Notes

LAWYERS AND LIMITED LIABILITY FOR ARIZONA'S PROFESSIONALS:

DELIVERANCE OR DAMNATION?

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INTRODUCTION

When a state grants a corporate charter to a regular commercial business,[1] corporate law confers certain benefits upon the owners of that business. One of the chief benefits enjoyed by the shareholders of a regular commercial corporation is "limited liability," whereby the shareholders' personal financial liability[2] for the debts[3] of the corporation is limited to the assets which they have invested in the corporation. Every American jurisdiction recognizes this "corporate veil" protecting the personal assets of a regular commercial corporation's shareholders.[4]

Whereas it is an established rule of American law that the shareholders of a regular commercial corporation are entitled to enjoy limited liability, it is not

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1. The term "regular commercial business" is used in this Note to distinguish such businesses from "professional businesses," such as law firms, medical firms, accounting firms, etc. Similarly, this Note uses the term "regular commercial corporation" to distinguish such corporations from professional corporations.

2. It is important to keep in mind the differences between vicarious liability (liability for the debts of another), personal liability (the responsibility of an individual to satisfy a debt from his personal assets), and joint-and-several liability (the ultimate responsibility of each debtor to fully satisfy a debt, regardless of the creditor's ability to collect from the other debtors). In the corporate context, "limited liability" typically means limiting each shareholder's liability for the corporation's debts to the amount which he has invested in the corporation. In other words, "limited liability" means limited *personal* liability.

3. The term "debts" includes those debts incurred by a business in the ordinary course of its operation (hereinafter "business debts"), as well as debts incurred by the business as a result of legal judgments against it (hereinafter "legal debts").

In the case of a professional business, legal debts can further be categorized as "professional debts," those which arise directly from the rendition of professional services (e.g. professional malpractice), and "non-professional legal debts," those debts which result from a legal judgment against the business, but do not arise from the rendition of professional services (e.g. tort liability for slip-and-fall accidents on the business' premises).

4. For a more complete discussion of limited liability in the context of the regular commercial corporation, see WILLIAM A. KLEIN and JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 140–42 (5th ed. 1993).

clear that the same degree of limited liability should be granted to the shareholders of professional corporations.[5]

Prior to 1992, Arizona was typical of many states[6] in providing that the shareholders of professional corporations[7] were not entitled to enjoy limited liability for the professional legal debts of their firm.[8] In 1992, however, Arizona altered its position and extended the protections of limited professional-debt liability to the shareholders of professional corporations.[9] Due to this change, a shareholder in an Arizona professional legal corporation is now able to avoid personal financial responsibility for any debts which are incurred by the firm, unless those debts are a result of professional misconduct by a lawyer who is under the shareholder's direct supervision and control.[10]

This Note considers the circumstances under which it is desirable to extend the right of limited liability to the owners[11] of a law firm. This Note argues that neither the interests of the legal profession nor the general public

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5. While much of the commentary in this Note may apply to the practice of other professions, its scope is restricted to the effects which limited liability has upon lawyers and the legal profession.

6. One feature of American professional-corporation law is the lack of uniformity in the various states' approaches to the issue of limited liability for professional-corporation shareholders. For a detailed analysis of the approaches taken by the states in addressing this issue, see Karen M. Maycheck, Comment, *Shareholder Liability in Professional Legal Corporations: A Survey of the States*, 47 U. PITT. L. REV. 817 (1986).

7. In addition to a professional corporation statute, Arizona has a limited liability company statute, which offers limited liability to attorneys who organize their firm as a limited liability company. *See* ARIZ. REV. STAT. ANN. §§ 29-601 to 29-857 (1992). In the interest of simplicity, this Note addresses the issue of limited liability mainly in the context of Arizona's professional corporation statute. However, the arguments concerning the appropriateness of allowing lawyers to enjoy limited liability apply equally to all attorneys, irrespective of the organizational form which their firm takes.

8. Prior to the 1992 changes, the professional-debt liability provision of Arizona's professional corporation statute provided:

> Nothing in this chapter shall be construed to alter any law applicable to the relationship between persons furnishing and receiving professional service, including but not limited to liability arising therefrom, and the shareholders of the corporation shall be and remain *jointly and severally responsible* for such liability.
> ARIZ. REV. STAT. ANN. § 10-905 (1977) (ammended 1992) (emphasis added).

However, shareholders were allowed to enjoy limited liability for the business debts and non-professional legal debts of their firm. *See* ARIZ. REV. STAT. ANN. § 10-908(5) (1984).

9. The amended ARIZ. REV. STAT. ANN. § 10-905 (1992) now provides, in pertinent part: "The liability of a shareholder of the professional corporation is several only, and a shareholder is not vicariously responsible for the liability of another shareholder." *Id.*

The professional-debt liability provision for professional limited liability companies organized under Arizona's Limited Liability Company Act, also enacted in 1992, is substantially similar. *See* ARIZ. REV. STAT. ANN. § 29-846 (1992).

10. Arizona has continued to impose personal liability upon a professional-corporation shareholder, as well as upon the owner of a professional business organized as a limited liability company, when the owner himself, or someone under his direct supervision and control, has engaged in professional misconduct. *See* ARIZ. REV. STAT. ANN. §§ 10-905, 29-846 (1992).

11. Lay ownership of a law firm is forbidden by rules of legal ethics. *See* ABA MODEL RULES OF PROFESSIONAL CONDUCT RULE 5.4 (1993). Because the owners of a law firm must therefore be attorneys, they typically are employees of the firm as well. However, a law firm often will employ attorneys who are not owners of the firm. This can cause conceptual difficulties when considering the issue of limited liability. This Note addresses only the issues surrounding limited liability for the owners of a law firm.

are served by granting the same degree[12] of limited liability to the owners of a professional legal corporation as is granted to the shareholders of a regular commercial corporation. Accordingly, this Note recommends that the limited liability provisions of Arizona's professional corporation statute[13] be construed narrowly when applied to law firms.

In evaluating whether it is desirable to limit the personal liability of lawyers, the first question which must be considered is: desirable for whom? At first glance, there might not appear to be an identity of interests between practicing lawyers and the general public.[14] However, no rule governing the practice of law truly can serve the interests of the legal profession unless it serves the interests of the general public.[15] Therefore, this Note will analyze the issues surrounding the limited liability provisions of Arizona's professional corporation statute[16] as matters of public policy.

Two criteria will be considered most heavily in evaluating the public-policy ramifications of Arizona's limited-liability rules: (1) Is the quality of legal services maximized? (2) Is public faith in the ethics and competency of the bar enhanced?

This Note first sets forth a brief overview of the evolution of limited liability for attorneys nationally, from nearly universal disapproval in the late 1950's to varying degrees of acceptance today.[17] It then considers the policy ramifications of applying limited liability to the business debts of a law firm, and argues that limited liability is appropriate for these debts.[18] Next, this Note evaluates the desirability of limiting the personal liability of shareholder-lawyers for the professional legal debts of their firm, and argues that limited liability for these debts is inappropriate.[19] Finally, it considers whether limiting the personal liability of law-firm owners for the non-professional legal debts of their firm is desirable, and argues that, in most cases, limited liability for these debts is appropriate.[20] At each point in the analysis, this Note will recommend a judicial interpretation of the limited liability provisions of Arizona's professional corporation statute[21] which is consistent with the interests of the general public.

12. This Note does not argue that Arizona's limited liability rules are inappropriate in all circumstances. In particular, this Note endorses limiting the personal liability of professional legal corporations' shareholders for the ordinary business debts of their firms, as well as for some non-professional legal debts of their firms.

13. *See supra* note 7.

14. This is because lawyers may appear to have a greater interest in enjoying limited liability than the public has in granting limited liability to lawyers.

15. This statement is founded on the assumption that law should be practiced as a public profession, ultimately dedicated to serving the interests of the general public. If rules governing the practice of law serve only the interests of lawyers, without serving the interests of the public, then those rules lose their legitimacy.

16. *See supra* note 7.

17. *See* Part I *infra*, notes 22–51 and accompanying text.

18. *See* Part II *infra*, notes 52–67 and accompanying text.

19. *See* Part III *infra*, notes 68–132 and accompanying text.

20. *See* Part IV *infra*, notes 133–144 and accompanying text.

21. *See supra* note 7.

PART I: THE EVOLUTION OF LIMITED LIABILITY FOR ATTORNEYS

A. Evolution of the Professional Corporation

Prior to the 1960's, no state allowed professionals to incorporate.[22] Therefore, all professionals, including lawyers, worked under the broad personal-liability rules governing partnerships and sole proprietorships.[23]

Resistance to allowing attorneys in particular to practice in the corporate form was based upon two general types of concerns:[24] (1) the possibility that the corporation itself might interfere with the professional relationship between each client and the attorney handling his case, and (2) the possibility that lawyers could avoid malpractice liability.[25] However, these "traditional" concerns over the ethical implications of allowing lawyers to incorporate got pushed aside in the 1960's and 1970's, as other considerations prompted professionals to lobby state courts and legislatures for the right to incorporate.[26]

The right to enjoy limited liability was not the only advantage which professionals stood to gain from being allowed to practice in the corporate form; other benefits also attended the act of incorporation.[27] The most significant of these benefits was the lenient tax treatment which corporations received,[28] and it was the desire to allow professionals to take advantage of these tax benefits which led states to permit professional incorporation.[29] Today, every American jurisdiction provides for the incorporation of professionals.[30]

Because the states' acceptance of professional incorporation was premised largely upon tax considerations,[31] it did not resolve the issue of whether, and to

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22. Stephen E. Kalish, *Lawyer Liability and Incorporation of the Law Firm: A Compromise Model Providing Lawyer-Owners with Limited Liability and Imposing Broad Vicarious Liability on Some Lawyer-Employees*, 29 ARIZ. L. REV. 563, 563 (1987).

23. At that time, incorporation was the only way for the owners of a business to enjoy limited liability. *See supra* note 7.

The owners of partnerships and sole proprietorships, on the other hand, are personally liable for the debts of their business. *See* UNIFORM PARTNERSHIP ACT §§ 13, 14, and 15.

24. *See* H. Bradley Jones, *The Professional Corporation*, 27 FORDHAM L. REV. 353, 354–355 (1958).

25. *Id.* at 355.

26. *See* Forest J. Bowman, *The Professional Corporation—Has the Death Knell Been Sounded?*, 10 PEPP. L. REV. 515, 516 (1983).

27. While significant in the context of regular commercial corporations, many benefits which typically are attendant upon incorporation, such as centrality of management, transferability of interest, and continuity of life, did not play a major role in the development of the professional corporation. For a discussion of these and other benefits in the context of the professional corporation, see *Id.* at 520–24.

28. Chief among the tax advantages accruing from incorporation at that time was the favorable treatment accorded qualified corporate retirement plans. *Id.* at 525.

29. Kalish, *supra* note 22, at 563–64. For a narrative of the struggle by professionals to gain access to corporate tax benefits, see David Paas, *Professional Corporations and Attorney-Shareholders: The Decline of Limited Liability*, 1986 J. CORP. L. 371, 372–74 (1986).

30. Nora Schneider, Comment, *Incorporated Lawyers—The Veil Rises and Falls*, 55 U. CIN. L. REV. 785, 787 (1987).

31. The Arizona courts have taken judicial notice of the fact that tax considerations were the main reason for the adoption of professional-corporation legislation. *See* Vinall v. Hoffman,

what extent, the shareholders of professional corporations should be allowed to limit their personal financial liability for the debts of their firm.[32] More recently, however, two developments have spurred heightened interest among practitioners and commentators in the possibility of limited liability for professionals in general, and for lawyers in particular: (1) the decline of the tax benefits associated with incorporation, and (2) an explosion in malpractice and other judgments against lawyers.[33]

The tax situation changed with the passage of the Economic Recovery Tax Act of 1981[34] and the Tax Equity and Fiscal Responsibility Act of 1982.[35] These Acts essentially equalized the tax treatment of corporations and other, non-corporate business organizations.[36] With the disappearance of tax reasons as a motivation[37] for incorporation, limited liability now stands as the only significant benefit which might be gained by forming a professional corporation.[38]

The prospect of limited liability for attorneys has taken on a special significance[39] as the size and number of malpractice and other legal judgments against lawyers has increased dramatically.[40] With this increased risk to their personal assets, it is little wonder that attorneys find limited liability attractive.

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133 Ariz. 322, 323–24, 651 P.2d 850, 851–52 (1982) ("[T]he primary reason for creating the professional corporation was to permit professionals to take advantage of various federal tax provisions available to a corporation and its employees but not available to self-employed persons or partnerships.").

32. Arizona resolved the issue by allowing professionals to incorporate, and allowing them to enjoy limited liability for business and non-professional legal debts, but continuing to subject them to broad personal liability for the professional legal debts of their firm. *See* ARIZ. REV. STAT. ANN. § 10–905 (1977) (amended 1992); § 10–908 ARIZ. REV. STAT. ANN. (1984).

Most states' professional corporation statutes provide shareholders at least some measure of limited liability. For a comprehensive discussion of the various states' position on limited liability for professional-corporation shareholders, see Maycheck, *supra* note 6; *see also* Kalish, *supra* note 22, at 568, n.21; Schneider, *supra* note 30, at 790–791, nn.31–33.

In those states where other forms of limited-liability business organization are available, professionals typically are allowed to take advantage of them as well. *See supra* note 7.

33. Other developments in the legal field, most notably the emergence of the huge, multistate law firm, also have contributed to an increased desire among lawyers to limit their personal liability for the misdeeds of their colleagues in the firm.

34. Pub. L. No. 97–34, 95 Stat. 172 (1981).

35. Pub. L. No. 97–248, 96 Stat. 324 (1982).

36. For a comprehensive treatment of the effects of the Economic Recovery Tax Act and the Tax Equity and Fiscal Responsibility Act, see Bowman, *supra* note 26.

37. In fact, "double taxation" (the term often used to refer to the fact that a corporation's income is taxed once when it is earned by the corporation and again when it is distributed to the shareholders) might serve as a *disincentive* to incorporation after the Economic Recovery Tax Act and the Tax Equity and Fiscal Responsibility Act equalized the tax treatment of corporate and non-corporate businesses.

38. *See supra* note 27.

39. The term "special significance" may not be strong enough; one observer described the desire for limited liability thus:

> These days, big-firm partners are looking to [limited liability]... with an enthusiasm perhaps more appropriately reserved for the Holy Grail.... The Grail may have promised the ultimate wisdom, but [limited liability] promise[s] to protect a partner's personal assets....

Lisa Isom-Rodriguez, *Limiting the Perils of Partnership*, AM. LAW., July-Aug. 1993, at 30 (*quoting* Michael Bohnen, partner at the Boston firm of Nutter, McClennen & Fish).

40. *See* David Schaefer, *Avoiding Malpractice Claims: Help Yourself Because Juries Won't*, 60 Def. Couns. J. 584 (1993) (*citing* Thomas W. Hyland, *Law Firms' Exposure to*

Against this backdrop, the Arizona Legislature amended its professional corporation statute to provide for limited professional-debt liability.[41] However, the Legislature may not necessarily have the last word when lawyers attempt to take advantage of Arizona's limited liability rules.

B. The Role of the Courts

State supreme courts often claim the authority to regulate the practice of law.[42] In many states, the courts' authority to regulate the practice of law has meant that attorneys needed to ask the courts for the right to incorporate, even after the state legislature passed a professional corporation statute.[43] In other states, attorneys have been allowed to take advantage of professional corporation statutes, but have not been permitted to enjoy the limited liability provisions of those statutes.[44]

Courts have not been timid about exercising their authority to regulate the practice of law.[45] In the Georgia case of *First Bank & Trust Co. v. Zagoria*,[46] the state supreme court explicitly denied that it was bound to apply the limited-liability provision of the state's professional corporation statute[47] to attorneys.[48] In ruling that lawyers were not entitled to enjoy limited liability,

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Third Parties: an Expanding Doctrine, LAWYRES LIABILITY REP. Q., April 1992, at 1 (a which reported that almost 40 percent of all law firms responding to the survey had malpractice claims filed against them between 1990 and 1992, and that nearly 60 percent of the responding firms with 41 or more attorneys had been sued for malpractice)). *See also* Gary Taylor, *$17 Million Malpractice Award Stuns*, NAT'L L.J., Jan. 22, 1990, at 3; Tracy Everbach, *Jury: Law Firm Should Pay Plaintiffs $6 Million*, DALLAS MORNING NEWS, Mar. 17, 1990, at 36A; Saundra Torry, *Big Law Firm to Pay $51 Million to U.S. Settlement Involves Failure of Lincoln S&L*, WA. POST, Apr. 20, 1993, p.d01 (concerning the Cleveland-based law firm of Jones, Day, Reavis & Pogue).

41. Testimony before the Arizona Senate committee considering the issue asserted that "fairness" required passage of the amendments to ARIZ. REV. STAT. ANN. § 10–905. *See* ARIZONA SENATE COMMITTEE ON COMMERCE AND LABOR, *Minutes of Committee on Commerce and Labor*, Feb. 26, 1992, at 8–9.

42. Typically, the power to regulate the bar is claimed to rest with the courts either because the judiciary has the inherent power to regulate the conduct of those who wish to be officers of the court, or as a result of the separation-of-powers doctrine. *See, e.g.*, In re Greer, 52 Ariz. 385, 389, 81 P.2d 96, 98 (1938) (officer-of-the court rationale); First Bank & Trust Co. v. Zagoria, 302 S.E.2d 674, 675 (Ga. 1983) (separation-of-powers rationale).

43. *See* OHIO GOV. BAR R. III (rule promulgated by Ohio Supreme Court in 1970, allowing attorneys for the first time to take advantage of Ohio's professional corporation statute, which had been enacted in 1961). Other state supreme court decisions specifically allowing attorneys to take advantage of already-existing professional corporation statutes include: *In re* Florida Bar, 133 So.2d 554 (Fla. 1961); Petition of Bar Association, 516 P.2d 1267 (Haw. 1973); Matter of Rhode Island Bar Association, 263 A.2d 692 (R.I. 1970).

44. *See infra* Part II, notes 52–67 and accompanying text for additional discussion of court decisions denying attorneys access to limited liability provisions of state professional corporation statutes.

45. Some commentators have been critical of court intervention into the essentially legislative realm of establishing the contours of corporate law. *See, e.g.*, Paas, *supra* note 29, at 389 ("Nothing is accomplished except introducing confusion into an already confusing area of corporate law.").

46. 302 S.E.2d 674 (Ga. 1983). Zagoria and Stoner, P.C. was a two-shareholder law firm. Zagoria had issued corporate checks to clients in connection with various loan closings. The checks were later dishonored because Zagoria had made withdrawals from the corporate account, leaving it with insufficient funds. The issue was whether Stoner, who was engaged in none of these transactions, could be held personally liable for the dishonored checks.

47. *See* GA. CODE ANN. 84–5403 (1970) (now GA. CODE ANN. 14-7-3 (1981))

48. The court stated:

the court simply stated that it could not "allow a corporate veil to hang from the cornices of professional corporations which engage in the law practice."[49]

The Arizona Supreme Court has held that while the Legislature has the right to establish the minimum requirements for admittance to the bar, the courts are free to impose higher standards.[50] Therefore, while the Arizona Legislature has reduced the minimum requirements governing the practice of law (by reducing the degree of personal liability which a law-firm owner must accept for the debts of his firm),[51] Arizona's courts remain free to re-impose higher standards of personal responsibility. However, if the Arizona courts were to decide that attorneys should be held to a higher standard of personal responsibility than the Legislature has established, the question would then become: what should those standards be?

PART II: LIABILITY FOR BUSINESS DEBTS

Business debts[52] are those obligations which any business might incur in the normal course of its operation. These include such business needs as leases on office space or purchases of equipment. Arizona law currently provides that shareholders of professional corporations are not liable for the ordinary business debts of the firm.[53] The appropriateness of allowing attorneys to take advantage of this provision can be evaluated by considering (1) its impact upon the quality of legal services rendered, and (2) its impact upon the image of the bar.

When a law firm contracts for its ordinary business needs, it is acting as a business no different from any regular commercial enterprise. The performance, or non-performance, of those contracts bears little relation to the quality of the legal services rendered by the firm.[54] Therefore, holding the owners of law firms personally liable for the ordinary business debts of their firms will have no impact on the quality of legal services provided to the

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> We do not view this case as one in which we need to interpret the statute providing for the creation and operation of professional corporations. We rather view this case as one which calls for the exercise of this court's authority to regulate the practice of law.

302 S.E.2d at 675.

49. 302 S.E.2d at 676.

50. *See In re* Greer, 52 Ariz. 385, 390, 81 P.2d 96, 98 (1938) ("[N]otwithstanding that an [attorney] may possess the qualifications required by the legislature, this does not entitle him to admission to practice, unless the court is also satisfied that such qualifications are sufficient."). *See also supra* note 42.

51. *See supra* notes 6–10 and accompanying text.

52. Using the term "business debts," as distinct from "legal debts," is something of a contrivance; the issue of limited liability arises only in the context of a debt, whatever its source, which has been reduced to a legal judgment. In this respect, all debts are "legal debts." Nevertheless, these terms are used in this Note to distinguish clearly between those situations in which limited liability might have an impact upon the legal profession and those in which limited liability has no effect upon the profession.

53. *See* ARIZ. REV. STAT. ANN. § 10–908(5) (1984). *See also* Ize Nantan Bagowa, Ltd. v. Scalia, 118 Ariz. 439, 442-43, 577 P.2d 725, 728-29 (Ct. App. 1978).

Arizona's limited liability company statute also provides a firm's owners with limited liability for ordinary business debts. *See* Ariz. Rev. Stat. Ann. §§ 29–843, 29–651 (1992).

54. While it might be possible to conceive of situations in which a law firm's failure to perform its contractual duties will affect its ability to perform its professional duties, any such connection is too attenuated to be of real concern.

public. Nevertheless, courts in both New York and Ohio have insisted that law-firm owners remain personally liable for such debts.[55]

In South High Development, Ltd. v. Weiner, Lippe & Cromley Co., L.P.A.,[56] the Supreme Court of Ohio held the owners of a law firm personally liable for the rent due under a lease.[57] The court asserted that the main goal of limited liability in the context of regular commercial corporations is to facilitate the accumulation of capital.[58] The court went on to reason that, since the purpose of a professional corporation is the rendition of professional services rather than the accumulation of capital, limited liability is inappropriate for attorneys.[59] While this might explain why limited liability is not as important for professional corporations as it is for regular commercial corporations,[60] it does not explain why *personal* liability for business debts is appropriate for law-firm owners.[61]

In the New York case of *Infosearch, Inc. v. Horowitz*,[62] the court stated its concern for the legal profession's image as the basis for a decision to impose personal liability upon the shareholders of a professional legal corporation for the firm's ordinary business debts.[63] However, it is not clear that the court's concern was well-founded.[64]

When a law firm is unable meet its ordinary business obligations, it brings no more discredit to the legal profession than any businessman brings to his trade in such a circumstance.[65] It is unlikely that the general public will be any more offended when a lawyer fails to pay his business debts than they are when any other corporation fails to do so. Absent circumstances which would justify piercing the limited-liability veil in the case of a regular commercial

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55. *See supra* Part I(B) ("The Role of the Courts"), notes 42–51 and accompanying text.
56. 445 N.E.2d 1106 (Ohio 1983) [hereinafter *South High*].
57. *Id.* at 1107.
58. *Id.* at 1108.
59. *Id.*
60. Ohio's professional corporation statute provided for limited shareholder liability. *Id.* (addressing Ohio's professional-corporation law).
61. At the end of its opinion, the Ohio Supreme Court stated that "the acceptance of [certain financial responsibilities] is a condition assumed by the attorney-shareholder when he becomes a member of [a professional legal] corporation." *Id.* at 1109. This may have been an allusion to what really bothered the court about attorneys enjoying limited liability: it looks bad.
62. 459 N.Y.S.2d 348 (N.Y. Civ. Ct. 1982).
63. *Id.* at 349 ("When one extends credit to a law firm, one expects that his debt is secured by the legal and moral obligation of the members of that firm....").
64. The Court of Appeals of New York has since allowed shareholder-attorneys to enjoy limited liability for ordinary business debts. *See* We're Associates Co. v. Cohen, Stracher & Bloom, P.C., 480 N.E. 2d 743 (N.Y. 1985) (limiting shareholders' liability for a corporate lease, and specifically rejecting the Ohio court's holding in *South High*).
65. It should be noted, however, that even a regular business corporation's "corporate veil" may be pierced in certain circumstances. Such circumstances are rare, and include instances of fraud and, sometimes, gross corporate under-capitalization. *See, e.g.*, Brunswick Corp. v. Waxman, 459 F.Supp. 1222 (E.D.N.Y. 1978), *aff'd* 599 F.2d 34 (2d Cir. 1979) (refusing to pierce the veil protecting the shareholders of an undercapitalized close corporation, where the plaintiff knew of the corporation's financial structure before entering into contracts with it). *See also* Klein and Coffee, *supra* note 4, at 140–42.

The leading Arizona case on professional-corporation veil piercing is Ize Nantan Bagowa, Ltd. v. Scalia, 118 Ariz. 439, 577 P.2d 725 (Ct. App. 1978) [hereinafter *Scalia*] (refusing to pierce professional corporation's "corporate veil" for business debts in the absence of fraud, even when the corporation was undercapitalized).

corporation,[66] the image of Arizona's attorneys will not be harmed by allowing law-firm owners to enjoy limited liability for the business debts of their firms.

Finally, landlords and other creditors may secure a law firm's debt by contractually binding one or more of the individual shareholders to personal liability in the case of default by the firm.[67] Such security is available to a law firm's creditors, just as it is to the creditors of any business.

With neither the quality of legal services nor the image of the bar at stake, and with business creditors having the option to secure law firms' debts with the personal guarantees of the firms' owners, there is no reason to deny attorneys the right to enjoy limited liability for their firms' business debts. Therefore, there is no reason for the Arizona courts to disturb the Legislature's finding that limited liability is appropriate with respect to law firms' ordinary business debts.

PART III: LIABILITY FOR PROFESSIONAL LEGAL DEBTS

Because a law firm's ability to perform its contracts for ordinary business needs bears little or no relationship either to the quality of legal services available to the public or to the image of the legal profession as a whole, it is appropriate to limit the personal liability of shareholder-attorneys for the business debts of their firm.[68] By contrast, an attorney's professional performance is affected by potential liability for professional misconduct, and it is self-evident that a law firm's performance of its professional duties is related directly to the quality of its services and to the bar's public image. Therefore, the courts should be wary of allowing attorneys to take advantage of the limited professional-debt liability provision of Arizona's professional corporation statute.[69]

1. Professional-Debt Liability and the Quality of Legal Services

The central purpose of tort law is to encourage socially desirable behavior[70] by exposing an actor to liability whenever his conduct is in conflict with social policy.[71] When an attorney is held liable for professional misconduct, tort law vindicates the social policy of ensuring that only high-

66. *See supra* note 65.

67. A creditor who had reason to know that a debtor corporation might not be able to meet its obligations, yet contracted with the corporation without securing the debt with the personal obligation of the shareholders, will often be found to have assumed the risk of default. *See, e.g.*, *Brunswick*; *Scalia*.

68. *See* Part II *supra*, notes 52–67 and accompanying text.

69. *See* ARIZ. REV. STAT. ANN. § 10–905 (1992) (professional-debt liability provision of Arizona's professional corporation statute); ARIZ. REV. STAT. ANN. § 29–846 (1992) (professional-debt liability provision for Arizona's professional limited liability companies).

70. *See, e.g.*, Foley v. Interactive Data Corp., 765 P.2d 373, 389 (Cal. 1988) ("[T]ort law is primarily designed to vindicate 'social policy.'").

71. This is the author's opinion regarding the purpose of tort law, and the theory upon which this Note proceeds. There are, however, other theories regarding the goals of tort law. For a brief overview of competing theories, *see* JAMES A. HENDERSON, JR. & RICHARD N. PEARSON, THE TORTS PROCESS, 38–42 (3d ed. 1988).

quality legal services are provided to the public,[72] since a lawyer who is in jeopardy of incurring personal financial liability for professional misconduct is thereby encouraged to be careful in rendering his professional services. Similarly, if a law firm's owners are exposed to personal liability for the professional misconduct of other lawyers in the firm, they will be encouraged to monitor the performance of their colleagues.[73]

It would appear, therefore, that the Arizona Legislature's 1992 amendments to the State's professional corporation statute, which allow professional-corporation shareholders to enjoy limited liability for professional debts, threaten to compromise the quality of legal services provided to the public.[74] However, proponents of limited professional-debt liability[75] defend their position with two types of arguments: (1) personal liability itself can jeopardize the quality of legal services rendered by the firm, and (2) factors other than the personal liability of a law firm's owners adequately ensure that high-quality legal services are provided by the firm.[76] Each of these arguments is considered in turn.

As noted earlier, traditional opposition to the incorporation of lawyers was based partially upon concern over the possibility that the corporate entity itself might interfere in the professional relationship between individual attorneys and their clients.[77] One modern commentator has turned this concern on its head by asserting that limited professional-debt liability actually protects the professional attorney-client relationship from interference.[78]

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72. High-quality legal services are those which conform to the attorney's ethical obligations, including the duty to provide competent representation. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1993).

73. The Model Rules of Professional Conduct require such monitoring. This requirement includes ensuring that junior lawyers in the firm provide competent legal representation to their clients. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1(a) (1993) ("A partner in a law firm shall make reasonable efforts to ensure that...all lawyers in the firm conform to the rules of professional conduct."); Rule 1.1 (1993) (duty to render competent representation).

74. The professional-debt liability provisions of both the professional corporation statute and the professional limited liability company statute retain personal liability for a professional only when the professional himself, or a person under his direct supervision and control, engages in professional misconduct. Personal liability no longer is imposed for the professional misconduct of any other professional in the firm. *See* ARIZ. REV. STAT. ANN. § 10–905 (1992) (professional corporation statute); § 29–846 (1992) (professional limited liability company statute).

75. There are many such proponents. *See, e.g.*, Maycheck, *supra* note 6 (mandatory liability insurance for professional corporations would justify limiting the professional-debt liability of "innocent" shareholders); Paas, *supra* note 29 at 388 (personal professional debt liability for non-supervisory shareholders amounts to "punishing the innocent"); Schneider, *supra* note 30 at 797–98 ("traditional bias" is the only justification for personal professional-debt liability). By far the most well-reasoned defense of limited professional-debt liability for professional legal corporation shareholders is set forth by the University of Nebraska's Stephen E. Kalish in his article, *Lawyer Liability and Incorporation of the Law Firm: A Compromise Model Providing Lawyer-Owners with Limited Liability and Imposing Broad Vicarious Liability on Some Lawyer-Employees*, 29 ARIZ. L. REV. 563 (1987) [hereinafter Kalish]. The arguments favoring limited professional-debt liability which this Note attempts to answer come mainly from Professor Kalish's article.

76. Kalish at 572–575.

77. *See supra* notes 24–26 and accompanying text.

78. Kalish at 572–74.

This "undue interference" theory[79] claims that junior lawyers' ability to fulfill their ethical duty to remain free from outside control[80] is threatened when shareholder-attorneys, fearing exposure to personal professional-debt liability, engage in "undue monitoring" of the junior lawyers in their firm.[81] Furthermore, excessive monitoring by other lawyers in the firm can compromise the quality of the professional relationship between the client and the attorney handling the case.[82] Only when shareholder-lawyers are protected from personal liability for the professional debts of their firm, as they now are under Arizona's professional corporation law,[83] will they refrain from such "officious interference."[84]

A second argument favoring limited professional-debt liability is that shareholder-lawyers who are exposed to personal professional-debt liability will be reluctant to experiment with innovative practice formats.[85] This "excessive reluctance" theory[86] is based upon the belief that, if they are at risk of personal liability for the professional misconduct of other lawyers in the firm, the owners of a law firm might not be willing to expand their firm's practice into an area of the law with which they are unfamiliar.[87] If law-firm owners are unwilling to experiment with various forms of practice, they will not discover "which format best facilitates efficient and effective practice."[88]

According to the "excessive reluctance" theory, the professional-debt provision of Arizona's professional corporation statute would tend to increase the quality of professional legal services, since shareholder attorneys do not need to fear personal liability for professional debts incurred by other members of the firm, including those who practice an unfamiliar type of law.[89] Theoretically, law-firm owners, essentially free from the fetters of personal professional-debt liability, will be willing to experiment with innovative practice formats until they find the one which best serves their clients' needs.[90]

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79. Title coined by author, not Professor Kalish.
80. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4 (1993).
81. Kalish at 573.
82. Kalish at 572–73. While this Note will answer Professor Kalish's arguments in more detail *infra*, two preliminary observations are in order: First, monitoring by other lawyers in the firm is not "outside interference" within the meaning of the Model Rules. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4 (1993). Second, even Professor Kalish recognizes the value of monitoring; what he does not like is monitoring by a law-firm owner who is not officially supervising or collaborating with the monitored lawyer in representing a client. *See* Kalish at 573, 589–96.
83. *See supra* note 74 and accompanying text.
84. Kalish at 573.
85. *See* Kalish at 574–75.
86. Again, this is the author's title for Professor Kalish's theory.
87. The example given by Professor Kalish is that of a Los Angeles tax firm which wants to merge with a bankruptcy firm in Atlanta, but is discouraged from doing so due to the Los Angeles shareholders' fears of incurring personal liability for the acts and omissions of the Atlanta lawyers. Kalish at 574.
88. *Id.*
89. *See* ARIZ. REV. STAT. ANN. §§ 10-905, 29-846 (1992).
90. The "Excessive Reluctance" theory can be applied to any business decision by a law firm's owners which will affect the professional services the firm provides. For example, the decision to increase the firm's size, even without diversifying the types of legal services provided, would theoretically be easier if the shareholders did not need to fear personal liability arising from professional misconduct by newly hired lawyers.

The basic argument underlying both the "undue interference" and "excessive reluctance" theories is that personal liability can lead shareholder-attorneys to invest too heavily in avoiding professional-debt liability. In other words, the benefits to be gained by encouraging each owner of a firm to monitor the performance of the other lawyers in the firm[91] are outweighed by the risk that shareholder-lawyers will allow their fear of personal liability to interfere with their firm's ability to provide high-quality legal services efficiently.[92]

If these were the only arguments in favor of limited professional-debt liability, the contrary case could be made simply by arguing that the legal profession is threatened less by overly-cautious shareholder-attorneys than by lawyers who, not being subject to extensive monitoring by the owners of their firm, might represent their clients incompetently.[93]

The argument in favor of limited professional-debt liability, however, can be bolstered by arguing that other factors already encourage law-firm owners to monitor the performance of other lawyers in their firm, and that broad professional-debt liability therefore poses more risks than it alleviates.[94] The "other factors" which are asserted to ensure adequate shareholder monitoring include the fact that negligent lawyers and their immediate supervisors still are exposed to personal liability, as well as the fact that the law firm's assets and professional reputation are at stake.[95]

By asserting that personal liability itself poses some danger to the quality of the legal services being offered by a firm, and that other factors tend to ensure adequate monitoring by shareholder-attorneys, proponents of limited liability make a case for the proposition that unlimited professional-debt liability causes more problems than it solves. As will be seen, however, law-firm owners will be unlikely to invest too heavily in avoiding professional-debt liability, even when they are exposed to personal liability.

The essence of the case in favor of broad professional-debt liability already has been stated: when shareholder-attorneys are exposed to personal liability, they will be encouraged to monitor the performance of the other lawyers in their firm in order to ensure that those lawyers are offering high-quality legal services to their clients.[96] While other factors (such as the risks

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91. *See supra* notes 70–73 and accompanying text.

92. Professor Kalish terms this a "dilemma." *See* Kalish at 572.

93. Incidentally, this is the position of this Note, even assuming, *arguendo*, that Professor Kalish's fears are well-founded.

94. *See* Kalish at 572.

95. *See* ARIZ. REV. STAT. ANN. § 10–905 (1992) (professional-corporation shareholder liable for his own misconduct, as well as that of persons under his direct supervision and control); ARIZ. REV. STAT. ANN. § 29–846 (1992) (same for owners of professional limited liability companies); Kalish at 572 (fact that firm's assets are at stake under the theory of *respondeat superior* encourages adequate monitoring). *See also* Paas, *supra* note 29 at 388 (disciplinary rules are adequate to ensure monitoring).

96. *See supra* notes 70–73 and accompanying text. In addition to the fact that personal professional-debt liability encourages adequate monitoring by law-firm owners, such personal liability is justified by the fact that the owners of the firm are in a better position than anyone outside the firm to identify potential problems before they erupt into professional misconduct. Once a potential problem is identified, the shareholders can use their authority within the firm to correct it. The exercise of this authority by an owner does not necessarily mean monitoring the situation himself; the concerned attorney could exercise any number of different options,

which professional-debt liability poses to the assets and professional reputation of the firm itself) also serve to encourage monitoring,[97] it seems self-evident that personal liability is the most effective way to guarantee that a law firm's owners will comply with their ethical duty to monitor their subordinates' conduct.[98]

What, then, is to keep shareholder-attorneys from engaging in excessive monitoring, as feared by the proponents of limited liability?[99] In answering this question, it is instructive to make a comparison between personal professional-debt liability for law-firm owners and strict liability for product manufacturers.

In United States v. Carroll Towing Co.,[100] Judge Learned Hand set forth his famous calculus for determining whether an actor has been negligent. According to the "Hand Formula", an injury is the result of negligence whenever the foreseeable costs of that injury to society were greater than the costs which the actor expended in attempting to prevent the injury.[101] At trial under traditional negligence law, it is the fact-finder who determines whether a defendant has met his burden under the Hand Formula.[102] If the fact-finder were to apply the Hand Formula correctly in every case, then only negligent actors would suffer liability, and only non-negligent actors would escape liability.[103]

In products-liability law, however, courts often abandon the Hand Formula in favor of holding the manufacturers of products strictly liable for injuries caused by those products.[104] One interesting fact about the use of strict liability in products-liability cases is that, in theory, it will not encourage a manufacturer to invest any more heavily in prevention than he would if the Hand Formula were applied correctly in every case.[105]

If the fact-finder were to perform the calculus of the Hand Formula correctly in every case, then the manufacturer of a product would invest in prevention only up to the point at which his costs of prevention equalled the social costs likely to result from defects in his product. Any further investment in prevention would be wasteful, since a correct application of the Hand

including the assignment of different or additional attorneys to a particular case, or the appointment of another lawyer in the firm to monitor the situation.

97. *See supra* note 95 and accompanying text.

98. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1 (1993).

99. *See supra* notes 77–84 and accompanying text.

100. 159 F.2d 169 (2d Cir. 1947).

101. *Id.* at 173.

102. One argument that has been made in favor of strict liability is that when the fact-finder is relieved of this responsibility, the costs of adjudicating liability decrease. *See* James Henderson, *Coping with the Time Dimension in Products Liability*, 69 CALIF. L. REV. 919, 933 (1981).

103. A "correct" application of the Hand Formula is one where the fact-finder accurately determines the foreseeable social costs of the injury, the likelihood that the injury would occur, and the costs to the actor in preventing the injury. *See, e.g.*, Guido Calabresi and Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1057, 1060 (1972).

104. The topic of strict liability has been a fertile field for legal commentators. This Note defers to those commentators for a more complete discussion of the topic. *See, e.g.*, *id.*; Richard A. Posner, *Strict Liability: A Comment*, 2 J. LEGAL STUD. 205 (1973); Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151 (1973).

105. *See supra* note 103.

Formula would determine that the manufacturer had fulfilled his duty, and was not negligent.[106]

Under a regime of strict liability, the manufacturer of a product will, by definition, be liable for injuries caused by a defect in that product, without regard to the amount which he has invested in prevention. However, since the manufacturer will want to avoid as much liability as he reasonably can, he will invest in prevention anyway.[107] Even so, a manufacturer operating under a regime of strict liability will invest in prevention only up to the point at which his prevention costs equal the liability costs which are likely to result from defects in his products.[108] Any further investment in prevention would be wasteful, since his avoidance costs would be greater than his liability costs.[109] Theoretically, therefore, strict liability does not encourage a manufacturer to invest any more heavily in prevention than does a traditional negligence regime.[110]

Just as strict liability does not encourage excessive investment in prevention by product manufacturers, personal liability will not encourage excessive monitoring by law-firm owners. A law-firm owner who is exposed to personal professional-debt liability will want to monitor the performance of other lawyers in his firm in order to reduce the risk of incurring professional legal debts.[111] As a businessman, however, the owner of a law firm also must take his clients' satisfaction into consideration.[112]

If monitoring by senior lawyers in a law firm begins to compromise the quality of the professional relationship between the firm's clients and the lawyers who represent them,[113] then the cost/benefit ratio of monitoring begins to increase.[114] That ratio reaches 1:1 at the point where the firm is losing as much revenue through client dissatisfaction as it is saving through the avoidance of malpractice liability. At that point, the firm's owners will not engage in any further monitoring of their colleagues.[115]

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106. Of course, the manufacturer would have to know in advance that the fact-finder would apply the Hand Formula correctly. The manufacturer would also have to apply a type of Hand-Formula calculus himself in order to determine the amount of prevention that he was required to take.

107. Henderson, *supra* note 102, at 932 n.58.

108. *Id.*

109. This balancing of the costs of avoiding and incurring liability *is* a type of Hand Formula. The difference is that it is being performed by the manufacturer *ex ante*, rather than by the fact-finder at trial. This difference offers an improvement over traditional negligence law, inasmuch as the manufacturer is usually more able and more willing to find the appropriate balance than is the fact-finder. *See, e.g., id.*; Calabresi and Hirschoff, *supra* note 103, at 1060.

110. For a more complete discussion of these and other issues concerning strict liability, see Henderson, *supra* note 102. *See also* Calabresi and Hirschoff, *supra* note 103.

111. *See supra* notes 70–73 and accompanying text.

112. Professor Kalish makes much of the point that lawyers are, in fact, businessmen. *See* Kalish at 575.

113. *See supra* notes 77–84 and accompanying text.

114. This ratio also increases when the law-firm owner spends his time monitoring other lawyers, rather than performing legal services himself.

115. Presumably, the degree of monitoring necessary to prevent professional misconduct is far less than that which would cause a client to take his business elsewhere. A prudent law-firm owner would take other remedial action before that point, such as firing a hopelessly-incompetent subordinate.

Similarly, a law firm which is considering the diversification of its practice will not decide against such a move unless the risks involved outweigh the benefits.[116] The owners of the firm will be reluctant to try an innovative practice format only when the risks to their personal assets are greater than the benefits which they expect to receive from the new format. A law firm's owners will not let their fear of personal professional-debt liability stand in the way of a business decision which appears likely to be more profitable than costly.[117]

If shareholder-attorneys are permitted to take full advantage of the professional-debt liability provision of Arizona's professional corporation statute, they will have less of an incentive to find the appropriate balance between the costs of avoiding and incurring professional-debt liability than they will if they are subject to personal liability for the professional legal debts of their firm. Since they will not be personally liable for the misconduct of any lawyer not under their direct supervision and control,[118] Arizona's shareholder-attorneys will not need to wait for the cost/benefit ratio of monitoring their colleagues to reach 1:1 before turning a blind eye to their subordinates' conduct.[119]

Because personal liability encourages law-firm owners to be sure that their firm provides competent and ethical legal services, limited professional-debt liability endangers the quality of legal services provided to the public.[120] On the other hand, the owners' own self-interest makes it unlikely that they will be unduly zealous in avoiding professional-debt liability.[121] Therefore, limiting the personal liability of law firms' owners for the professional legal debts of their firms jeopardizes the goal of ensuring that high-quality legal services are available to the public.

2. Professional-Debt Liability and the Image of the Bar

In addition to endangering the quality of the legal services available to the public, allowing lawyers to enjoy limited professional-debt liability puts the public's confidence in the competence and ethics of the legal profession at risk.

When asked, Americans typically give lawyers very low marks for ethical behavior.[122] The first step in changing the public's perception of the profession is to demonstrate, in both word and deed, that lawyers hold

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116. *See supra* notes 85–90 and accompanying text.

117. Of course, the owners of a law firm will not always be accurate in their predictions of profit or risk, but this is no different than the situation facing any businessman who needs to make a decision. What personal professional-debt liability does to this situation is to help ensure that professional attorneys do not make such decisions cavalierly.

118. *See* ARIZ REV. STAT. ANN. §§ 10–905, 29–846 (1992).

119. *See supra* notes 111–113 and accompanying text.

120. *See supra* notes 70–74 and accompanying text.

121. *See supra* notes 109–115 and accompanying text.

122. The standard comparison is to used-car dealers. *See, e.g.*, Jan Wong, *Agents Go After One of Their Own*, BOSTON GLOBE, Apr. 3, 1984, Economy Section (poll by Florida insurance agents); Richard A. Salomon, *If the Legal Profession Doesn't Clean Up Its Act...*, CHICAGO TRIB., Nov. 25, 1986, Perspective Section at 15 (Gallop poll); Clark, *Zahn to Replace Sullivan*, CHICAGO TRIB., Feb. 16, 1990, News Section at 20 (poll by *New York Woman* magazine); Ari Goldman, *Survey Finds Confidence in Clergy Has Slipped*, STAR TRIB., Dec. 3, 1992 at 07E (poll by the Princeton Religion Research Center).

themselves to the highest standards of personal and professional responsibility. Unfortunately, the 1992 amendments to the professional-debt liability provision of Arizona's professional corporation statute are a step in the opposite direction.[123]

While it is true that a public outcry over Arizona's new liability rules has yet to materialize, it seems highly unlikely that the public image of the bar will be enhanced by law-firm owners who use the law to shield themselves from personal liability when their firm is found to have engaged in professional misconduct.[124] Public reaction in other states which have enacted statutes offering limited liability to attorneys has not been encouraging; Texas' Limited Liability Partnership Act has become known publicly as the "Help-a-Lawyer Bill."[125] There is no reason to expect that the public will have a more favorable reaction to Arizona's law.

At a time when lawyers are deemed to be the ethical equals of used-car salesmen,[126] it probably is unwise to permit lawyers to take advantage of limited professional-debt liability.

3. Personal Gain and Personal Liability

There is one final factor which supports the position that Arizona's law-firm owners should not be allowed to take shelter from personal liability for the professional legal debts of their firm; limited liability for shareholder-attorneys will allow the owners of a law firm to enjoy the fruits of their colleagues' labor without sharing the responsibilities.

When two attorneys who are not in the same firm want to divide the legal fees paid by a client, and one of the lawyers does not render any legal services on behalf of the client, the Model Rules of Professional Conduct require that each lawyer assume joint responsibility for the representation.[127] While this provision of the Model Rules does not apply to the splitting of fees between a law firm's junior lawyers and its shareholders, it does evidence a recognition by the American Bar Association that lawyers who share fees should share responsibility.

Because the owners of a law firm are entitled to benefit financially whenever a lawyer in the firm receives a fee for professional services rendered,[128] it is appropriate to hold those owners financially liable whenever a lawyer in the firm engages in professional misconduct.[129]

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123. *See* ARIZ. REV. STAT. ANN. §§ 10-905, 29-846 (1992).

124. Other attempts by lawyers to use the law for their own benefit have been met with harsh (and well-deserved) criticism. When Harvey Saferstein, President of the State Bar of California, suggested that lawyer jokes be criminalized as hate speech, the public reacted quickly and angrily. *See* Letters to the Editor, L.A. TIMES, July 12, 1993, at B6; Saillant, *A Plea Against Lawyer Jokes Brings Backlash*, L.A. TIMES, Sep. 29, 1993, at B3.

125. Isom-Rodriguez, *supra* note 39, at 32.

126. *See supra* note 122.

127. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(e)(1) (1994).

128. The shareholders in professional legal corporations typically are entitled to a personal share of the fees received by the firm.

129. This is not to say that shareholders of regular commercial corporations should be held personally liable for the company's debts; such a discussion is beyond the scope of this Note. However, limited liability does seem appropriate in the commercial context, since

4. Summary of Limited Professional-Debt Liability

While exposure to personal liability for the professional debts of the firm helps ensure that a law firm's owners adequately monitor the conduct of the other lawyers in the firm,[130] the enlightened self-interest of the firm's owners helps to ensure that such monitoring does not become excessive.[131] On the other hand, limited liability for professional debts endangers the public's perception of the legal profession.[132] Finally, shareholder-attorneys should share the financial responsibility whenever a lawyer in their firm engages in professional misconduct, since they are entitled to share the financial benefit whenever a lawyer in their firm receives a fee for the competent rendition of professional services.[133] For each of these reasons, the courts should not allow law-firm owners to use the professional-debt liability provision of Arizona's professional corporation statute to shield themselves from personal professional-debt liability.[134]

IV. LIABILITY FOR NON-PROFESSIONAL LEGAL DEBTS

Like its commercial counterparts, a law firm may face legal debts which arise simply by virtue of its existence as a legal entity.[135] In many cases, these non-professional legal debts are analogous to business debts, and it is appropriate to allow law-firm owners to limit their personal liability for them.[136] In other cases, however, a non-professional legal debt might arise as a result of conduct which is disgraceful[137] to the legal profession. In such cases, limited liability may not be appropriate.

Among those non-professional legal debts for which limited liability is appropriate are those arising from such accidental occurrences as slip-and-fall injuries suffered on company property. Since unintentional torts of this kind affect neither the adequacy of the professional services offered by the firm's attorneys nor the public's confidence in the ethics and competency of the bar, there is no reason that attorneys should not enjoy limited liability for this kind of debt.[138]

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commercial-corporation shareholders often lack the influence, skill, knowledge, and opportunity necessary to direct corporate affairs.

130. *See supra* notes 70–74 and accompanying text.

131. *See supra* notes 109–15 and accompanying text.

132. *See supra* notes 122–26 and accompanying text.

133. *See supra* notes 127–29 and accompanying text.

134. *See supra* Part I(B) ("The Role of the Courts"), notes 42–51 and accompanying text.

135. Arizona law grants limited liability for non-professional legal debts to both professional-corporation shareholders and owners of professional limited liability companies. *See* ARIZ. REV. STAT. ANN. § 10–908 (1984); § 29–651 (1992).

136. *See supra* Part II, notes 52–67 and accompanying text.

137. As used in this Part, an act is "disgraceful" if it compromises the quality of the legal services provided by a law firm, or if it tends to harm the public's perception of the legal profession as a whole.

138. Of course, the company itself will still be liable for this type of debt; limited liability will protect only the personal assets of the firm's owners.

However, there are several types of non-professional legal debts which might bring disgrace upon the profession.[139] These debts include[140] those arising from intentional torts committed by members of the firm while acting in their capacity as employees of the firm,[141] those arising from fraud,[142] and those arising from violations of equal-employment laws.[143]

When a debt arises from an act which tends to bring disgrace upon the profession,[144] it may not be appropriate to allow the debtor firm's owners to enjoy limited liability. If it is determined that the act giving rise to the debt could have been prevented through adequate monitoring within the firm,[145] then the personal liability of the owners should not be limited.[146]

Though limited liability for the owners of a law firm probably will be appropriate in most cases involving non-professional legal debts, the courts should be willing to pierce that protective veil when debts result from conduct which not only tends to disgrace the legal profession, but also is preventable through adequate monitoring.

CONCLUSION

Like everyone else, lawyers want to keep their personal assets as safe as possible. Unlike anyone else, however, lawyers have a special responsibility not to use the law solely for their own benefit. Because of this, courts should be reluctant to allow lawyers to enjoy limited liability until it is shown that doing so serves the interests of the general public.

The owners of Arizona's law firms are entitled by statute to enjoy limited liability for three different kinds of debt, and the appropriateness of limiting law-firm owners' personal liability is different in each case.

In the case of a law firm which is indebted by reason of its failure to perform under a contract which it has entered in order to meet its ordinary business needs, it is appropriate for the owners of the firm to have limited liability for those debts.

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139. Non-professional legal debts which result from conduct that tends to bring disgrace upon the bar are closely analogous to debts arising from the professional relationship between attorney and client. Therefore, analysis of these debts should be similar to that used in *supra* Part III (Liability for Professional Legal Debts), notes 68–134 and accompanying text.

140. This is not an exhaustive list of the types of non-professional legal debts which are capable of bringing disgrace upon the legal profession.

141. *See* RESTATEMENT (SECOND) OF AGENCY § 229 (1957) (defining conduct within the scope of employment).

142. Fraud can arise in the context of the professional relationship between attorney and client, and in the context of other, non-professional business relationships. Only fraud in the latter context is discussed here.

143. The latter two examples are excellent candidates for denying limited liability, since they are the type of conduct which can effectively be avoided through monitoring by senior members of the firm.

144. *See supra* note 137.

145. What is recommended is a two-pronged test: First, does the act giving rise to the debt tend to disgrace the legal profession? Second, could such conduct be prevented through adequate monitoring?

146. Fraud and equal-employment law violations are good examples of conduct which is both disgraceful and preventable through monitoring. Intentional torts by law-firm employees, however, may not be preventable through monitoring.

In contrast, in the case of a firm which is indebted because one of its attorneys has engaged in professional misconduct, limited liability for the firm's owners endangers not only the quality of the legal services available to the public, but also the public's confidence in the ethics and competency of the bar. In such a case, Arizona's courts should exercise their authority to establish adequate levels of professional responsibility among the members of the bar, and deny lawyers access to the limited liability provisions of Arizona's professional corporation law.

Finally, in a case where a law firm has incurred non-professional legal debts, the ability of the firm's owners to enjoy limited liability should depend on a two-part test. First, if the debts arose out of conduct which tends to bring disgrace upon the legal profession, then the courts should be skeptical of allowing the owners of the firm to limit their personal liability for those debts. Second, if it is determined that the conduct was capable of being prevented through adequate monitoring by the owners of the firm, then the protections of limited liability should be denied.

The hearts of most owners of law firms in Arizona probably are not terribly heavy over the large degree of limited liability which those owners currently enjoy under Arizona law. Nevertheless, for the overall interests of both the public and the legal profession, allowing lawyers to take full advantage of Arizona's limited liability rules for professionals would be more of a damnation than a deliverance.