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The Limitation of Liability
Through Business Forms

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I. [15.1] INTRODUCTION

At one time, law firms assumed that each individual member was responsible for the liability of every other member. Traditionally, partnership liability and vicarious liability were applied to law firm liability and the liability of individual partners and members. Today, business forms such as the professional corporation (PC), the limited liability company (LLC), and the limited liability partnership (LLP) are available to law firms. As new forms of doing business have become more commonplace, every state has adopted rules allowing law firms to limit liability by organizing into new business forms and structures.

Illinois was the last state to adopt a rule limiting the vicarious liability of lawyers. Prior to July 1, 2003, Illinois lawyers could practice law in professional service corporations, professional associations, or LLCs; however, these business forms did not insulate member lawyers from the liability of other member lawyers having an ownership interest in the business form for acts, errors, or omissions arising out of the performance of professional services. The Supreme Court amended Supreme Court Rule 721 effective July 1, 2003, to eliminate joint and several liability for lawyers organized in a professional corporation, professional association, LLC, or registered limited liability partnership as long as the business form maintains minimum insurance or proof of financial responsibility pursuant to S.Ct Rule 722. However, neither Rule 721 nor Rule 722 relieves any lawyer from personal liability for claims arising out of acts, errors, or omissions in the performance of professional services by that lawyer or any person under that lawyer’s direct supervision and control. S.Ct. Rule 722(c).

Sections 15.2 – 15.11 below discuss the law governing business forms available to businesses in Illinois, with special emphasis on the business forms available to lawyers. Sections 15.12 – 15.16 below discuss Rules 721 and 722. Sections 15.17 – 15.22 below discuss individual liability, supervisory responsibility under Illinois Rule of Professional Conduct 5.1, and malpractice insurance, as well as related issues.

II. [15.2] BUSINESS FORMS IN ILLINOIS

Sections 15.3 – 15.11 below discuss the various business forms available generally to businesses in Illinois.

A. [15.3] Sole Proprietorship

The business forms traditionally favored by law firms are the sole proprietorship and the general partnership (discussed in §15.4 below). Solo practitioners often choose a sole proprietorship as their business form. A sole proprietorship has no legal identity separate from that of the individual who owns it. Vernon v. Schuster, 179 Ill.2d 338, 688 N.E.2d 1172, 1176 – 1177, 228 Ill.Dec. 195 (1997); York Group, Inc. v. Wuxi Taihu Tractor Co., 632 F.3d 399, 403 (7th Cir. 2011). Doing business under another name does not create an entity distinct from the person operating the business. Vernon, supra, 688 N.E.2d at 1177. A sole proprietorship is an individual, not a corporation, and is not a suable entity separate from the sole proprietor. Bartlett v. Heibl, 128 F.3d 497, 500 (7th Cir. 1997); Fleet Mortgage Corp. v. Nelson, No. 86 C 3586, 1986 WL 6259 (N.D.Ill. May 23, 1986). A sole proprietorship and its owner are legally

**B. [15.4] General Partnership**


As with a sole proprietorship, a general partnership does not insulate the general partners from the debts and liabilities of the firm. A partnership, however, provides the advantages of pass-through taxation and control by the general partners, who can establish their relationship with flexibility. The disadvantage of the general partnership is the potential of a large judgment that can be enforced directly against the individual partners.

A law partnership and its members are liable for a tortious wrong or a contractual breach committed within the scope, or apparent scope, of the agency by one of its members. Ronald E. Mallen and Jeffrey M. Smith, 1 LEGAL MALPRACTICE §5.3 (2012). The substance and not the form of a business relationship determines whether the relationship qualifies as a partnership. *Davis v. Loftus*, 334 Ill.App.3d 761, 778 N.E.2d 1144, 1151, 268 Ill.Dec. 522 (1st Dist. 2002). Illinois law does not limit liability with respect to innocent copartners. *Keck, Mahin & Cate v. Billauer (In re Keck, Mahin & Cate)*, 274 B.R. 740, 748 (Bankr. N.D.Ill. 2002).

In addition, the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.*, provides:

(a) A partnership may sue or be sued in the names of the partners as individuals doing business as the partnership, or in the firm name, or both.

(b) An unsatisfied judgment against a partnership in its firm name does not bar an action to enforce the individual liability of any partner. 735 ILCS 5/2-411.

A partnership is a flow-through entity, meaning that the income of the partnership is taxed to its partners. ILLINOIS FORMS: LEGAL AND BUSINESS §30:10 (2011). All partners are jointly and severally liable for the wrongful acts of any other partner. 805 ILCS 206/305, 206/306. Under the UPA (1997), a partnership may utilize a statement of partnership authority setting forth the authority of a partner to enter into transactions on behalf of a partnership. 805 ILCS 206/303. A statement of partnership authority must set forth the following:

(i) the name of the partnership;

(ii) the street address of its chief executive office and of one office in this State, if there is one;

(iii) the names and mailing addresses of all of the partners or of an agent appointed and maintained by the partnership for the purpose of subsection (b); and

(iv) the names of the partners authorized to execute an instrument transferring real property held in the name of the partnership. 805 ILCS 206/303(a)(1).

In addition, the statement of authority “may state the authority, or limitations on the authority, of some or all of the partners to enter into other transactions on behalf of the partnership and any other matter.” 805 ILCS 206/303(a)(2).

The UPA (1997) provides that a purported partner may be liable to a person relying on his or her representations as well as anyone consenting to the representation as follows:

(a) If a person, by words or conduct, purports to be a partner, or consents to being represented by another as a partner, in a partnership or with one or more persons not partners, the purported partner is liable to a person to whom the representation is made, if that person, relying on the representation, enters into a transaction with the actual or purported partnership. If the representation, either by the purported partner or by a person with the purported partner’s consent, is made in a public manner, the purported partner is liable to a person who relies upon the purported partnership even if the purported partner is not aware of being held out as a partner to the claimant. If partnership liability results, the purported partner is liable with respect to that liability as if the purported partner were a partner. If no partnership liability results, the purported partner is liable with respect to that liability jointly and severally with any other person consenting to the representation.

(b) If a person is thus represented to be a partner in an existing partnership, or with one or more persons not partners, the purported partner is an agent of persons consenting to the representation to bind them to the same extent and in the same manner as if the purported partner were a partner, with respect to persons who enter into transactions in reliance upon the representation. If all of the partners of the existing partnership consent to the representation, a partnership act or obligation results. If fewer than all of the partners of the existing partnership
consent to the representation, the person acting and the partners consenting to the representation are jointly and severally liable. [Emphasis added.] 805 ILCS 206/308(a) – 206/308(b).

However, “[a] person is not liable as a partner merely because the person is named by another in a statement of partnership authority.” 805 ILCS 206/308(c).

For more information on general partnerships, see ILLINOIS BUSINESS LAW: LLCs AND PARTNERSHIPS (IICLE®, 2011).

C. [15.5] Limited Partnership


Under the ULPA (2001), a “limited partnership” is defined as a partnership of one or more general partners and one or more limited partners. 805 ILCS 215/102(13). A limited partner’s interest is essentially an investment. Samson v. Prokopf (In re Smith), 185 B.R. 285 (Bankr. S.D. Ill. 1995).

Under the ULPA (2001), “[a] limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership.” 805 ILCS 215/303.

General partners, on the other hand, are jointly and severally liable for all obligations of the limited partnership. See 805 ILCS 215/404.

**PRACTICE POINTERS**

- A schedule of limited partnership forms and filing fees is available on the Secretary of State’s website at www.cyberdriveillinois.com/publications/business_services/lp.html.

- A limited partnership is not one of the entities specified under S.Ct. Rule 721.

The fundamental difference between the liability of general partners and limited partners is that general partners are responsible in solido for the debts and obligations of the firm, without regard to the amounts contributed by them to the capital, while limited partners are not personally liable if the statute has been complied with because their cash contributions are substituted for


For more information on limited partnerships, see ILLINOIS BUSINESS LAW: LLCs AND PARTNERSHIPS (IICLE®, 2011).

**D. [15.6] Limited Liability Partnership**

The Uniform Partnership Act (1997) provides that a partnership may become a limited liability partnership. 805 ILCS 206/1001.

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**PRACTICE POINTER**

✓ A schedule of LLP forms and filing fees is available on the Secretary of State’s website at [www.cyberdriveillinois.com/publications/business_services/11p.html](http://www.cyberdriveillinois.com/publications/business_services/11p.html).

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An LLP is fairly simple to set up and is treated for tax purposes like a general partnership. Thus, an advantage of the LLP is that there is no double taxation as in a corporation.

The UPA (1997), 805 ILCS 206/306, provides:

(a) Except as otherwise provided in subsections (b) and (c) of this Section, all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.

(b) A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person’s admission as a partner.

(c) An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. 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. This subsection applies notwithstanding anything inconsistent in the partnership agreement that existed immediately before the vote required to become a limited liability partnership under Section 1001(b) of this Act.

For more on LLPs, see James W. Dodge, Ch. 7, *Limited Liability Partnerships*, ILLINOIS BUSINESS LAW: LLCs AND PARTNERSHIPS (IICLE®, 2011).
E. [15.7] Limited Liability Limited Partnership

The Uniform Limited Partnership Act (2001) provides that a limited partnership governed by its provisions may be a “limited liability limited partnership” (LLLP), which it defines as “a limited partnership whose certificate of limited partnership states that the limited partnership is a limited liability limited partnership.” 805 ILCS 215/102(11). The name of an LLLP must contain the phrase “limited liability limited partnership” or the abbreviation “LLLP” or “L.L.L.P.” 805 ILCS 215/108(c). 805 ILCS 215/404(c) provides that a general partner of an LLLP is not personally liable for an obligation of the LLLP:

(c) An obligation of a limited partnership incurred while the limited partnership is a limited liability limited partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the limited partnership. A general partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or acting as a general partner. This subsection applies despite anything inconsistent in the partnership agreement that existed immediately before the consent required to become a limited liability limited partnership under Section 406(b)(2).

As is the case with the limited partnership, the LLLP maintains the delineation between limited partners and general partners. The practitioner should be cautioned that LLLPs have not been addressed by the Supreme Court, although S.Ct. Rule 721(a) permits a law firm to organize as a registered LLP. The rule, as discussed more fully in §§15.12 – 15.15 below, provides that the following organizations may engage in the practice of law:

Professional service corporations formed under the Professional Service Corporation Act (805 ILCS 10/1 et seq.), professional associations organized under the Professional Association Act (805 ILCS 305/1 et seq.), limited liability companies organized under the Limited Liability Company Act (805 ILCS 180/1-1 et seq.), or registered limited liability partnerships organized under the Uniform Partnership Act (1997) (805 ILCS 206/100 et seq.), or professional corporations, professional associations, limited liability companies, or registered limited liability partnerships formed under similar provisions of successor Acts to any of the foregoing legislation or under similar statutes of other states or jurisdictions of the United States. S.Ct. Rule 721(a).

The LLLP is not one of the enumerated entities mentioned in Rule 721(a) and is the latest form in the evolution of unincorporated business entities. See Sheldon I. Banoff and Richard M. Lipton, Service Firms Practicing as LLLPs: What are the Tax Consequences? 103 J.Tax’n 124 (2005), for a discussion of potential advantages and disadvantages of LLLPs.

F. [15.8] Professional Corporation

The professional corporation emerged in the 1960s as a popular business form for law firms wishing to limit liability. Illinois adopted the Professional Service Corporation Act, 805 ILCS 10/1, et seq., in 1969. Under Illinois law, a “professional corporation” is defined as
a corporation organized ... solely for the purpose of rendering one category of
professional service or related professional services and which has as its
shareholders, directors, officers, agents and employees (other than ancillary
personnel) only individuals who are duly licensed by this State or by the United
States Patent Office or the Internal Revenue Service of the United States Treasury
Department to render that particular category of professional service or related
professional services (except that the secretary of the corporation need not be so
licensed), except that the registered agent of the corporation need not be licensed in
such case where the registered agent is not a shareholder, director, officer or
employee (other than ancillary personnel). 805 ILCS 10/3.4(a).

The Professional Service Corporation Act provides, in part:

Any officer, shareholder, agent or employee of a corporation organized under this
Act shall remain personally and fully liable and accountable for any negligent or
wrongful acts or misconduct committed by him, or by any ancillary personnel or
person under his direct supervision and control, while rendering professional
services on behalf of the corporation to the person for whom such professional
services were being rendered. However, a professional corporation shall have no
greater liability for the conduct of its agents than a general business corporation.
805 ILCS 10/8.

A PC is similar to a traditional corporation. The PC may issue shares of ownership important
in providing alternate means for management and also offers a broad range of benefits not
available in an unincorporated organization. In re Zisook, 88 Ill.2d 321, 430 N.E.2d 1037, 1044,
58 Ill.Dec. 786 (1981). In addition to the statutory alignment of PCs with traditional corporations,
the attributes of the PC and the benefits available under this form of organization closely parallel
those of a traditional corporation. Id.

Professional service corporations differ from ordinary business corporations in that only
licensed professionals can be members or shareholders. Riggs v. Woman to Woman, Obstetrics &
The purpose of the Professional Service Corporation Act is to provide certain tax breaks and to
reduce potential civil liability. Chatham Foot Specialists, P.C. v. Health Care Service Corp., 216
Ill.2d 366, 837 N.E.2d 48, 63, 297 Ill.Dec. 268 (2005). The failure of a business to obtain a
certificate of registration under the Professional Service Corporation Act is not akin to the failure
of individuals within that business to possess a professional license. See Id. (fact that podiatrists
failed to register as PC did not mean that they were engaging in unlicensed practice of medicine).
See also Riggs, supra.

For more information on PCs, see Thomas P. Conley, Ch. 8, Professional and Medical
Corporations, ILLINOIS BUSINESS LAW: CHOICE OF ENTITY ISSUES AND
CORPORATIONS (IICLE® , 2011).
G. [15.9] C Corporation

A C corporation is a corporation taxed under Subchapter C of the Internal Revenue Code. Regular business corporations under Illinois law are governed by the Business Corporation Act of 1983 (BCA), 805 ILCS 5/1.01, et seq. The BCA defines a “corporation” as a “corporation subject to the provisions of this Act, except a foreign corporation.” 805 ILCS 5/1.80(a). Section 2.10 of the BCA sets forth the requirements for a corporation’s articles of incorporation.

A corporation as a legal entity exists separately from its shareholders, directors, and officers, who are not ordinarily liable for the corporation’s obligations. Cosgrove Distributors, Inc. v. Haff, 343 Ill.App.3d 426, 798 N.E.2d 139, 141, 278 Ill.Dec. 292 (3d Dist. 2003); Main Bank of Chicago v. Baker, 86 Ill.2d 188, 427 N.E.2d 94, 56 Ill.Dec. 14 (1981). Thus, an advantage of the C corporation is that generally it will shield its shareholders, directors, and officers from liability, and potential losses are limited to the amount of the investment. The major disadvantage of the corporate entity is that a corporation is taxed twice, or subject to what is often characterized as “double taxation,” meaning that the corporation is taxed on its own income as earned, and, if the corporation pays dividends to its shareholders, the shareholders are then taxed on the dividends.

PRACTICE POINTERS

✓ A corporation may practice under an assumed name pursuant to 805 ILCS 5/4.15, provided that the corporation complies with the statutory requirements, including filing its true corporate name, the state or country where it is organized, its intention to transact business under an assumed name, and the assumed name it proposes to use.


For further discussion of C corporations, see ILLINOIS BUSINESS LAW: CHOICE OF ENTITY ISSUES AND CORPORATIONS (IICLE®, 2011).

H. [15.10] S Corporation

A variation on the corporate form is the S corporation. As in the case of a C corporation, the liability of an S corporation’s shareholders is limited to the amount of their investment. An S corporation is so designated because it is taxed according to Subchapter S of the Internal Revenue Code. In order to qualify as an S corporation, each of the corporation’s stockholders must elect S corporation status. 26 U.S.C. §1362. There are numerous criteria for qualifying for S corporation status. See 26 U.S.C. §§1361 – 1379. For example, there is a limit of 100 shareholders. 26 U.S.C. §1361(b)(1). For a thorough discussion of the pros and cons of electing S corporation status, see LIMITED LIABILITY COMPANIES AND S CORPORATIONS (IICLE®, 2010). See also John B. Truskowski, Ch. 7, S Corporations, ILLINOIS BUSINESS LAW: CHOICE OF ENTITY ISSUES AND CORPORATIONS (IICLE®, 2011).
I. [15.11] Limited Liability Company

In 1992, Illinois approved the Limited Liability Company Act (LLCA), 805 ILCS 180/1-1, et seq., which became effective January 1, 1994. A law firm wishing to form an LLC must file articles of organization with the Secretary of State. 805 ILCS 180/5-1(a).

PRACTICE POINTER
✓ A schedule of LLC forms and filing fees is available on the Secretary of State’s website at www.cyberdriveillinois.com/publications/business_services/11c.html.

Similar to an LLP or an LLLP, the name of each LLC in its articles of incorporation shall contain the term “limited liability company,” “L.L.C.,” or “LLC.” 805 ILCS 180/1-10(a). The court in Longview Aluminum, L.L.C. v. Industrial General, L.L.C., No. 02 C 0168, 2003 WL 21518585 at *5 (N.D.Ill. July 2, 2003), however, noted that a company’s failure to refer to its limited liability status in its name as required by state statute does not precipitate “the loss of all protections and advantages of the corporate form among them the fundamental protection of limited liability.” An owner of an LLC is defined as a “member.” An LLC is a legal entity distinct from its members and must have one or more members. 805 ILCS 180/5-1(b), 180/5-1(c).

Under 805 ILCS 180/13-5(a)(1),

[each member is an agent of the limited liability company for the purpose of its business, and an act of a member, including the signing of an instrument in the company’s name, for apparently carrying on, in the ordinary course, the company’s business or business of the kind carried on by the company binds the company, unless the member had no authority to act for the company in the particular matter and the person with whom the member was dealing knew or had notice that the member lacked authority.

Active members are taxed like general partners of a general partnership.

An LLC must have an operating agreement. See Katris v. Carroll, 362 Ill.App.3d 1140, 842 N.E.2d 221, 299 Ill.Dec. 482 (1st Dist. 2005); Edward Feldman, Essential Elements of an Operating Agreement for a Law Firm Organized as an LLC, 16 CBA Rec., No. 3, 30 (Apr. 2002) (discussing importance of operating agreement). See also LIMITED LIABILITY COMPANIES AND S CORPORATIONS (IICLE®, 2010). 805 ILCS 180/15-5(a) provides:

All members of a limited liability company may enter into an operating agreement to regulate the affairs of the company and the conduct of its business and to govern relations among the members, managers, and company. To the extent the operating agreement does not otherwise provide, this Act governs relations among the members, managers, and company. Except as provided in subsection (b) of this Section, an operating agreement may modify any provision or provisions of this Act governing relations among the members, managers, and company.

Under S.Ct. Rules 721 and 722, a law firm may organize as an LLC and enjoy protection from vicarious liability as more fully explained in §§15.12 – 15.16 below.

For further discussion of LLCs, see ILLINOIS BUSINESS LAW: LLCs AND PARTNERSHIPS (IICLE®, 2011).

### III. ILLINOIS SUPREME COURT RULES 721 AND 722

#### A. [15.12] Supreme Court Rule 721

S.Ct. Rule 721 was amended effective July 1, 2003. Prior to its amendment, the only entities available to Illinois attorneys were a professional association organized under the Professional Association Act, 805 ILCS 305/0.01, *et seq.*, a PC organized under the Professional Service Corporation Act, or an LLC organized under the Limited Liability Company Act. Rule 721 did not permit attorneys to practice as an LLP. The rule now provides that lawyers may practice as a registered limited liability partnership organized under the Uniform Partnership Act. S.Ct. Rule 721(a). See Steven G. Frost et al., *Limited Liability Practice: What Lawyers Should Consider, What Firms Should Do*, 91 Ill.B.J. 388 (2003). The rule applies to PCs, professional associations, LLCs, and registered limited liability partnerships formed under similar provisions of successor acts to any of the foregoing legislation or under similar statutes of other states or jurisdictions of the United States. S.Ct. Rule 721(a). This provision of the rule suggests that it will apply only to those enumerated acts as well as amendments or superseding acts. For a thorough discussion of S.Ct. Rule 721, see Sheldon I. Banoff and Steven F. Pflaum, *Limited Liability Legal Practice: New Opportunities and Responsibilities for Illinois Lawyers*, 17 CBA Rec., No. 3, 37 (Apr. 2003).

The rule does not address LPs or LLLPs. The practitioner should be cautioned that since LPs and LLLPs are not specifically mentioned in Rule 721, these entities are not currently available to Illinois attorneys.

Rule 721 provides that the enumerated entities may engage in the practice of law provided they meet certain criteria discussed in §§15.13 – 15.15 below.

S.Ct. Rule 721 provides that

each natural person shall be licensed to practice law who is (A) a shareholder, officer, or director of the corporation (except the secretary of the corporation), member of the association, member (or manager, if any) of the limited liability company, or partner of the registered limited liability partnership, (B) a shareholder, officer, or director of a corporation (except the secretary of the corporation), member of an association, member (or manager, if any) of a limited liability company, or partner of a registered limited liability partnership that itself is a shareholder of a corporation, member of an association, member (or manager, if any) of a limited liability company, or partner of a registered limited liability partnership engaged in the practice of law, or (C) engaged in the practice of law and an employee of any such corporation, association, limited liability company, or registered limited liability partnership. S.Ct. Rule 721(a)(1).

In addition, Rule 721(a)(2) provides that

one or more persons shall be members of the bar of Illinois, and engaged in the practice of law in Illinois, who are either (A) shareholders of the corporation, members of the association or limited liability company, or partners of the registered limited liability partnership permitted to engage in the practice of law in Illinois hereunder, or (B) shareholders of a corporation, members of an association or limited liability company, or partners in a registered limited liability partnership permitted to engage in the practice of law in Illinois hereunder that itself is a shareholder of the corporation, member of the association or limited liability company, or partner of the registered limited liability partnership permitted to engage in the practice of law in Illinois hereunder.

Rule 721 extends its protection to non-Illinois shareholders, members, or partners of the entity provided that at least one such individual is a member of the Illinois bar and practices law in Illinois. However, the rule makes clear that in order to practice law in Illinois, at least one person must be a member of the Illinois bar or specially admitted by court order to practice in Illinois. S.Ct. Rule 721(a)(4).

The rule emphasizes that no corporation, association, LLC, or registered limited liability partnership shall do anything that would violate the standards of professional conduct (S.Ct. Rule 721(a)(3)) and that “[t]his rule does not diminish or change the obligation of each attorney engaged in the practice of law in behalf of the corporation, association, limited liability company, or registered limited liability partnership to conduct himself or herself in accordance with the standards of professional conduct applicable to attorneys licensed by this court” (S.Ct. Rule 721(b)).

2. [15.14] Certificate of Registration

A law firm wishing to organize as a corporation, association, LLC, or registered limited liability partnership must apply for and obtain a certificate of registration in order to engage in the
practice of law in Illinois or maintain an establishment in Illinois for that purpose. S.Ct. Rule 721(c). A certificate of registration shall continue in effect until it is suspended or revoked subject to annual renewal on or before January 31 of each year. S.Ct. Rule 721(f).

PRACTICE POINTER

✓ An application for a certificate of registration to engage in the practice of law as a professional corporation, professional association, LLC, or registered limited liability partnership may be found on the Illinois Supreme Court’s website at www.state.il.us/court/supremecourt/prof_serv/app_profcorp.pdf.

In the event a law firm fails to comply with the requirements of Rule 721, it loses its right to invoke the corporate protections of limited liability that are encompassed in the rule. Storto v. Becker, 341 Ill.App.3d 337, 792 N.E.2d 384, 390 – 391, 275 Ill.Dec. 153 (2d Dist. 2003). The appellate court in Storto stated that Rule 721 was not enacted to protect the public, but rather was enacted to benefit law firms seeking to gain the benefits of incorporation. 792 N.E.2d at 391. Therefore, the court held that failure of a law firm to register for a license to practice law in Illinois did not void the contract between the law firm and the client, noting that the client had not been harmed by the failure to register and reasoning:

Consequently, a client who has been the victim of an incorporated law firm’s malpractice would be in a better position if the law firm had not complied with Rule 721 than if it had. . . . Based on this reality, it is apparent that Rule 721 was not enacted for public safety but rather to benefit the law firms that were seeking to gain the benefits of incorporation. Accordingly, we hold that the plaintiff’s failure to register as a corporation pursuant to Rule 721 did not render its contract with the defendant void on public policy grounds. [Citation omitted.] 792 N.E.2d at 390 – 391.

In Ford Motor Credit Co. v. Sperry, 214 Ill.2d 371, 827 N.E.2d 422, 427, 292 Ill.Dec. 893, (2005), the Supreme Court addressed the issue of whether a law firm’s failure to register as a professional service corporation pursuant to Rule 721 rendered the legal services provided by that law firm the unauthorized practice of law, nullified the proceedings in which the law firm participated, and caused the resulting judgments of the proceedings to be void. Citing Storto, supra, the Sperry court stated:

We adopt the analysis of Rule 721 set forth by the court in the Storto decision. We hold that a violation of the registration requirement contained in Rule 721(c) does not lead to the conclusion that the lawyers of the unregistered firm lacked either the authority or the competence to practice law. We emphasize that there is a fundamental difference between an unlicensed individual representing a party in legal proceedings or performing activities traditionally considered to be the “practice of law” and duly licensed attorneys who happen to belong to a law firm that has not filed its registration and paid its fees pursuant to Rule 721(c). The material inquiry in assessing whether there has been an unauthorized practice of
law is whether the individual who acts on behalf of a client is duly licensed by this court, as it is only individuals — and not corporations — who are granted the privilege to practice law. 827 N.E.2d at 432.

The Sperry court further noted that failure to comply with Rule 721(c) harms the noncomplying firm rather than the public. The fact that an attorney is duly licensed but belongs to an unregistered firm does not render the legal services provided by the firm’s attorneys the unauthorized practice of law. Id. For a discussion of Sperry, see Helen W. Gunnarsson, Law Firm’s Failure to Register Under Rule 721 Not UPL, 93 Ill.B.J. 330 (2005).

3. [15.15] Compliance with Supreme Court Rule 722

The greatest change effectuated by the 2003 amendment to S.Ct. Rule 721 is the ability of attorneys to limit joint and several liability, provided they maintain minimum insurance consistent with S.Ct. Rule 722. (Attorneys, however, are always bound by the Rules of Professional Conduct, and Rule 721 does not shield an attorney for supervisory liability as discussed in §15.18 below.)

Prior to the amendment, the rule provided that professional service corporations, professional associations, and LLCs did not insulate member lawyers from the liability of other member lawyers having an ownership interest in the business form for acts, errors, or omissions arising out of the performance of professional services. Former Rule 721(d) provided:

The articles of incorporation or association or organization shall provide, and the shareholders of the corporation or members of the association or limited liability company shall be deemed to agree by virtue of becoming shareholders or members, that all shareholders or members shall be jointly and severally liable for the acts, errors and omissions of the shareholders or members and other employees of the corporation or association or limited liability company arising out of the performance of professional services by the corporation or association or limited liability company while they are shareholders or members. [Emphasis added.]

Vicarious liability protection was virtually nonexistent because the rule required that the articles of incorporation or association provide that the shareholders or members be jointly and severally liable for the acts, errors, and omissions of the shareholders or members and other employees of the corporation, association, or LLC arising out of the performance of professional services.

Rule 721(d) now provides:

Unless the corporation, association, limited liability company, or registered limited liability partnership maintains minimum insurance or proof of financial responsibility in accordance with Rule 722, the articles of incorporation or association or organization, or the partnership agreement, shall provide, and in any event the shareholders of the corporation, members of the association or limited liability company, or partners of the registered limited liability partnership shall be deemed to
agree by virtue of becoming shareholders, members, or partners, that all shareholders, members, or partners shall be jointly and severally liable for the acts, errors, and omissions of the shareholders, members, or partners, and other employees of the corporation, association, limited liability company, or registered limited liability partnership, arising out of the performance of professional services by the corporation, association, limited liability company, or registered limited liability partnership while they are shareholders, members, or partners. [Emphasis added.]

Thus, the rule now allows a corporation, association, LLC, or registered limited liability partnership to avoid joint and several liability as long as the entity maintains minimum insurance or proof of financial responsibility in accordance with Rule 722.

B. [15.16] Supreme Court Rule 722

As discussed in §15.15 above, S.Ct. Rule 721(d) requires that limited liability entities comply with S.Ct. Rule 722, which was adopted April 1, 2003, and became effective July 1, 2003. Rule 722 provides, in part:

(b) The liability, if any, of owners of a limited liability entity, for a claim asserted against the limited liability entity or any of its owners or employees arising out of wrongful conduct, shall be determined by the provisions of the statute under which the limited liability entity is organized if that entity maintains minimum insurance or proof of financial responsibility. [Emphasis added.]

“Minimum insurance” is defined as “a professional liability insurance policy applicable to a limited liability entity, and any of its owners or employees, for wrongful conduct.” S.Ct. Rule 722(b)(1). The entity must have insurance in one or more policies for claims asserted during the annual policy period for wrongful conduct occurring during the policy period and the previous six years. The minimum amount of insurance is $100,000 per claim and $250,000 annual aggregate, times the number of lawyers in the firm at the beginning of the annual policy period. The insurance need not exceed $5 million per claim and $10 million annual aggregate. Id. An authorized shareholder, member, or partner of a limited liability entity must provide an affidavit or a verification by certification under §1-109 of the Code of Civil Procedure, 735 ILCS 5/1-109, with each application for registration or renewal. S.Ct. Rule 722(b)(1).

The minimum amount of insurance required is not affected by any policy exclusions that are customary in professional liability policies, by the fact that the entity did not maintain coverage at the time the wrongful conduct occurred as long as the policy covers prior acts, or if the per claim or annual aggregate limits are exceeded by any claims, judgments, or settlements. Id.

Unless an entity that provides evidence of insurance with a registration or renewal application fraudulently or willfully fails to maintain minimum insurance during the period covered by the registration or renewal, joint and several liability will be limited to the minimum per claim amount of insurance. Id. In any event, owners of an LLC are jointly and severally liable for the deductible or retention amount for claims arising out of alleged wrongful conduct unless the entity has provided proof of financial responsibility in an amount equivalent to the deductible or retention. S.Ct. Rule 722(b)(2). “Proof of financial responsibility” means that the funds are

The rule provides a definition and guidelines for determining adequate insurance and financial responsibility. However, Rule 722(c) provides that nothing shall relieve a lawyer “from personal liability for claims arising out of acts, errors, or omissions in the performance of professional services by the lawyer or any person under the lawyer’s direct supervision and control.”

IV. [15.17] INDIVIDUAL LIABILITY

Regardless of the business form, an attorney is always liable for his or her own acts or omissions. There is no way to limit the direct liability of a lawyer to the firm’s client in the rendering of professional services. In addition, a lawyer is liable for those individuals under his or her supervision or control.

The practitioner should be aware that compliance with entity formalities will be necessary to protect the individual attorney from piercing of the business veil.

V. [15.18] SUPERVISORY RESPONSIBILITY UNDER ILLINOIS RULE OF PROFESSIONAL CONDUCT 5.1

In addition to the Illinois Supreme Court Rules, the Illinois Rules of Professional Conduct govern the practice of law in Illinois. Illinois limited liability forms can exist only in harmony with the Supreme Court Rules and the Rules of Professional Conduct of 2010.

An attorney’s supervisory responsibilities for another lawyer are set forth in RPC 5.1, which provides:

(a) A partner in a law firm and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.

(b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.

(c) A lawyer shall be responsible for another lawyer’s violation of the Rules of Professional Conduct if:
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(1) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

A lawyer shall be responsible for another lawyer’s violation of the rules when a lawyer has ordered or had knowledge of another lawyer’s violation of the rules and ratifies the conduct involved, or is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action. RPC 5.1

VI. [15.19] ABA FORMAL OPINION ON THE PRACTICE OF LAW AS AN LLP

The ABA Committee on Ethics and Professional Responsibility issued Formal Op. 96-401 (Aug. 2, 1996), after investigating the interplay between the Model Rules of Professional Conduct and the increasing trend of law firms throughout the nation in practicing law as LLPs. Formal Op. 96-401 concluded that an LLP is a permissible form for the practice of law and does not violate the Model Rules of Professional Conduct if (a) the applicable law provides that the lawyer rendering the legal services remains personally liable to the client, (b) the requirements of the law in the relevant jurisdiction are met, and (c) the form of business organization is accurately described by the lawyers in their communications with clients. The opinion also approved use of the LLP abbreviation. Formal Op. 96-401 is indicative of the increased popularity of LLP and LLC business forms for law firms.

VII. [15.20] VICARIOUS LIABILITY UNDER RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS

The RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (2000) is intended to be a restatement of the current decisional and statutory law governing lawyers. RESTATEMENT §58 discusses the vicarious liability of law firms as follows:

(1) A law firm is subject to civil liability for injury legally caused to a person by any wrongful act or omission of any principal or employee of the firm who was acting in the ordinary course of the firm’s business or with actual or apparent authority.

(2) Each of the principals of a law firm organized as a general partnership without limited liability is liable jointly and severally with the firm.
(3) A principal of a law firm organized other than as a general partnership without limited liability as authorized by law is vicariously liable for the acts of another principal or employee of the firm to the extent provided by law.

The comment to RESTATEMENT §58 provides that, on the one hand, vicarious liability may help to ensure the quality of legal services and compensation for those with claims against the principals of the firm, but, on the other hand, “limited liability is a principle generally accepted for those engaged in gainful occupations, and it may be difficult for a lawyer to monitor effectively the behavior of other lawyers in a firm.” RESTATEMENT §58, cmt. b. The practical difficulties and implications for lawyers to monitor other lawyers in a firm has led to the adoption of modified partnership forms.

The RESTATEMENT recognizes that individuals remain liable for their own negligence and provides that a lawyer may not “make an agreement prospectively limiting the lawyer’s liability to a client for malpractice.” RESTATEMENT §54(4)(a). Even if the attorney is not a partner under traditional partnership notions, if a person represents himself or herself to be a partner or consents to another’s representation, that attorney may be vicariously liable. RESTATEMENT §58, cmt. c.

VIII. MALPRACTICE INSURANCE

A. [15.21] Adequate Insurance Under Supreme Court Rule 721

Supreme Court Rule 721 requires a law firm to maintain minimum insurance or proof of financial responsibility in order to take advantage of limiting liability by organizing as an LLC or LLP, and Supreme Court Rule 756(e) requires Illinois lawyers to report whether they have insurance to the Attorney Registration and Disciplinary Commission. In the Lawyer Search engine, www.iardc.org/lawyersearch.asp, the Attorney Registration and Disciplinary Commission currently reports whether an attorney has reported malpractice insurance in his or her Lawyer Registration form.

As of its 2001 annual report, the Attorney Registration and Disciplinary Commission reported that 40 percent of solo practitioners in Illinois admitted to not having any malpractice insurance. See Chart F: Malpractice Survey, in the 2001 Annual Report of the Attorney Registration and Disciplinary Commission of the Supreme Court of Illinois, www.iardc.org/new_page_2_copy1.htm. The results of the 60,000 responses to the survey are as follows:
The 2011 annual report shows the percentage of attorneys reporting legal malpractice insurance with 46,107 (52.4%) reporting insurance and 41,836 (47.6%) reporting lack of insurance in 2011. The 2011 annual report is available at www.iardc.org/annualreport2011.pdf.

Since solo practitioners favor sole proprietorships, the new business forms and resulting insurance requirements may not impact these attorneys. However, even firms that report having insurance may not have adequate insurance as set forth in S.Ct. Rule 722 in order to take advantage of the limitation of liability provided by business forms. See definition of “minimum insurance” in §15.16 above. The impact of Rules 721 and 722, particularly on small firms remains to be seen.

B. [15.22] Other Malpractice Insurance Considerations

Although Illinois law firms now have greater flexibility in limiting liability by organizing as LLPs and LLCs, law firms remain attractive targets for law suits. In addition, more often than not, attorneys rely on malpractice insurance to insulate them from personal liability rather than business forms. Limited liability entities may indeed lessen the impact of large claims, particularly underinsured claims against individuals. However, only time will tell regarding the effect the business form has on a firm’s malpractice insurance premiums or the availability of insurance. Traditionally, the factors taken into account in determining the size of the policy limits include the risk and financial exposure of the matters handled by the attorneys, the form of the practice, the assets of the law firm, the personal assets of each attorney and other principals who need protection, the skills and experience of the practicing attorneys, and the number of employees. See 5 Ronald E. Mallen and Jeffrey M. Smith, LEGAL MALPRACTICE §36.1, et seq. (2012).
Whether insurers will alter the structure used to set rates and determine insurability based on limited liability structures will likely be affected by caselaw interpreting the degree of protection provided to law firms by limited liability entities. In addition, a law firm and its individual attorneys cannot limit liability for the individual attorney’s wrongful conduct. Given this climate, Illinois attorneys should continue to focus on careful loss prevention measures to reduce risk, including increased attention to supervisory responsibility of members and employees, and adequate insurance levels.

IX. [15.23] CONCLUSION

Illinois attorneys now enjoy more freedom in choosing a business form. However, law firm and individual exposure cannot be limited for an individual’s wrongful conduct. As more and more firms adopt limited liability forms, whether the form of the business will have any effect on malpractice insurance and coverage should become more apparent. At any rate, law firms should maintain adequate levels of malpractice insurance and good risk management practices to minimize individual liability.