duty to mitigate damages from the breach of a contract on the nonbreaching party. The nonbreaching party's failure to mitigate results in a reduction of the monetary damages that he is otherwise entitled to receive.[146] *Sixth*, default rules should induce optimal risk-taking by business participants by imposing a level of liability that is neither overly lenient nor excessively punitive.[147] *Seventh*, default rules should internalize the cost of harm within the business entities that have caused the harm rather than spreading it to every corner of the society.[148] This rationale has been invoked to justify a limited liability for at least publicly held corporations whose shareholder base constantly evolves with share transfers. People who are shareholders at the time a cause of action accrues against a corporation may have sold their shares and severed all ties with the corporation at the time the corporation is found liable.[149]

C. Shortfalls of the Narrow Interpretation of Limited Liability

The Narrow Interpretation of limited liability is incompatible with the principles of law-making discussed in the previous section.

First, from the perspective of setting the rules that reflect the preferences of interested parties, research has shown that risk aversion leads

144. Cox, *supra* note 130, at 266–68

> ("The touchstone for judicial protection, whether in the form of monetary relief or ordering dissolution, is whether the majority has substantially defeated the reasonable expectations of the minority holder . . . The protective feature finds force in the 'bargained for' exchange rhetoric, but the efficacy flows instead from what law anchored deeply in public policy believed necessary to protect expectations so as to promote entrepreneurial activity.").

145. Robert B. Thompson, *Corporate Law Criteria: Law's Relation to Private Ordering*, 2 BERKELEY BUS. L.J. 95, 102 (2005).

146. RESTATEMENT (SECOND) OF CONTRACTS, § 350 (AM. LAW. INST. 2020). *See*, *e.g.*, Warrington v. Great Falls Clinic, LLP, 443 P.3d 369 (Mont. 2019); TPL, Inc. v. United States, 118 Fed. Cl. 434 (2014).

147. Eisenberg & Cox, *supra* note 129, at 410 ("[L]imited liability provides corporations with an incentive to take risks that are economically undue in the sense that managers who desire to advance the interests of their shareholders may make investments that would be inefficient if all externalities had to be taken into account.").

148. Eisenberg & Cox, *supra* note 129, at 413 (arguing in favor of limited liability on the ground that "making those shareholders liable seems inconsistent with the argument that the objective of shareholder liability is to make the corporation internalize the cost of its wrongs.").

149. Eisenberg & Cox, *supra* note 129, at 413.

to entrepreneurs' preference for limited liability.[150] Indeed the preference for limited liability fueled the development of joint stock companies in the 19th century.[151] In 2019, the authors of this paper conducted an experiment in which the participants were forty-two second-year and third-year law students enrolled in a business law class at the University of Cincinnati College of Law. The participants had learned about attributes of general partnerships, including the joint and several liability among partners, but they were unfamiliar with limited liability partnerships. The participants were given a statute resembling the provision of RUPA § 306 (c) on limited liability. They were asked to take on the role of partners of an LLP that faced a financing decision: a loan at three percent interest rate from a fellow partner versus a loan at four percent interest rate from an outside creditor. The two loans were otherwise identical. The participants were asked to choose one of the loans in two scenarios: (1) limited liability applies to both loans, and (2) limited liability applies to only the loan from the outside creditor. In the first scenario, twenty-six out of forty-two participants chose the three percent loan from a fellow partner, whereas in the second scenario, only five out of forty-two participants chose the loan from the partner. The difference was statistically significant at five percent level.[152] In a follow-up question, the LLP was described as experiencing financial difficulties. The participants were asked to choose between (1) dissolving the business, taking no distribution from the partnership because all assets would be used to satisfy creditors, but incurring no personal liability for any unsatisfied debts, and (2) taking a loan from a partner at a low interest rate to pay off existing debts and continuing the business, but incurring personal liability if the partnership was to default on the loan. The first option was selected in thirty-nine out of forty-two answers. These results suggest that most LLP partners strongly prefer limited liability even though it means they would incur a slightly higher interest cost or close the business completely.

Second, from the perspective of setting the default rules *against* an informed party to elicit his disclosure of information, a partner who extends credit to the partnership is informed about the terms of the loan and its likely impact on the partnership's financial condition. He is better informed about the likelihood of the partnership's default than his fellow partners who are not privy to the negotiations and who may not even know about the existence

150. *See* Michael T. K. Horvath & Michael J. Woywode, *Entrepreneurs and the Choice of Limited Liability*, 161 J. INSTITUTIONAL & THEORETICAL ECON. 681 (2005).

151. Paddy Ireland, *Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility,* 34 CAMBRIDGE J. OF ECON. 837 (2010).

152. The Fisher exact test statistic value is <0.00001, the difference is significant at $p<0.05$.

of the loan. Thus, the default rule of liability should be set against the creditor-partner to incentivize him to explicitly negotiate the issue of personal liability with the partnership and other partners. In the process of this negotiation, the other partners are alerted of the risk of unlimited liability and given an opportunity to evaluate the terms of the loan against that risk.

Third, from the perspective of agency costs, the actual difficulty in monitoring the conducts of managing partners in a partnership with concentrated authorities contradicts the traditional notion of mutual agency upon which personal liability was justified.[153] Currently partnership law seeks to control the agency problem arising from self-dealing transactions of the managing partners through imposing a duty of loyalty that prevents any partner from acting adversely to the interest of the partnership.[154] Judicial scrutiny over self-dealing transactions has focused on the fairness of the terms of the transactions. Terms at the prevailing market rates are generally upheld by courts in absence of any flagrant evidence suggesting that the transactions are incompatible with the partnership's strategic goals or financial conditions.[155] Under the Narrow Interpretation of limited liability, a transaction that is fair in its terms and concordant with the partnership's overall interest may nonetheless be "adverse" to the interest of the majority of the partners given their strong aversion to personal liability. The management's self-dealings that sow the seed for future personal liabilities would present a thorny agency problem for the partnership law to contend with. Can the partnership law solve the problem by prohibiting all self-dealings unless the partnership agreement permits otherwise? Such a broad restriction prevents the partnership from taking advantage of opportunities whose merits may indeed override the concern for personal liability. In addition, as discussed earlier in this paper, an ex-ante authorization is likely a boilerplate provision in the partnership agreement which many partners are powerless to gainsay given the inequality in their bargaining powers. Can the partnership law install procedural safeguards such as requiring at least the majority vote of the partners before any self-dealing can occur? Such a deal-specific approval procedure is likely cumbersome and disruptive. Imagine a situation in which Baker & McKenzie, one of the biggest law firms with more than one thousand partners and ten offices in the U.S. alone, looks

153. Ireland, *supra* note 151, at 840.

154. *See* RUPA, *supra* note 10, at § 409(b) (a partner's fiduciary duty includes accounting for partnership property and profits, refraining from appropriating partnership opportunities, avoiding conflicts of interests, and refraining from competing with the partnership).

155. J&J Celcom v. AT&T Wireless Servs., 481 F.3d 1138 (9th Cir. 2007); Gum v. Schaefer, 683 S.W.2d 803 (Tex. App. 1984).

for a storage place in New York for its backup office equipment. If a New York partner owns a place ideal for this purpose and offers it to the firm for a discounted rent, should the firm seek a vote of all partners, including those located in California, Florida, Illinois, Texas, etc. before accepting the deal? Likewise, should all partners vote before the firm's Miami, Florida office retains the catering service of another partnership or an LLC in which one of the firm's partners owns a major interest? Arguably the firm can prevent the triviality by specifying a transaction threshold amount beyond which all partners are given a right to vote. But fixing the adequate threshold may itself be a challenge because adequacy is in the eye of the beholder – a wealthy partner may view $1 million as a good trigger for a firm-wide voting whereas a less affluent partner may demand a much lower threshold. A broad liability shield irrespective of the status of the creditors avoids this type of agency problem. It imposes the burden to negotiate for a deviation on self-dealing partners who, in the least, have an option to abandon the transaction if negotiation is unsuccessful. A broad liability shield aligns with the existing paradigm of partnership fiduciary duty by permitting self-dealing transactions to occur if they pass the courts' fairness probe, without forcing a calamitous consequence of personal liability on less equal partners.

Fourth, a Narrow Interpretation of limited liability, as endorsed by *Ederer v. Gursky*, is incongruous with the reasonable expectation of LLP partners who rely on partnership statutes that model after the RUPA on limited liability. As part of the experiment discussed earlier in this paper,[156] the participants were asked to read RUPA § 306(c) and answer whether it calls for personal liability of partners when the LLP defaults on a $3 million loan from (1) an outside creditor, and (2) a fellow partner. In the first scenario, forty out of forty-two participants answered "no" to personal liability; in the second scenario, thirty-six out of forty-two participants answered "no." The two ratios are statistically indifferent at five percent significance level.[157] The slight difference was possibly due to some participants' familiarity with the decision in *Ederer v. Gursky*.[158] This experiment shows that most people do not distinguish, based on the statutory provision, debts owed to partners from those owed to outsiders for the purpose of limited liability. Such indifference is also reflected in the advice

156. *See* discussion *supra* Section IV.C.

157. The Fisher exact test statistic value is 0.2646. The difference in the two ratios is insignificant at $p<0.05$.

158. *Ederer v. Gursky*, *supra* note 14, was a case included in the textbook that the participants used for studying partnership law. Although the survey was conducted about one week before *Ederer v.Gurskyy* was assigned for reading, some participants might have read in advance and become acquainted with the decision before taking the survey.

that lawyers provide on their websites regarding LLPs.[159] The Narrow Interpretation of limited liability, if widely followed, would render the plain language of RUPA § 306 (c) profoundly misleading.

Fifth, from the perspective of allocating liabilities to those better positioned to bear the cost of harm, some scholars have argued that limited liability is inappropriate at least for tort cases where victims are hapless individuals typically impuissant to bear the consequences of the injury.[160] Whether or not limited liability suits tort cases is beyond the scope of this paper, but to the extent tort liability continues to be limited under partnership statutes,[161] the Narrow Interpretation of the liability shield would result in injured partners being treated more favorably than outside victims in terms of damage recovery. If both a partner and a client are hit by a fallen chandelier in the partnership's office, and the partnership lacks sufficient assets to pay for the damage awards, the Narrow Interpretation allows the partner to recover more by pursuing personal liabilities against other partners while the client cannot. This difference is nonsensical in light of the fact the partner is an insider who is privy to information on the partnership's financial conditions and insurance coverage. He is better positioned than the client to protect himself from mishaps like this by, for example, purchasing more insurance on his own. The same argument applies to a contractual setting as well - a partner who extends loans or services to the partnership is better informed about the partnership's risk of default than is an outside creditor and hence should not be treated preferentially in debt collection. In addition, when a creditor-partner seeks to recover from personal assets of innocent bystander-partners who own just a miniscule percentage of interest in the partnership, their relative ability to bear the consequence of the partnership's default is not immediately clear.

Sixth, in terms of setting the liability level to induce an optimal risk-taking, some scholars have argued that limited liability creates a moral hazard by allowing the owners of the business to shift the costs to the general

159. *See* Akhbari, *supra* note 17; *see generally, Limited Liability Partnership – LLP formations*, *Benefits of an LLP*, SIMPLE FORMATIONS, *supra* note 17; Hart *supra* note 17; Keatinge et al. supra note 17 at 147 ("An LLP is a general partnership in which the vicarious liability of the partners for the obligations of the partnership has been limited").

160. Alexander, *supra* note 107, at 391 ("The ability to externalize costs provides an incentive to the corporation and its managers to take insufficient care. Limited liability thus threatens the animating principles of tort law"). *See also* Fortney, *supra* note 141, *at 753* (arguing that limited liability in torts together with protections afforded by the Bankruptcy Code led to thin capitalization and low liability insurance).

161. Currently vicarious tort liabilities of LLP partners are shielded by LLP statutes in every jurisdiction. *See* Alison Martin-Rhodes et al., *Law Firms' Entity Choices Reflect Appeal of Newer Business Forms*, BUSINESS ENTITIES, July-Aug. 2014, at 16, 20–21.

public, and hence leads to excessive risk-taking, thin capitalization, and inadequate liability insurance.[162] Research has shown that the rate of medical malpractice in New York hospitals was thirty percent less than what it would have been were there no liability for medical malpractice.[163] However, research has also shown that when bankruptcy is built into consideration as a decision-maker chooses risk exposures, any gain from excessive risk is more than offset by the higher probability of bankruptcy. Bankruptcy aversion translates into a preference for safer prospects by risk-neutral individuals.[164] While it is always beneficial for a decisionmaker to choose higher risk when his initial wealth is zero, close to zero or negative so as to gain a chance at resurrection, his chosen risk exposure declines when endowed with substantial wealth that can be lost in bankruptcy.[165] In any case, if personal liability prompts the partnership to reduce risk exposures, there is no reason to create such an incentive only when the counterparty to the transaction is a partner as opposed to an outsider.

Seventh, cost internalization also counsels against the Narrow Interpretation of limited liability. Although selling partnership interest is more involved than simply submitting a sell order on the website of a leading stock brokerage firm, as is often the case for selling shares of publicly traded corporations, dissociations from the partnership do occur from time to time either because of partners' voluntary decision to sever the ties, rightfully or wrongfully, or involuntary departures such as deaths, personal bankruptcies, or expulsions. Although RUPA § 701 requires the partnership to indemnify the departing partner for all past and future debts and obligations,[166] the indemnification is not a release that requires the consent of the person holding a claim;[167] it merely obligates the partnership to reimburse the dissociated partner should he be found liable for activities during his tenure

162. Fortney, *supra* note 141, at 753.

163. *Id.* at 745. *See also* Sascha Füllbrunn & Tibor Neugebauer, *Limited Liability, Moral Hazard, and Risk Taking: A Safety Net Game Experiment*, 51 ECON. INQUIRY 1389 (2013) (explaining that the authors designed an experiment in which a risk taker faces either a full liability for his negligence or a limited liability by shifting some of loss to other people in the same company. The result shows care levels are lower with limited liability).

164. Wing Suen, *Risk Avoidance under Limited Liability*, 65 J. ECON. THEORY 627 (1995).

165. Christian Gollier, Pierre-Francois Koelh & Jean-Charles Rochet, *Risk-Taking Behavior with Limited Liability and Risk Aversion*; 64 J. RISK INS. 347 (1997).

166. RUPA, *supra* note 10, at § 701(d) ("A partnership shall defend, indemnify, and hold harmless a person dissociated as a partner whose interest is being purchased against all partnership liabilities, whether incurred before or after the dissociation, except liabilities incurred by an act of the person under Section 702.").

167. RUPA, *supra* note 10, at § 703 (c) ("By agreement with a creditor of a partnership and the partnership, a person dissociated as a partner may be released from liability for a debt, obligation, or other liability of the partnership.").

at the partnership. There are ample cases in which partners were held liable, under the joint-and-several-liability framework of general partnerships, in lawsuits brought years after their severance from the partnership. A case often cited to illustrate the lasting threat of liability is *Redman v. Walters*.[168] The defendant was an ex-partner of a law firm retained by the plaintiff in a lawsuit brought against a third person. The plaintiff's dealings with the law firm were exclusively through another attorney, and the defendant never met the plaintiff, nor communicated in any way with her or received any compensation for any services purportedly rendered on her behalf. The defendant later dissociated from the firm and practiced elsewhere. The law firm continued representing the client in the lawsuit until four years after the defendant's departure when the lawsuit was dismissed due to the failure of the plaintiff to bring it to trial within five years. The plaintiff brought a malpractice lawsuit against the firm, its existing and previous partners, including the defendant. The California Court of Appeals refused to dismiss the plaintiff's action against the defendant, reasoning that "[a]n individual partner's liability in such a case will not be terminated except by performance of an agreement creating the liability, or by express or implied consent of the other contracting party that he need not so perform."[169] Similarly in *Thompson by Thompson v. Gilmore*,[170] the plaintiff sued a law firm's ex-partners for malpractice which caused the plaintiff's wrongful death action on behalf of a deceased relative to be time barred by the Statute of Limitations. The law firm was dissolved by the time of the malpractice lawsuit, but the Missouri Court of Appeals held that the dissolution did not relieve ex-partners who did not work on the plaintiff's case from vicarious liability.[171] Consistent with these precedents, under the Narrow Interpretation of limited liability for LLP partners, a partner would be under the shadow of potential vicarious liabilities long after his dissociation from the partnership. The concern about such externality has been a compelling argument in favor of limited liability for shareholders of corporations.[172]

VI CONCLUSION

Does limited vicarious liability apply to LLP partners when the obligations (arising from torts or contracts) are owed to a fellow partner? There is a split of authority among the few courts that have dealt with this

168. Redman v. Walters, 152 Cal. Rptr. 42 (Ct. App. 1979).
169. *Id.* at 45.
170. Thompson by Thompson v. Gilmore, 888 S.W.2d 715, 716 (Mo. Ct. App. 1994).
171. *Id.* at 716.
172. Eisenberg & Cox, *supra* note 129, at 413.

issue. The New York Court of Appeals denied the applicability and the California Court of Appeals upheld it, based on similarly worded and structured LLP statutes of their respective jurisdictions that model after the RUPA. The issue is profoundly important as it matters to the fundamental decisions of where to register a business and in what form the venture should be organized – people who fear personal liability may choose to either form an LLC or register an LLP in a jurisdiction such as California. The issue is also pertinent to the managerial style and decision-making process of LLPs – the lingering personal liability may prompt partners to insist on unanimous votes even on matters that are otherwise ordinary and trivial. The issue also likely impacts the partnership's substantive business decisions – partners may vote to pay off debts owed fellow partners at the expense of outside creditors and business expansion opportunities. New York's Narrow Interpretation of limited liability has eluded the attention of lawyers who continue to advise clients on the similarity in the liability shield of LLPs and corporations/LLCs.

This paper shows that the Narrow Interpretation is inconsistent with the legislative intent behind the enactment of LLP statutes to provide a uniform liability framework for corporate shareholders, LLC members and LLP partners. In partnerships with a hierarchical management structure, the Narrow Interpretation causes inadvertent personal liabilities that contradicts the statutory requirement that the liability shield can only be waived by partners knowingly and intentionally. The Narrow Interpretation results in lasting ties between dissociated partners and the remaining partners that survive the dissolution of the partnership, in contravention to the "clean severance" ideal of the partnership statutes. The Narrow Interpretation leads to an *unus pro omnibus* situation in which one partner's provision of guaranty results in the same personal liability as if all partners have guaranteed the obligation, including those partners who have explicitly refused to do so. Such a result violates the law on guaranty that requires any guaranty to be provided with the consent of the guarantor and supported by consideration.

There are also procedural impediments to enforcing personally liabilities granted by the Narrow Interpretation. The Due Process requirement of minimum contacts with the forum state goes beyond a mere equity interest in the partnership that is registered in the forum state. Enforcing personal liabilities against a large number of partners of an LLP with offices sprawling across the country may require bringing simultaneous lawsuits in multiple jurisdictions at inhibitive costs. The end result is selective enforcements against wealthy partners, causing disparate values of unit interests in the partnership that depend on the partners' personal wealth.

Although the bankruptcy court has nationwide jurisdiction, the bankruptcy trustee can only reach assets that belong to the partnership as opposed to creditors, and only in Chapter 7 liquidations rather than Chapter 11 reorganizations. Although the Bankruptcy Code permits the trustee to reach the assets of general partners who are personally liable for contribution to the partnership's debts, there is no comparable provision that applies to LLPs. However, there are cases that have restricted the trustee's power from reaching the assets of shareholders who are found personally liable for the debts of the corporation under the alter ego doctrine.

There is an additional layer of uncertainty regarding an LLP partner's standing to petition for an involuntary Chapter 7 liquidation on behalf of the partnership. Existing cases denied such a standing on the ground that LLP partners have no personal liability for partnership debts, so they should be treated as corporate shareholders whose standing has been explicitly negated by the Bankruptcy Code. How a Narrow Interpretation of limited liability will impact future cases on this issue is yet to be seen.

The Narrow interpretation defies widely accepted wisdoms of law-making. These wisdoms counsel for default rules that replicate the majoritarian intent, incentivize information disclosure, minimize agency costs, meet the reasonable expectations of concerned parties, and internalize the cost of harm. The Narrow Interpretation undermines all the above. It treats partner-creditors more favorably than outside creditors, even though the former are insiders who have an unobstructed view of the full palette of the firm's financial and operational conditions.

The Narrow Interpretation of limited liability leaves an (overlooked) hole in the shield that is inconsistent with acknowledged legislative intents, prone to procedural challenges in enforcement, inharmonious with settled legal doctrines, and contradictory to reasonable expectations from reading the plain language of the partnership statute. Such an interpretation is plainly wrong.